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*Ellen M. Immergut and Ikuo Kume, editors*

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Introduction: A Crisis of Governance in Japan and Europe

ELLEN M. IMMERGUT* and IKUO KUME**

The set of essays presented in this special issue of Governance is a result of a project launched by Ikuo Kume on the “Political Economy of Crisis,” under the auspices of the Japanese Political Science Association and the European Consortium for Political Research program to stimulate comparative research on Japan and Europe. The idea was to bring together scholars of European and Japanese politics and to encourage cross-regional comparisons. As a substantive focus, we examined recent crises of governance in Sweden, Japan, and Germany. These countries were chosen because they represent outstanding examples of an alternative and (previously) successful model of governance. In contrast to the political economies of Britain and the United States—which analysts have typically viewed as “free market” or “liberal”—those of Japan, Germany, and Sweden were termed “neo-corporatist,” “consensual,” “socially embedded,” and, most recently, “coordinated market economies” (terms that will be defined in more detail below, as well as in the essays that follow). In spite of their long records of economic success, however, these nations have recently experienced economic downturns and political problems. We interpret these crises as “crises of governance,” because the very organization of political and economic coordination in these countries has been called into question. Our project investigates the development and response to this crisis in a number of specific policy spheres—industrial relations, banking, economic policy, and electoral reform. By analyzing the renegotiation of the institutions of coordinated market economies in response to crisis, we aim to better understand how these political economies work today, as well as the ways in which these governance models worked in the past.

Discussions of such an “alternate governance model” have a long history. From the beginning of the twentieth century through the postwar period, numerous scholars, such as Rudolf Hilferding, Joseph Schumpeter, or Andrew Shonfield—to name just a few examples—pointed to various political and social institutions that made possible diverse types of capitalism. Responses to the economic crisis of the 1970s brought a
renewal of the debate, with books such as Peter Katzenstein’s *Between Power and Plenty* (1978) focusing on “domestic structures”—comprised of centralized versus decentralized “states” and “societies”—as a critical variable in explaining economic adjustment to the oil crisis. Although the concept of a “strong state” has been the subject of much discussion, a well-developed executive bureaucracy capable of professional implementation of public policies was a key element of this perspective on the state. Similarly, highly organized interest-group associations (enrolling large proportions of potential members, with exclusive jurisdictions, and aggregated into peak associations) were thought to provide the institutional (“neo-corporatist”) basis for constructive societal participation in both the legislative decision making and administrative implementation phases of the policy process, particularly for groups representing “capital” and “labor” (Berger 1981; Goldthorpe 1984; Katzenstein 1985; Schmidt 1979). More recent work on “varieties of capitalism” has shifted the focus slightly to production regimes (Berger and Dore 1996; Crouch and Streeck 1997; Hall and Soskice 2001; Hollingsworth and Boyer 1999; Kitschelt et al. 1999). This means paying more attention to firms, banks, and coordination among employers, as well as on the product markets that can sustain high-cost and high-value-added production processes (Streeck and Yamamura 2001).

Our collective project focuses more squarely on the politics of crisis, and hence on the political basis for such societal political and economic coordination. Furthermore, whereas much of the varieties of capitalism literature has stressed the comparative advantage of particular institutional arrangements, and thus the sources of continued institutional stability and hence capitalist diversity, we focus on current changes—or attempted changes—in these institutions (see also Kitschelt and Streeck 2003; Streeck and Yamamura 2001). In so doing, we hope to contribute to the recent focus of some new institutionalists on the problem of institutional change (Pierson 2000; Streeck and Thelen 2005; Thelen 1999, 2003, 2004). The essays that follow examine the politics of crisis in specific areas of public policy: industrial relations; finance; economic and fiscal policy; social policy; and constitutional reform. The authors analyze attempts to renegotiate the institutions of these coordinated market economies in these particular domains, and discuss the extent to which a new organizational equilibrium has emerged. As we will see, in each case institutional change has been attempted, but there are important differences, both cross-nationally and across the various policy sectors.

Kathleen Thelen and Ikuo Kume examine the political dynamics of employer coordination in Sweden, Germany, and Japan. They argue that the varieties of capitalism approach is indeed useful for understanding the comparative advantage yielded to employers in these coordinated market economies, and hence for explaining why many employers in these nations seek to preserve their institutions for coordination, even when faced with “globalization” pressures. However, Thelen and Kume also
point out that the varieties of capitalism approach has tended to stress distinctly national patterns of employer interests, neglecting internal variance in the preferences of both employers and workers in these political economies. Moreover, even if the concept of comparative advantage is useful for understanding the continued resilience of these forms of economic coordination, it has neglected the need for continual political renegotiation of the terms of coordination. That is, in viewing cooperation as based on mutual self-interest, the varieties of capitalism approach has tended to adopt the rational choice view of institutional equilibria as “self-enforcing.” By contrast, Thelen and Kume argue that mutual advantage is not sufficient as an explanation for patterns of institutional stability and change in the area of industrial relations. Instead, they view employer (and labor) coordination as a “political settlement,” which may not only entail “the exercise of power or dominance of some firms or industries over others,” but which is best conceived of as a “political process . . . that is not self-sustaining but in fact has to be constantly nurtured and “patched up,” and sometimes renegotiated entirely.” The consequence of this more political view of economic coordination is that socially embedded institutions are no longer analyzed in terms of periods of stasis interrupted by sudden, inexplicable changes. Rather, Thelen and Kume view change as continual, and as part and parcel of the sustainability of particular sets of institutions. However, some outcomes of these political negotiations may indeed have repercussions that provoke more deep-seated change. This has been the case in Sweden, Germany, and Japan, albeit movement toward a new status quo has gone furthest in Sweden. Although employers as well as liberal economists and political parties have been quite visible in publicly questioning the viability of coordinated systems of industrial relations in these countries—as well as the generous wages and benefits paid to industrial workers—it is not abandonment of systems of employer coordination that we see, but renewed coordination among a smaller core group of firms in these economies. Moreover, it is precisely the intensified coordination among the employers and unions within this core that has made traditional economy-wide or sector-wide coordination more difficult, thereby leading to new forms of dualism in these political economies.

Torsten Svensson, Masaru Mabuchi, and Ryunoshin Kamikawa compare the banking crises in Sweden and Japan. In Sweden, a center-right coalition government reacted decisively to the banking crisis with the support of the Social Democrats, spending billions of Swedish crowns to set up a government guarantee and banking authority to rescue the banks. The subsequent recovery of the financial sector was so rapid that the government in the end spent less than one-half of what had been allocated for the bank bailout. In Japan, by contrast, policy makers were slow to acknowledge the banking crisis, and loath to put a stop to questionable banking practices that exacerbated the extent of the problem. Different strategies of “blame avoidance” account for these differences. In Sweden,
the banking sector had been deregulated and “privatized” to such an extent that policy makers could blame the banks for the crisis without implicating themselves. Indeed, politicians and bureaucrats had an interest in pointing out the failures of the banks to the public, so that together with the very rapid and dramatic denouement of the crisis, a credible argument could be made that public money and massive government intervention would be necessary to halt the crisis. In Japan, the Ministry of Finance continued to be deeply involved in the financial sector, which made it very difficult to point to problems without taking on blame or to call for a government bailout without being accused of corruption. This made it more attractive for financial experts within the executive to minimize the extent of the problem, downplaying it to both politicians and the public. Furthermore, the large size of the Japanese economy (in comparison to the Swedish) and the more gradual development of the crisis provided more scope for this avoidance behavior. Thus we see that strategies of “blame avoidance” are limited by institutional settings and public beliefs. The extent to which politicians (and bureaucrats) can avoid blame, and the strategies they can pursue in order to do so, depend upon the exact nature of relationships among politicians, bureaucrats, and private actors within a specific policy sector. Moreover, public beliefs are not infinitely malleable, but depend upon common sense reactions to both the problem at hand and to the previous policy record of executive governments. Swedish voters were prepared to believe that spending government money to bail out the banks was necessary and legitimate; Japanese voters, on the other hand, saw the banking crisis as just one more instance of governmental and bureaucratic mismanagement.

Similarly, Junko Kato and Bo Rothstein address the causes for the greater success of Swedish Social Democratic governments in comparison to Japanese Liberal Democratic governments in controlling deficits and deploying the tools of economic policy to restart the economy after the crisis of the 1990s. This outcome is particularly surprising given the usual assumption in studies of political partisanship that social democratic governments are more prone to deficit spending and large public sectors than conservative governments. Indeed, ceteris paribus, it should be more difficult to control deficits in countries with large public sectors than small ones. Just how little partisanship contributes to an understanding of fiscal and economic policy results is further demonstrated by the economic record of interim opposition governments that took office in both countries in the 1990s, interrupting periods of nearly unparalleled social democratic versus liberal democratic (respectively) one-party dominance. Center-right governments in Sweden proved ineffective in reducing deficits in spite of their antideficit liberal ideology; similarly, when the Japanese opposition parties came to power, they were neither able to reduce the deficit nor stimulate the economy through expansion of public spending, despite a long record of promoting greater government involvement in social redistribution. Kato and Rothstein argue that these patterns of
policy stability are best accounted for by “bureaucratic structures” and “institutionally driven public beliefs.” This argument is distinct from standard policy feedback or universalism arguments as advanced by Gösta Esping-Andersen (1990), Walter Korpi (1989), or Paul Pierson (1993), although it shares some similarities. Kato and Rothstein look more closely at the micro links between politicians, bureaucrats, and citizens. As they put it, “[p]olitical parties actively seek to make their policy stances permanent by structuring taxation and expenditure policies so as to create institutionalized support for their policy preferences.” In Sweden, universal social policies were financed by high levels of general taxation and payroll taxes. From its inception, the Swedish welfare state was designed to be nonstigmatizing through policies that did not require means tests, and hence, did not allow much leeway for administrative discretion in policy implementation. Further, the emphasis on graduated benefits in its cash benefit programs and high-quality standards of treatment in the social services meant that middle-class voters were prepared to pay relatively high taxes for this high-quality social protection. In contrast to the efficient revenue mechanisms of the Swedish tax system, Japanese liberal democratic politicians and bureaucrats sought to limit the institutional means for generating public funds, so as to create fiscal pressures against expanding public programs, especially redistributive ones. Instead, bond financing was more compatible with public works projects and distributive subsidies to favored constituents, as well as with higher deficit levels. These institutional logics created very different patterns of public beliefs in the two countries. In Sweden, public spending was viewed as legitimate, with benefits allocated according to fair procedural standards, and the burdens of taxation to be equally fairly distributed. In Japan, the public viewed government spending as based on particularistic interests and as economically ineffective. Consequently, Swedish politicians had more scope for raising taxes and cutting social benefits than their Japanese counterparts, who were unable to obtain political support for raising taxes to cut the deficit and failed in their efforts to use deficit spending as an economic stimulus.

Finally, Ellen Immergut and Sven Jochem address the role of political institutions in the development and renegotiation of “strong state” governance in Japan and Sweden. They argue that executive governments based on stable parliamentary majorities—and indeed, “one-party dominance”—was crucial to the consensus model of governance that emerged in these two countries in the postwar period. Consequently, the elimination of the institutional basis for one-party dominance through electoral and constitutional reform delivered a severe blow to these governance models, just as they were being subjected to pressure by international economic changes. In Sweden, constitutional reform initiated by the Social Democrats (Socialdemokratiska Arbetarepartiet) eliminated the Upper House of parliament and made the electoral system more proportional, thereby greatly increasing the probability of changes in govern-
ment, and hence, destroying the basis for one-party dominance. In Japan, Liberal Democratic Party (LDP) defectors joined with the opposition to reform the electoral method for the Lower House, introducing a mixed-member system based on single-member districts combined with seats allocated via proportional representation. Whereas the splitting-off of the members of some LDP factions into new parties, as well as improvements in the apportionment of the electoral districts reduced the electoral share for the LDP, the new single-member districts rendered the LDP a higher number of seats per voter share than the previous system. In addition, the single-member districts (although viewed as a requirement for ending political corruption) provide the LDP with many opportunities for strategic maneuvering to maximize their number of parliamentary seats, as well as incentives for distributive politics that satisfy local interests. Not surprisingly, the policy consequences of these constitutional and electoral reforms in both countries have been different. In both cases, the one-party dominance of the postwar period under which a single party maintained its control of the executive without serious challenge from Parliament has been broken. Even though the previously dominant parties retain their status as the largest parties, majority government of extended tenure has been replaced by coalition governments of shorter duration and more frequent changes in the partisan composition of government. In Sweden, however, the tough competition of the new electoral method, as well as the mistakes made in adjusting to the economic crisis of the 1970s, have encouraged continual innovation of the governance model and a complete break with state-led governance in the 1990s. In Japan, on the other hand, the electoral rewards for sticking to traditional policies have made a radical break with previous policy more difficult, and a new governance model has yet to emerge, although the latest election (2005) may constitute a political watershed.

Immergut and Jochem thus conclude by arguing that the changed political frame for the institutions of these coordinated market economies may explain some of the recurring policy patterns across the cases. In all areas of policy, Swedish governments appear to have gone further in introducing radical crisis measures and supporting significant modifications to the traditional Swedish model of strong-state government. Welfare state programs have been significantly restructured (including the historically significant Allmän Tilläggs pension [ATP, universal supplementary] pension system) and social policy benefits have been cut; the role of the national bank in industrial policy has been eliminated virtually; the government has removed itself as an informal arbiter in industrial relations agreements. Perhaps even more significant, the ambition of tightly coupled policy interventions involving negotiations and coordination across classes, industrial sectors, and regions has been abandoned in favor of a more liberal and decentralized approach. In Germany—a case that has been more systematically covered by Yamamura and Streeck (2003) as well as Kitschelt and Streeck (2003)—similar types of reforms
have been discussed, but few have been implemented. Similarly, in Japan, reforms have been debated since the outset of the 1990s, but progress has been slow. In all three countries, the political stability necessary for the government to play a role in making the “credible commitments” necessary for the institutions of coordinated market economies (as Peter Gourevitch and James Shinn 2005 point out) has been severely lessened, if not entirely eradicated. However, the causes for this loss of “Berechenbarkeit” or calculability as Max Weber called it are different, and consequently, the policy consequences are different as well. In Sweden, constitutional changes were directly responsible for the loss of one-party dominance and, after a messy transition period, political actors came to recognize that the entire governance model was outdated. Even though many political and normative commitments, such as to social equality and the welfare state, were maintained, political actors eventually accepted that new approaches to public policy were required, and that even the scope of government action itself needed to be reconsidered. In Japan, political scission within the dominant party ended one-party dominance, but the ensuing electoral reform buttressed liberal democratic power and failed to eradicate some incentives for criticized policies, making the reform process more difficult than had been hoped. In Germany, as Stewart Wood (2001) points out, continuity in policy had been guaranteed by the many veto points in the German system, which meant that agreement between government and opposition was necessary for political decision making. In the 1990s, however, changes in the party system and a new regional cleavage caused by German unification have so increased electoral competition that previous areas of political consensus—such as the pension system, for example—are now marked by intense political conflict.3

The other authors in this special issue of *Governance* view the relative variation in reform efforts in Sweden, Germany, and Japan in the same light—with Sweden showing markedly more changes in its governance model in all policy areas than either Japan or Germany—but take a less “state-centered” approach. Thelen and Kume point out that while the state may have had an impact on the Swedish pattern of industrial relations, in recent employer and union negotiations in Japan and Germany, executive governments have strictly adhered to the principle of autonomy in collective bargaining. Shifts in the industrial relations systems have come about because of the interplay of changes in economic interest among various strata of forms and workers with political negotiations regarding how to cope with these changes in both the domestic and world economy. Kato and Rothstein see the difficulties in Japanese efforts to control its deficit as rooted in both its policy instruments and decades of policy feedback at the administrative level. Bond financing and political resistance to increasing tax revenues have resulted in a pattern of policy expenditures that does not convince the public that increased public revenues will be put to good use, such that even effects to raise taxes to cut the deficit have been met with public resistance. Furthermore, they point
out how at various points in both Japanese and Swedish history, the economic myths created by political parties have come back to haunt them by affecting contemporary policy making in unanticipated ways through their influence on the beliefs of citizens. Svensson, Mabuchi, and Kamikawa also focus on institutionally driven public beliefs in explaining the scope for different types of blame avoidance strategies, and hence the greater hesitation of Japanese policy makers to grapple with the bank crisis.

Cutting across these essays is a focus on politics that constitutes the unifying theme of this special issue. As adherents of the “new institutionalism,” we have found to our own surprise that our research on the politics of crisis in coordinated market economies has resulted in a renewed emphasis on the role of public attitudes in many of our essays. This is surprising because the role of public attitudes is a theme, which was actually more emphasized in an earlier phase of policy studies, namely, by the political behavior movement, to which the new institutionalism responds. Thus we see that what may emerge as a potential area for future research on this topic may in fact entail a rediscovery of earlier work.

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Notes

1. For a fuller discussion see Thelen (2004).
2. Some exceptions are Kitschelt (2003a, 2003b) and Wood (2001) as well as papers presented at a conference on “Political Institutions and Varieties of Capitalism,” organized by Tom Cusack and David Soskice and held at the Science Center Berlin (Wissenschaftszentrum Berlin) from October 31–November 1, 2003.
3. After the election of September 2005, the Christian Democratic, Christian Social, and Social Democratic parties have formed a “grand coalition,” which may help to contain rivalry amongst these parties, but will not eliminate competition from the smaller parties outside the coalition.
References


Coordination as a Political Problem in Coordinated Market Economies

KATHLEEN THELEN* and IKUO KUME**

The purpose of this article is to explore the political dynamics of employer coordination in three well-known “coordinated market economies.” We examine differences in how employer coordination has been organized in Sweden, Germany, and Japan in the area of industrial relations, and we examine the extent to which such coordination represents a self-sustaining equilibrium, as some of the most influential treatments suggest. To preview the findings, we argue that precisely the intensification of cooperation between labor and management in some firms and industries (that the “varieties of capitalism” literature correctly emphasizes) has paradoxically had deeply destabilizing collateral effects that have undermined or are undermining these systems as they were traditionally constituted. All three cases are characterized not so much by a full-blown breakdown of coordination so much as a very significant reconfiguration of the terms and scope of such coordination. Specifically, all three countries feature the emergence of new or intensified forms of dualism—different in each case based on different starting points—in which continued coordination within a smaller core has in some ways been underwritten through the breaking off of other, more peripheral, firms and workers.

Introduction

A relatively new and highly influential line of thought in the literature on the political economy of advanced capitalism draws attention to the central role of employer coordination in the construction and maintenance of distinctive “varieties of capitalism” (see, especially, Hall and Soskice 2001). Whereas much of the earlier literature on democratic corporatism cited the central importance of labor strength and centralization to a variety of institutional and macroeconomic outcomes, this newer body of work argues that the capacity of employers to coordinate among themselves is what holds the key to understanding a range of outcomes that in the past were associated with corporatism (Soskice 1990).

The varieties of capitalism literature has provided a powerful corrective to a previous wave of theorizing that saw traditional labor institu-
tions, especially in “coordinated market economies,” as extremely fragile in the face of neoliberal ideology and more volatile international markets since the 1980s. Much of the previous literature was premised on the idea that globalization would push all countries toward neoliberalism and deregulation, encouraging firms to lower labor costs and increase labor market flexibility while undermining the power of unions to prevent these (Kapstein 1996; Katz and Darbishire 1999; Martin and Ross 1999). However, convergence theories predicting a uniform slide into deregulation have not been borne out (Berger and Dore 1996; Boyer and Hollingsworth 1997; Ferner and Hyman 1998; Wallerstein, Golden, and Lange 1997; Zysman 1996). Moreover, theories that attributed the resilience of traditional bargaining institutions in some countries to successful union defense do not provide much purchase, either, on observed cross-national patterns of stability and change (e.g., Katz 1993; Turner 1998).

The varieties of capitalism (VOC) perspective is premised on a distinction between “coordinated” versus “liberal” market economies, which points to differences in the extent to which employers can coordinate among themselves to achieve joint gains. These differences are expressed in different clusters of institutions in the two types of political economies—including particular kinds of financial institutions, collective bargaining institutions, vocational training institutions, even welfare state institutions—that in turn support distinctive types of employer strategies in the market (see also Ebbinghaus and Manow 2001). Because of their divergent arrangements, the two types of political economies are associated with efficiency in the production of different sets of goods (Hall and Soskice 2001, 36–44).

The VOC literature suggests that—far from convergence—we should see continued diversity and indeed even stronger divergence between the liberal market economies and coordinated market economies (see also Iversen, Pontusson, and Soskice 2000; Kitschelt et al. 1999; Thelen 2001). Rather than universally embracing deregulation, employers in the developed democracies will seek to confront new market challenges by building on and deepening previous sources of comparative institutional advantage. Thus, while employers in the United States and United Kingdom may well seek deregulation, employers in countries such as Germany, Sweden, and Japan will hold to traditional arrangements, because the strategies they have developed in the market rely on a high degree of labor cooperation, strong worker investment in skill acquisition, and peaceful plant relations—all of these being elements that traditional labor relations institutions and practices provide.

In short, and in contrast to convergence or even “common trajectory” theories (Pontusson 2000), the VOC literature, if anything, predicts heightened divergence across systems. The argument above all draws attention to how employers themselves have become invested in various institutions (including centralized wage bargaining in some of Europe’s corporatist democracies, and also traditional industrial relations practices
such as lifetime employment and seniority wages in Japan’s coordinated market economy). The basic logic is that, because employers have organized their competitive strategies around these institutions, and especially because these institutions now act as crucial supports for these strategies, employers will not abandon them in the face of new market pressures (Thelen 2000). To the extent that the theory sees employers as supportive of, and indeed dependent on, existing institutions, all feedback within the system is, so to speak, positive and supports the maintenance of traditional institutions.

### Problems with the VOC Framework and the Concept of Employer Coordination in Particular

In general, we think that the emphasis in the varieties of capitalism literature on employers’ own continuing interest in traditional labor relations institutions in the coordinated market economies does provide a better explanation of the surprising resilience of such institutions in the face of new competitive pressures than rival theories that attribute these outcomes to “institutional inertia” or successful union defense (Thelen 2001, 2002; Thelen and Kume 1999).

However, as an empirical matter, we know there have been and in some cases continue to be rather significant tensions at work in traditional industrial relations institutions in coordinated market economies, including those that are the focus of this article, Sweden, Germany, and Japan. In Sweden, tensions were already high in the 1980s but came to a head in 1990 when the national confederation of Swedish employers (Svenska Arbetsgivareföreningen [SAF]) withdrew entirely from the tripartite structures that had traditionally defined that country’s particular (and particularly centralized) version of coordination. In Germany, serious strains in traditional industrial relations institutions have been evident, especially since the 1990s as declining union membership and problems within key employer associations have resulted in a noticeable drop in collective bargaining coverage in some core industries. Finally, in Japan, recent years have witnessed some well-publicized cases of retreat by key employers from traditional practices including, above all, seniority wages and, to a lesser extent, commitment to lifetime employment.

Such tensions and changes in these institutions are enormously difficult to get a handle on if we stay within the varieties of capitalism framework, and we think that a part of the problem has to do with the key concept of “coordination.” There are several related issues (for elaboration, see Thelen 2002). First, employer coordination is a quite apolitical and, in practice, often essentially bimodal concept that enters into the analysis as a “condition” or characteristic that some countries have and others lack. Second, and related to this, much writing in the VOC literature (including, self-critically, Thelen 2001) is based on a very stylized and highly composite (national-level) picture of employer interests. Thus, in
this literature, employers (as a whole—within a given country) in coordinated market economies are seen as “invested” in various institutions (wage bargaining institutions, for instance), and from this it follows that they will have an interest in maintaining these institutions—among other things—as the site within which they can continue to coordinate among themselves, to the benefit of all.

In what follows, we examine employer coordination as a political problem in Sweden, Germany, and Japan in the contemporary period. Rather than looking at employer interests from the perspective of a highly composite view, we focus on the problem of sustaining employer coordination in a context in which the interests of various segments of capital (and for that matter, labor) are diverging in the face of new market conditions, and where coordination is sustained in part by a political settlement among them (often also the exercise of power or dominance of some firms or industries over others). Contemporary market conditions do not just activate new conflicts between labor and capital (as is widely known and theorized); they also activate new tensions and strains among firms and industries that are differently situated in domestic and international markets. Rather than thinking of coordination as a “thing” or “state of affairs” that whole countries either have or do not have, we think it is much more useful to conceive of coordination as a political process and something that is not at all self-sustaining but in fact has to be constantly nurtured and “patched up,” and sometimes renegotiated entirely.

By disaggregating “employers” (and “labor”) and by adopting a more explicitly political approach to the problem of “coordination,” we are able to embrace and incorporate some of the core insights of the VOC perspective, especially regarding the continuing interests of some employers in traditional industrial relations institutions and practices. At the same time, we address the tensions in these institutions that the VOC literature has tended to ignore or minimize. In contrast to much VOC-based theorizing, which sees all feedback in these systems as positive and stabilizing, we argue that precisely the intensification of cooperation between labor and management in some firms and industries (that the VOC literature correctly emphasizes) has paradoxically had deeply destabilizing collateral effects that have undermined or are undermining these systems as they were traditionally constituted. The next sections lay out the dynamics for Sweden, Germany, and Japan, respectively.

**Coordination as a Political Process: Case Studies**

**Sweden**

Among the coordinated market economies, Sweden was notable for the high level of centralization that traditionally characterized industrial relations there. Between 1956 and 1983, the broad parameters for wage settlements covering most of the economy were set at the national level
in peak negotiations between the main (blue-collar) union confederation, *Landsorganisationen* (LO), and the national confederation of Swedish employers, SAF (see, e.g., Martin 1991). This system broke down, in a halting way in the 1980s, but decisively and apparently irreversibly in the early 1990s when SAF eliminated its own bargaining unit (leaving its counterpart on the union side, LO, no one to negotiate with) (Pontusson and Swenson 1996, 224). Michael Wallerstein and Miriam Golden (1997) single out Sweden as one of two cases—along with Britain—of significant institutional change in collective bargaining in the 1980s and early 1990s.

Developments since the early 1990s do not, however, point to a full breakdown of all coordination and a free fall into decentralization; instead, wage bargaining has re-equilibrated on the basis of a very different pattern of coordination. Currently, the Swedish system is characterized by highly coordinated bargaining across industries within the export sector (including much stronger cooperation than ever before between unions organizing blue-collar and white-collar workers)—combined, however, with much looser coordination between the exposed and sheltered sectors of the economy. Sweden’s touted system of solidaristic wage bargaining, which had resulted in a significant compression of wages across the economy, was a main casualty in the reorganization, as reflected in growing wage differentiation within and especially between these broad bargaining clusters (Hibbs and Locking 2000).

The breakdown of the previous model of bargaining has been analyzed by others and need not be recounted at length here (Martin 1991; Pontusson and Swenson 1996). Swedish employers had originally agreed to centralized bargaining as a way of ensuring wage moderation; however, over time the system had come to deliver wage settlements that were both rigid and highly inflationary (Martin 1991, 33). Centralized bargaining up to the 1960s was associated with a form of wage solidarism that equalized pay across industries and plants (“equal pay for equal work” regardless of a firm’s profitability). This was consistent with and in fact promoted an ongoing shift in resources (including labor) out of declining and into more competitive industries. However, by the late 1960s “wage solidarity took a more radically egalitarian turn, . . . in the direction of compressing relative wages more or less across the board” (Hibbs and Locking 2000, 759, 762). Specifically, provisions negotiated in central bargaining began to compensate low-paid groups (public sector and low-skilled industrial workers) for wage drift enjoyed by skilled industrial workers (Martin 1991, 35; Pontusson and Swenson 1996, 232–233). These provisions had highly inflationary consequences, fueling a chronic, institutionalized ratcheting up of wages (Elvander 1997, 13; Martin 1991, 35).

The negative effects of these developments were felt especially intensely in the engineering industry, and the employer association in that sector (Verkstadsföreningen, or VF; later Verstadsindustrier, or VI) led the drive for bargaining decentralization in the 1980s and 1990s. The
VF/VI had opposed the new wage-leveling clauses cited above from early on (Martin 1991, 85), but its appeals to oppose them found no resonance among employers in other industries that were less affected. In the absence of movement on these issues in national negotiations, the VI in 1983 decided to go it alone and withdrew from traditional peak (confederal) bargaining altogether, striking a separate deal with the metalworkers’ union, Metall. This dealt a decisive blow to the traditional nationally coordinated system, one from which that system never really recovered.  

While it is clear that employers (and specifically employers in the engineering industry) led the charge against the old system, studies have revealed that what has sometimes been coded as a neoliberal employer offensive against the traditional Swedish system is better characterized as a cross-class realignment that brought together employers and unions in the export sectors (but especially in the engineering industry), at the expense of traditional, more encompassing forms of coordination and solidarity (e.g., especially Iversen 1996). First, and as Jonas Pontusson and Peter Swenson (1996, 228) emphasize, the initial break with centralized bargaining (in 1983) was not accomplished through conflict, but instead took the form of a deal in which the VF offered the metalworkers’ union (Metall) a wage increase above what the union had demanded, but in exchange for decoupling negotiations from the peak bargain and eliminating contractual provisions that compressed the wages of skilled and unskilled workers.  

A wage offer that exceeded the union’s own demand would in any event have been hard to decline. However, in addition, Metall had also developed its own reasons for disliking aspects of the wage system as traditionally constituted and as practiced under the new (expanded) terms of wage solidarity. Among other things, engineering workers had come to think of public-sector workers as “pay parasites” and resented their ability to free-ride on the productivity gains in engineering through the compensation clauses mentioned above (Pontusson and Swenson 1996, 234). Beyond this, the interoccupational leveling clauses (between skilled and unskilled workers) had also become a problem for Metall. Technological changes in engineering had blurred the line between skilled blue-collar and white-collar occupations, so that high-skill metalworkers often found themselves working in jobs very similar to that of members of the separate white-collar union, Svenska Industriägerrättarförbundet (SIF), but—because of wage compression within Metall—at a much lower rate of pay (Mahon 1991; Martin 1991, 36).  

VI’s break with the system of peak-level bargaining ushered in a period of uncertainty, characterized by demands on the part of some influential firms like Volvo, Ericsson, and ABB for further decentralization to the plant level, but with other firms and sectors advocating the more intermediate solution of industry-level negotiations. Full decentralization to the plant level proved unrealistic (see, e.g., Thelen 2001), and SAF’s dis-
mantling of its own bargaining apparatus in 1990 of course made a return to national-level bargaining along the old lines impossible. It therefore looked as though the settling point would be industry-level bargaining, without any interindustry coordination. However, the 1995 bargaining round was crucial in highlighting the potential pitfalls (for employers) of a lack of cooperation across industries within private sector manufacturing. In that year, a very high settlement in the (then-booming) paper and pulp industry disrupted negotiations in the metalworking industry, leading to costly work stoppages and, ultimately, a higher settlement (see Elvander 1997, 49–50; Kjellberg 1998; also Thelen 2001 for a more extended version). Employers continued to oppose vociferously any recentralization of national bargaining under the auspices of the LO and SAF, but the events of 1995 underscored the disadvantages of completely uncoordinated (industry-level) bargaining in a context in which unions are capable of backing up their demands with actions that export-dependent industries find extremely expensive in highly competitive and tightly integrated global markets.\(^6\)

The lessons employers learned in 1995 set the stage for a reconfiguration of bargaining that is based on a strengthening of cooperation across industries and between labor and capital within the export sector, but largely at the expense of more encompassing forms of coordination and solidarity at the national level (see also Thelen 2001). In 1996, in a move spearheaded by the head of the metalworkers’ union, Göran Johnsson, Metall joined with its white-collar counterpart (SIF) and other unions in export sectors; together they issued a public invitation to their counterparts on the employers’ side to engage in joint negotiations over wage formation and mediation procedures to avoid costly conflicts of the sort they had fought the previous year (Dagens Nyheter, 1 June 1996, A4; see also Elvander n.d., 15). By March of 1997, eight unions and 12 employer associations covering the manufacturing sector as a whole had concluded a new “Agreement on Industrial Development and Wage Formation” designed to support “constructive negotiations” and to avoid “the need to resort to industrial action” (18 March 1997, appendix A, paragraph 1; see also Elvander n.d.). The agreement establishes an “Industry Committee” composed of equal numbers of representatives of unions and employers to oversee its implementation and—especially important—to select mediators (“impartial chairmen”) who accompany and facilitate industry-level wage negotiations. The 1997 deal also contains a number of “practical rules” governing the bargaining process—for example, requiring unions to submit their demands well in advance of the expiration of current contracts, providing for the mediator to enter discussions well before the contract runs out, and allowing him/her to force a delay in planned industrial actions (Berg 2003a). In general the role of the mediators has served to promote peaceful compromise within industries, as well as to broker coordination across industries in the exposed sector as a whole (see also Elvander n.d., 22).
For the unions, but especially for Metall, the agreement was important in prompting the VI to abandon its earlier efforts to push for full decentralization, thus ending years of struggle in this key industry over the structure of negotiations. Employers for their part have praised the new conflict mediation procedures that lie at the center of the agreement and that they see as crucial to managing their heightened vulnerability to interruptions in production, including strikes. As Nils Elvander has put it, the agreement “covers by and large the whole competitive sector in the Swedish economy, it bridges old class distinctions [between blue and white collar] on the trade union side, and it presents an entirely new model for collective bargaining and conflict resolution” (n.d., 15). The agreement thus puts to rest the wage competition between blocs (public versus private and blue versus white collar) that both unions and employers (particularly in engineering) had—for different reasons—come to find so problematic. It does so by delinking bargaining in the exposed sector from that in the sheltered sector, and by facilitating a closer interface between white- and blue-collar contracts in industry.

These new arrangements sideline the national trade union confederation LO rather completely, which is why that organization was unenthusiastic, if resigned, about the industry agreement. The LO has generally been casting about for a way to resuscitate some national-level forum in which it could continue to play a central role. One opportunity appeared to present itself in 1997 when the government (partly in response to developments in the export sector) formed a commission to explore the possibility of creating a new national mediation authority. Initially, the LO had favored the idea, hoping that such an institution would facilitate the linking of wage settlements across the economy and, with that, restore the LO to an important role in the bargaining process. However, representatives of the export sector (on both the labor and employer sides) opposed any government machinery that would circumvent or supersede the successful procedures they had worked out for themselves, a position that was respected in the legislation that ultimately emerged in 2000. Public-sector workers, for their part, were concerned with protecting their relatively newly won (1966) right to strike and hurried to conclude a voluntary agreement similar to the industry agreement in order to keep themselves out of government mediation machinery. As Anders Kjellberg (2000, 558–559) notes, the prospect of state regulation may have helped to spur greater attempts at self-regulation, and in fact by the end of 2001, 16 agreements covering over half of the entire workforce in Sweden had been concluded (Berg 2002b; Skiöld 2001).

These developments did not forestall legislation, however, and in 2000 a new national Mediation Authority (Medlingsinstitutet) was established, replacing the old, weaker National Conciliator’s Office (Förlikningsmanns expeditionen) (Skiöld 2001). The new authority was not intended to supersede, only to complement, the voluntary industry agreements; as one of the state officials who helped draft the bill remarked, the govern-
ment much preferred the social partners to “solve their problems by themselves.” Thus, the new mediation authority specifically promotes and works around existing agreements and covers those industries—transportation and retail trade among them—that have no such voluntary agreement (Berg 1999; Skiöld 2001). Similar to provisions under the voluntary arrangements, the Mediation authority can encourage an early (prenegotiation) exchange of information between the bargaining parties and appoint a mediator to facilitate the negotiations themselves. The rules under the new law also call for advanced notice before anticipated industrial action by either party, and allow state mediators to force a postponement of such action (Berg 1999; Skiöld 2001). However, like the industry agreements, the mediators only have power of persuasion, and cannot impose a solution. In this sense the Swedish authority remains less powerful than its Danish counterpart even if many of the goals—to avoid industrial strife and especially to facilitate coordination across industries behind the lead of the exposed sectors—are the same. So far the new routines and procedures in Sweden appear to be quite successful in achieving these goals. Negotiations in a majority of industries in the 2001 and 2004 bargaining rounds were accompanied by mediators, and resulted in long-running (three-year) agreements (Berg 2002b, 2004). A partial exception came in 2003 when the municipal workers union (Kommunal) took advantage of a clause in the 2001 agreement to opt out of the existing (three-year) contract a year early, and struck for higher wages and a boost for lower-paid workers. The negotiations (again facilitated by a mediator) resulted in adjustments along these lines—but this was in large part a function of employers’ own eagerness to increase the wages of low-paid healthcare workers to address intense labor shortages in that area (Berg 2003b). There were worries that this would lead to a cascading effect with unions in other industries demanding a similar deal. However, this was not the case and in fact most of the key industrial unions (including the metalworkers, the paper and pulp workers, and the Swedish Industry Workers union) were critical of the municipal workers union for its actions (Berg 2003b). The following year, 2004, industry again led the bargaining, and again signed a long-term contract. Other sectors were “more or less held back by the Mediation Authority (Medlingsinstitutet), which prefers the industry agreements to be settled first, thus maintaining the normal order in the labour market” (Berg 2004).

The negotiations surrounding the establishment of the Mediation Institute and subsequent developments reveal the constellation of interests and power relations behind the “new” Swedish model. There is high coordination within the exposed sector, where the resulting contracts also effectively set the pace for the country as a whole. However, any intimations of a resurrection of wage solidarity on an economy-wide basis have been vehemently rejected not just by SAF and the main employer associations for industry, but also by leading industrial unions such as Metall. Far from longing for the old system, Metall wants no part of any move-
ment that would revive or reinstate the previous power of the peak union confederation, LO. All indications are that Metall is much more interested in cooperating with white-collar unions (and employers) within the metalworking sector than with coordinating with other blue-collar unions within the LO.13

These developments thus signal and institutionalize the end to solidaristic wage bargaining as it had come to be practiced in the 1960s and 1970s, and it comes as no surprise that they have been associated with increased wage dispersion (Hibbs and Locking 2000), as well as with heightened “tensions between unions representing low-paid groups and other unions whose members are in a better position” (Ahlberg 1997). Indeed, and as many commentators have noted, in the pattern bargaining system that has emerged under the industry agreement, local government and private-sector service workers have more or less been “left behind” (Ahlberg 1997; Berg 2002a) an outcome that is fully embraced not just by employers but also by unions in the key export sectors. In the 1998 collective bargaining round, for example, there was some informal coordination among blue-collar unions in the LO, but prominent unions in the export sector (above all metalworkers and paper workers) “threatened to back out if the low-paid were given ‘too much’” (Ahlberg 1997). The criticisms leveled by these same unions against the actions of the municipal workers union in 2003 suggest that this has not changed much.

Summarizing developments from the early 1980s to the present, one could conclude that in the Swedish case, “employer coordination” has proved more resilient than adherents to a strict neoliberal offensive thesis might have predicted. Full decentralization to the plant level—as advocated in the 1980s and 1990s by prominent firms such as ABB, Volvo, and Ericsson—has been averted, and there is significant coordination across the industry sector as a whole. At the same time, however, the issue of “who is coordinating with whom” has shifted decisively—from coordination at a very encompassing, confederal level (but with white- and blue-collar workers negotiating separately), to coordination across the blue-/white-collar divide and across export industries—but less closely linked to the public and private service sectors. In general, and as Kjellberg (2000) notes, since the 1990s, “union alliances based upon class were increasingly replaced by constellations based upon sector” (555).

The changes described above amount to a significant renegotiation of the terms of coordination, accomplished in two steps. In the first move, from confederal to industry-level bargaining, employers sloughed off several layers of coordination that they had come to view as a drag on their ability to restructure production and to maneuver effectively in increasingly competitive international markets. Above all, VI’s initial withdrawal from peak negotiations dealt a double blow to solidaristic wage bargaining as traditionally practiced in Sweden (i.e., producing wage leveling both across industries and between skilled and unskilled
workers within individual sectors). While some of the literature had treated this first move as an example of a neoliberal offensive by employers against labor, we have argued that it is actually more properly understood as the result of an intensification of cooperation between labor and capital in the metalworking industry at the expense of solidarity and coordination across sectors.

The second phase of reorganization/recoordination of bargaining across the industry sector (but separate from bargaining in the public and private service sectors) solidified and in some ways shored up this new arrangement. It solidified the arrangement by relinking the metal industry to other export industries, thus bringing potential rogues (like the paper and pulp industry was, in 1995) back into a form of coordination organized around what the industry sector as a whole can bear. It shores up this new arrangement, moreover, by acknowledging the negative effects (on both sides) of industrial conflict and by underwriting mutual restraint through the new mediation procedures.

We can say that Sweden is a coordinated market economy before and after. But this cannot obscure the fact that a significant shift has occurred. Above all, the LO has been decisively relegated to the distant sidelines when it comes to wage negotiations, and with that, wage solidarity on the old terms is irretrievably gone. Employers are, as one representative put it, “dead against” any return to national-level bargaining (under whatever auspices, either LO or under the auspices of the new national mediation institution) However, in their campaign against any such recentralizing initiatives they have been massively aided and abetted by the most powerful industrial unions (especially Metall), which have their own reasons to support the arrangements described above that rest on a new form of accommodation between labor and capital within key export industries.

Germany

German industrial relations were never centralized at the national level as in Sweden, but traditionally a high degree of coordination has nonetheless been achieved through multi-industrial bargaining under the informal leadership of the metalworking industry. It is precisely in this industry where the most important new “cracks” in the system have appeared. No one predicts a complete convergence of this relatively centralized model on, say, the U.S. system, but here, too, it seems clear that there are serious and undeniable pressures at work—and the outcome is in many ways still much more in flux at present than in Sweden.

The most sobering recent trends in Germany, by far, are the signs of organizational disarray in the Association of German Metalworking firms (Gesamtmetall) and its union counterpart (IG Metall), which together have played the key flagship role in Germany’s de facto system of pattern
bargaining over most of the postwar period. On the employer side, firms within the metal association have grown increasingly critical of “rigid” central contracts and have begun calling for reforms that would inject much greater flexibility to adapt central bargains to the needs of individual firms. More consequentially still, a significant number of firms have voted with their feet, withdrawing from the association and thus also from the terms of the central bargains it negotiates with the union. Such a trend is deeply destabilizing since, historically, rather high collective bargaining coverage rates in Germany (estimated for the 1960s at around 80% of all firms accounting for 90% of all workers—[Zagelmeyer 1997]) have always been a function of high employer organization, not union membership. Union organization in Germany is rather low, especially compared to Sweden, hovering around 30% of all workers for most of the postwar period, as against Swedish unions’ 80+%. However, employers have traditionally been extremely well organized, and this has stabilized encompassing bargaining because contracts signed by the employer associations cover all workers in the member firms, regardless of their status as union members or not (Thelen 1991).

The origins of contemporary tensions in the metalworking industry go back in part to a divergence in interests between different employers within Gesamtmetall itself. Simplifying somewhat, the system has traditionally rested on a particular kind of accommodation between the country’s large export firms and its sizable sector of small and medium-sized firms (Mittelstand). The core of the deal was one in which large firms dominated the employer association (and its main decision-making bodies), but typically also bore the burden of industrial conflict in order to secure moderate settlements with the unions on a range of issues, including, but not limited, to wages. These settlements, it is important to note, did not exhaust the ability of these large firms to pay; there was room for them to “top up” the industry deal in subsequent plant-level bargaining with their own works councils, resulting in wages and benefits “above the going rate” (übertarifliche Leistungen). Such flexibility in the past was important in reducing pressure on centralized bargaining by providing an outlet for de facto (upward) differentiation based on conditions in individual firms (Thelen 1991).

Developments over the last 20 or so years have disrupted this basic deal, but as in Sweden the problem is not well captured by arguments that stress a straightforward neoliberal offensive waged by employers against labor. Some of the most destabilizing trends in fact go back to an intensification of cooperation between labor and capital at the plant level (especially in larger firms)—the “collateral” effects of which, however, have begun to interfere with continued coordination among firms and among workers at the industry level. Clear tensions began to emerge already in the 1980s, in the context of negotiations over working time reduction. A series of bargaining rounds in that decade produced reductions in regular working hours in several steps, down to 35
hours throughout western Germany. Larger firms were able to offset the costs of such reductions by taking advantage of clauses allowing greater flexibility in working times—expanding shift work or devising differentiated working time arrangements. However, smaller companies were not able to make these same kinds of adjustments and thus were hit more heavily by the sheer costs of reduced working hours (Silvia 1997).\textsuperscript{18} Discontent within the employers association grew as smaller firms listed under the weight of agreements they felt did not reflect their interests.

The results of subsequent collective bargaining rounds in the 1990s did not ease and in many ways exacerbated problems of solidarity on the employer side. In key sectors such as automobiles, German producers had begun to face much stiffer competition from high-quality (lower-cost) producers in Japan and elsewhere. These more competitive markets, along with more tightly linked production networks, increased dramatically the costs to firms of industrial conflict, because interruptions in production would result in lost market shares. Until the mid-1990s a typical ritual in German industrial relations was for a strike by the union (or threat thereof) to be met with a more or less equally effective lockout (or plausible threat of lockout) by the employers association.\textsuperscript{19} However, starting in 1995 (arguably much before, it only became manifest in the mid- to late 1990s), Gesamtmetall was unable to continue the previous pattern, as many of its members had become conflict averse in the extreme.\textsuperscript{20} Many of the core firms on which Gesamtmetall had traditionally relied to carry it through conflicts with the union could (as before) afford a somewhat higher wage settlement; they now much preferred this to the prospect of shouldering the burden of a conflict with the union that would bring losses in the market for which they could not possibly be compensated by the association and from which they could not easily recover.

The latter half of the 1990s thus witnessed a number of bargaining rounds that featured remarkable displays of disunity on the part of metalworking employers, and an utter incapacity to put together a credible lockout threat in the face of conflict with the union (on this, see especially Thelen and van Wijnbergen 2003). This situation led to a series of industry settlements that came much closer than ever before to exhausting the ability of the strongest firms to pay, in effect absorbing the flexibility mentioned above on which the internal political balance within the employers’ association rested. On the basis of a survey of nearly eight thousand firms (in eastern and western Germany), Lutz Bellmann, Susanne Kohaut, and Claus Schnabel (1998) show that the percentage of firms paying wage increases over the collective bargain dropped from 60.6\% in 1993 to 48.9\% in 1997. Firms that did continue to pay above the going rate paid less, on average two percentage points less, than before (averaging across all firms) over those four years (Bellmann, Kohaut, and Schnabel 1998). What this means is that the weaker firms were being forced to pay
wages much closer than before to those of the strongest companies (Hassel 1999; Hassel and Schulten 1998).

These developments in working-time regimes and in wages produced highly corrosive feedback effects, prompting a hemorrhaging of the employer association itself, as weaker firms began to opt out of the industry-level contract altogether. Sometimes these firms have severed ties completely; in other cases they have found their way into new organizations that have been constructed by, and alongside, the old employer associations and that promise all the previous benefits of membership, but do not commit the firms to the terms of the contracts negotiated with the unions (Verbände ohne Tarifbindung, or so-called OT-Verbände).21 Either way, though, the result has been a growing number of firms outside the regular employers associations and, with that, also outside the system of industry-wide bargaining. Between 1990 and 2001, Gesamtmetall has recorded steady and very significant losses, as 30% of its member firms in the West dropped out of the association in that period (Behrens 2002b). The trend in the East is even more dramatic, with 66.8% of firms there relinquishing their membership (Behrens 2002b). Overall, larger firms are more likely to stay in the associations, so the number of workers affected is smaller than the number of firms. Nevertheless, collective bargaining coverage has eroded significantly. The most recent data available (for 2002, for the economy as a whole) reveal that the number of employees covered by industry wide agreements has fallen steadily in the West, from 72.2% in 1995 to 61% in 2002. Figures for the East indicate a drop from 56.3% in 1996 to only 35% in 2002 (Behrens 2002a, 2004).22

In other words, intensified reliance of Germany’s core firms on continued peace and stability in their relations with labor at the plant level has begun to feed back in deeply paradoxical ways, stabilizing the system in a formal sense (by deflecting demands for formal decentralization and allowing the union to reach settlements with employers in collective bargaining rounds), while at the same time undermining the deeper foundation on which the system rests (as central bargaining over time comes to cover a shrinking number of firms). Union victories over disorganized employers in key collective bargaining rounds in the mid- to late 1990s were therefore highly ambiguous. While some scholars have coded these events as system stabilizing (cases of successful union defense against employer attacks on the system), the results of these bargaining rounds generated instability by heightening Gesamtmetall’s internal problems. Union leaders realize that their own ability to conclude binding and encompassing agreements hinges on continued organizational viability on the employer side, which is why their own celebrations of these victories were muted, and frequently accompanied by expressions of concern about the weakness of the employer association.23

Internal organization problems on the employer side complicate enormously the problems of coordination on the labor side as well. Different
from Sweden, where large export firms such as ABB were among the most vocal proponents of radical decentralization, in Germany large firms are among the system’s most loyal defenders. This is true because in fact (and often in contrast to smaller firms) large companies have been rather successful in negotiating the flexibility they need within the traditional framework (Hassel and Rehder 2001, 4). The local deals on working-time reduction with flexibility mentioned above are just one example of this. As Anke Hassel and Britta Rehder (2001) note, the 1990s have seen a growing number of company-level pacts for employment and competitiveness (betriebliche Bündnisse zur Beschäftigungs und Wettbewerbsicherung) in which managers are able to secure cost-saving concessions on working time and pay flexibility in exchange for increased job security. A survey of the 120 biggest companies in Germany indicates that in the 1990s, 46% of these firms negotiated some kind of company-level pact along these lines, and a larger number have negotiated other kinds of arrangements (e.g., variable or performance-based pay) (Hassel and Rehder 2001). Such deals in some ways shore up the traditional system, providing as they do an outlet for demands for flexibility, therefore forestalling demands for more radical reform of the framework as a whole. But it is also clear that they intensify the problems that unions like the IG Metall face in forging solidarity among (and imposing uniform conditions for) workers across firms that are very differently positioned in the market.

Lack of unity and discord are therefore also prominent features of the IG Metall’s internal politics at present. There have long been thinly veiled disputes within the union between so called “traditionalist” and “reformist” perspectives, with the latter generally seeking to shore up social partnership through targeted concessions to accommodate employers’ demands for greater flexibility in bargaining arrangements. Such internal disputes explain the union’s hesitant and sometimes erratic strategic course in recent years. Overtures and signals by the IG Metall of a willingness to accept some trade-off between wage restraint and employment have often been followed by determined calls for an end to moderation (Ende der Bescheidenheit). Some union leaders have been willing to agree to more moderate collective bargaining outcomes (e.g., greater differentiation in industry-wide deals along dimensions such as working times). However, such concessions are becoming harder to sell internally. Indeed, every movement in that direction exposes advocates to challenge from internal opponents who push for a more aggressive stand by the union (on the split in the union, see, e.g., Süddeutsche Zeitung June 13, 2003).

Such conflicts were vividly on display during and after an ill-conceived strike in the eastern metalworking industry in 2003. The specific demand on the table was a reduction in weekly working times in the East, from 38 to 35 hours, to match levels in the West. The demand was widely criticized by economists and had also in fact been rejected by union leaders in a number of regions the previous autumn (Spiegel, June 2, 2003,
The head of the IG Metall, reformist Klaus Zwickel, had warned that a push for general working-time reduction in the East had no chance in the current economic and market environment (Spiegel, June 2, 2003, 83), but his vice president Jürgen Peters pushed forward and (narrowly) carried the day in the relevant decision-making bodies.

The strike failed, a first for the IG Metall since the 1950s. Early signs of trouble were reports of strike breakers and controversies about workers being brought in from the outside to man eastern strike posts. But the strike collapsed entirely in the face of opposition by powerful works councils in the West as soon as their own plants were drawn into the fray (Süddeutsche Zeitung, June 24, 2003, 20, June 25, 2003, 6). When parts shortages due to strikes in the East began to result in production stoppages elsewhere, many western works councilors and union officials complained that these indirect effects and the de facto expansion of the conflict was “never debated and never decided” (Süddeutsche Zeitung, June 21, 2003, 25). Internal conflict within the union, combined with growing unity and resolve among employers, forced union leaders to call off the strike, an unequivocal defeat for labor. The subsequent political fallout brought the union’s divisions and conflicts painfully into the public spotlight, as competing factions blamed each other for the loss of the strike. Elections to choose a new union leader for the retiring Zwickel were pushed forward to try to resolve the crisis, but so deep was the schism and so evenly divided between the two sides that the union decided to allow the leaders of both factions to (try to) govern together (Süddeutsche Zeitung, July 1, 2003; Spiegel June 2, 2003, 72–76; Tagesspiegel, July 2003, 17; Frankfurter Allgemeine Zeitung, July 24, 2003).

To summarize, in Germany, as in Sweden, elements of stability and change are inextricably linked. Contrary to accounts that mostly emphasize conflicts between labor and capital, some of the most destabilizing trends go back to an intensification of cooperation between the two within particular kinds of firms (especially large firms), which complicates rather than reinforces coordination at higher levels. Aversion to conflict at the national level on the part of core firms in the West, combined with closer cooperation at the plant level between large firms and works councils in the interests of protecting employment has stabilized German industrial relations in a formal sense (avoiding a big fight over the system as a whole) while subtly undermining the foundations on which it rests (as coverage shrinks). Disarray and lack of unity on the employer side, so prominently on display in the late 1990s, have lately been overshadowed by an even more dramatic collapse of unity on the union side. But the problem in both cases is in part structural and has its roots in contemporary market and political developments as these have played into preexisting cleavages between firms and workers who are differently situated in the market and differently constrained and enabled by the current collective bargaining framework.
Current instabilities, it must be emphasized, coexist alongside continued significant support among employers for maintaining the traditional system of coordinated industry-wide bargaining. Even in the midst of the 2003 conflict in the East, the head of Gesamtmetall, Martin Kannegiesser, worried about the IG Metall’s internal divisions, emphasizing that Germany needs unions capable of enforcing their policies (durchsetzungsfähige Gewerkschaften). In a context where, like in Sweden, unions still command considerable power to disrupt production, and where, more in fact than in Sweden, social partnership has traditionally been characterized by periodic displays of force and mobilizations, employers such as Kannegiesser explicitly defend the collective bargaining system for the “order” and “predictability” that it helps to impose on the labor market (e.g., Die Zeit June 26, 2003, 18). German employers do not want to abolish the traditional framework so much as render it more flexible, and indeed as we have seen, while they wait for reforms many firms are already helping themselves to existing possibilities to secure more flexibility—either formally and within the parameters the system already allows (company-level pacts in many large firms, mostly negotiated with union participation) or outside the framework, through informal contraventions of the terms of the contracts. However, as Hassel and Rehder (2001, 15–16) note, this trend has come bundled with an important reversal in the relationship between central agreements and plant bargaining. Whereas in the past plant-level bargaining implemented and often topped up industry agreements, the trend now is for collective bargains to implement and sanction practices that are in many cases already well advanced at the plant level.

The corrosive effects of these developments are clear, but it is important to underscore that they are as much a product of new forms of cooperation between labor and capital within the system as they are a consequence of employer attacks on that system. For this very reason, the problem is knottier and more difficult to solve than a straightforward neoliberal offensive thesis might have it. What we see here is that employer coordination in Germany has traditionally rested on a particular balance of power within key employer associations and between these and unions. That being the case, the continued viability of these institutions is not really a question of labor’s successful defense of the system (as many labor scholars argue), nor does it follow automatically from the efficiency effects of these institutions (as in the VOC perspective). Rather, continued stability relies on the reproduction (or perhaps renegotiation) of the political settlement on which these institutions rest. And against the sometimes optimistic leanings of much of the VOC literature, it seems there is no guarantee that German employers (or unions, for that matter) will succeed in reconsolidating their organizations on the basis of a new internal balance of power, despite the fact that their failure to do so might well be against their individual and collective interests.
Japan

Many aspects of traditional Japanese industrial relations practices are also under undeniable tension and strain. Leftists criticize these challenges as a total attack on labor and assume that the breakdown of the existing system is inevitable because unions are too weak to resist. Proponents of neoliberalism and deregulation, by contrast, have celebrated initial steps to change industrial relations practices as the opening move in a broad, efficiency-enhancing, reform movement, while lamenting the slow speed of change. As in the other cases considered in this article, we can observe contradictory views on the robustness and trajectory of Japanese management practices, and as in Germany, the outcome seems to be uncertain at present.

Through the postwar period, Japanese industrial relations were characterized by a form of coordination that is different from Germany and Sweden in many important respects. The system in the past has rested on two pillars—“lifetime” employment practices and the seniority wage system—that predominated in the large-firm sector. Both practices date back to compromises in the economic turmoil after World War II, when management confronted militant demands by unions for job security and tenure-based wages. Over time management came to appreciate the merits of “lifetime” employment as a means to secure workers’ loyalty to the company, and tenure-based wages also turned out to be economically rational so long as workers’ skills continued to be upgraded over the course of their career in the firm. Indeed by the 1980s, many economists were pointing out how successfully this system operated in motivating workers to invest in their skills (e.g., Koike 1991, 1997).

Because these two pillars of traditional Japanese management practices operate at the level of the firm, industrial relations might appear not to rest on the kind of coordination among employers emphasized in the VOC literature. However, seniority wages and long-term employment practices are sustainable only if employers (at least large employers) coordinate among themselves. The seniority wage system, for example, is only viable where employers refrain from outbidding each other for entry-level workers. All firms, in other words, have to agree to hire entry-level workers at relatively low wages and let their earnings rise over the course of their careers in the firm. This is linked to long-term employment as well, because it is ongoing skill acquisition that makes it sensible for a firm to maintain a “lifetime” commitment to workers—an alternative being to hire skills from the outside. In short, lifetime employment only works if workers start at low wages, and then gradually acquire skills that make them increasingly productive and valuable to the company. In that sense, both seniority wages and lifetime employment practices are founded on a degree of coordination, at least among core firms.

Whereas coordination in the German and Swedish systems takes place through highly formalized channels, in Japan it occurs somewhat less
formally in the context of the Shunto wage bargaining system. Within the Shunto framework, intensive discussion and informal bargaining start well before the formal negotiations. Usually the national and industry-level actors, such as Sohyo (General Council of Trade Unions) and Nikkeiren (Japan Federation of Employer Associations), discuss proposed wage increases for more than three months. This is a very political process, involving considerable tactical maneuvering, but it is also a process that allows the bargaining parties to share information. Since the 1960s, the metal industry had become the main pattern-setting industry. Bargainers in this export-oriented sector care about its competitiveness, and unions, organized in the IMF-JC (International Metal Workers’ Federation Japan Council), have traditionally demanded “economically rational” wage increases. The wage levels thus established then set the pace for other industries. Employers benefited from this Shunto coordination as a way to control competition (Sako and Sato 1997; Sato 2001, 255), allowing them as noted above to maintain the seniority wage system as well as the “lifetime” employment practices as effective incentive mechanisms for workers.

As in the other two country cases considered above, recent developments have introduced new strains into these traditional practices and institutions. The long economic downturn since the bursting of the bubble economy has robbed management of confidence in long-term employment, especially as business leaders and economists began to argue that the practice had to be abandoned to revitalize Japanese industry. When the financial-sector crisis deepened in 1998, more companies began discussing “restructuring,” by which they in fact meant layoffs. According to the survey of labor economy (Rodokeizai Doko Chosa), in the early 1990s, employment adjustments had mainly been accomplished by reducing overtime work and by reassigning jobs within the same firm or across firms in the same keiretsu group. By the late 1990s, the percentage of early retirements—the main mechanism in Japan for actually reducing the workforce—had increased (Ministry of Health, Labor, and Welfare, all years).

Recent years have also seen intensified questioning of the traditional wage system. Employer organizations such as Keidanren (Federation of Economic Organizations) and Nikkeiren have criticized seniority wages as rigid and debilitating for Japanese firms. Advocates of change usually cite three developments that make this wage system increasingly untenable (e.g., Miyamoto 1997). The first is that demographic change (an aging workforce) has increased the number of older workers, and with that, increased also the total wage costs that firms must bear. A second reason is the alleged change in the nature of the seniority wage system, which has come closer to an automatic wage raise for many workers despite different job capabilities among workers of the same age (i.e., a loosening of the link between wages and productivity-enhancing increases in skills). Third, in some industries, especially electrical equipment, new technology (the “IT revolution”) has changed the kinds of skills that firms
need, such that traditional on-the-job training over a worker’s career is less attractive than hiring engineers with the relevant skills from outside the company (Miyamoto 1997). For these reasons, many companies have moved to abolish the seniority wage system, often replacing this with performance-based wages. In some cases this translates into a straightforward job-based wage system, but another variation is management by objective (MBO), in which individual workers are assigned specific goals once a year and paid a wage based on the extent to which the assigned target is met.

However, as in Germany and Sweden, one finds in Japan evidence of continued employer support for both lifetime employment practices and substantial aspects of traditional wage systems. In 1995, Nikkeiren published a report, “A Japanese Management System in the New Era,” advocating that firms distinguish among three different types of workers: long-term employed workers with accumulated skills, workers with professional skills, and short-term/flexibly employed workers. While this report is often read as evidence that Nikkeiren abandoned its commitment to Japanese employment practices (the second two types of workers), it is also noteworthy that Nikkeiren sees the first type of worker still as the core of the labor force and essential to Japanese enterprises. In general, Nikkeiren has been very vocal in defending employment security. In 1999, Chairman Hiroshi Okuda, in a seminar for top managers, argued, “Even if there are redundant workers, it is management’s responsibility to seek new business opportunities to redeploy them. Employers without the entrepreneurship to find such business opportunities should retire.” The chairman of the board of Fujitsu concurred with Okuda in this seminar, citing his company’s successful efforts to retain (through retraining and redeployment) 500 workers made redundant in a recent restructuring (Nikkei August 6, 1999). One informed labor specialist who has been influential in making employment policy in the Ministry of Labor (now the Ministry of Health, Labor, and Welfare) recalled that this Nikkeiren seminar was a watershed in the discourse on labor mobility. According to this specialist, employers who had been thinking about radical reduction of employment became very hesitant after this speech.

In sum, Japanese employers are not sure to what extent long-term secure employment should be reformed or how to accomplish it. Here we can see the efficiency of the traditional management practice producing resiliency, as the VOC thesis predicts.

The same observation can be made for the reform of the wage system. It is true that more companies have actually implemented reforms of the wage system than of “lifetime” employment. However, they have embraced it much more gingerly than many popular accounts suggest, realizing how difficult it is to maintain high commitment and morale among workers with the new performance-based system. One company that pioneered such reform, Takeda Chemical (the largest pharmaceutical company in Japan), found it difficult to keep employees committed to the
company. Managers had expected that the new wage system would be very popular among workers, but when union surveys revealed only very ambiguous (and in fact declining) support for the reforms, the company began fine-tuning the system to shore up worker loyalty to the company (Yanagishita 2003). Fujitsu, another pioneer of wage reform in the 1990s, introduced a performance-based annual salary system for managers in 1993, and then expanded it to all employees, abolishing the seniority element in the wage portfolio. However, company management subsequently realized that workers became too concerned with short-term goals, to the detriment of the company’s ability to develop competitive products. Thus, in 1999, Fujitsu decided to incorporate the company’s performance as a whole as well as the individual worker’s performance, into the salary calculation (Nikkei February 5, 2000). In these processes of experimentation, Fujitsu management came to the conclusion that it is important to evaluate workers’ potential ability and “work process” independently of “outcome” (Asahi March 19, 2001; Joe 2004; see also Takewaki and Suyama 2002, 77–79).

The major problem with which managers have been grappling is how to make individualistic wages compatible with the group-oriented work organization characteristic of Japanese firms. Many companies are eager to preserve essential features of traditional practices even as they fine-tune their reformed wage systems in order to maintain their institutional competitiveness (Takahashi 2004). Nippon Steel Corporation decided to introduce a new performance-based wage system for its Electronics and Information Division. However, managers worried that a fully individualized wage system would create “winner take all” situations that would weaken work organization, and decided instead to take the performance of the division as a team into account in wage calculations. Similar adjustments are often made in other companies that are trying to reform the seniority wage system (Nikkei February 5, 2000). Some companies (e.g., Seiko) realize that in order to develop workers’ skill, a simple “outcome”-based evaluation would not work effectively (Nikkei Sangyo November 27, 2000). It is also telling that while Toyota is willing to reform its wage system toward greater performance orientation, it continues to emphasize job capability and group performance in wage determination.

Moreover, like a significant number of other companies, Toyota seems convinced that secure employment should be the basis of its competitiveness.36 When Moody’s Investors Service downgraded Toyota’s long-term debt from Aaa to Aa1 (claiming that its commitment to “lifetime” employment would hamper its competitiveness), Toyota management counter-argued that such an employment practice should be a source of strength (Nikkei Sangyo, October 1, 1998).37 Nissan is another instructive case. It was taken over by the French automaker Renault in 1998 due to its financial difficulties and went through a very tough restructuring with massive dismissals (in the form of voluntary retirements). However, after achieving a V-curve recovery, President Carlos Ghosn maintained a
bottom-up decision-making style, which is regarded as very Japanese (Ghosn 2001), and made it clear that the company’s main strength should reside in worker commitment to the firm. In wage bargaining for 2001, and in the context of concerns about revitalizing work organization, Nissan unilaterally declared that it would pay the full amount of bonuses demanded by the union. Even the information technology company Fujitsu, which was the vanguard of wage-system reform in the 1990s, is willing to maintain secure employment as a basis of its competitiveness.

However, not all companies can accomplish this same balance—incorporating elements of traditional employment practices while fine-tuning their reformed wage systems. An emerging important new divide among core firms in the Japanese economy is between stronger firms (such as Toyota) which have been careful to preserve some of the essential strengths of the traditional system by intensifying their relationship with core workers (even as they may adopt more flexible wage systems), and weaker firms which have moved away from traditional practices (including laying off workers) in a straightforward effort to reduce labor costs. For example, Mazda abandoned seniority-based wages in favor of a more performance-based system in part because the company could no longer afford Toyota-style wage and employment practices (Sako 2001).^38^ In cases like Mazda, radical reform of the wage system often wound up demoralizing workers, and did not improve company competitiveness (Yanagishita 2003).^39^

This emerging divide now seems to be jeopardizing employer coordination in Japan. In the 1990s, as stronger and more profitable companies began introducing performance-based wage systems that also took company performance into account, wage increases across firms within the same industry became more diversified. This trend was strengthened by the fact that individual companies were more willing to compensate workers with bonuses rather than salary increases, in order to maintain flexibility in managing total labor costs.^40^ Here it becomes clear that the increasing adoption of performance-based wage systems has made it very difficult to maintain the traditional Shunto system. As practiced in the past, Shunto coordination required leading firms to act as pattern setters both within their own industry and also with an eye to other industries for which their settlement would provide the benchmark. Performance-based wages interfere with this because it is more difficult to coordinate wage increases once company profits begin to play a prominent role in wage determination (not to mention individual performance targets). This had become a problem already in the 1990s when Takeda Chemical Industry and Mitsui Mining and Smelting adopted performance-based wages and simply left the Shunto framework altogether.

In this context, Toyota’s behavior in the 1997 Shunto wage round is very revealing. Early on in the negotiations, Toyota management argued that wage increases should be moderated in order to change the “high-cost economy.” At the time, many employers had been arguing that inter-
nationally high labor costs had made it unattractive for them to do business in Japan, and were especially critical of the high wages in protected sectors such as services and energy. Toyota management worried that if Toyota, which was actually booming thanks to the weak yen, raised the regular wage, this result would spill over into other industries and exacerbate the high cost problem. As an alternative, managers proposed that the increased company profit be distributed in the form of bonus payments, which are less linked to the Shunto (Nikkei March 20, 1997).

In the end, however, Toyota decided to increase its regular wage by a larger margin than other companies in the metal sector did, in effect abdicating its role as benchmark and pattern setter. This was a surprise attack on many companies. The president of Nissho (Japan Chamber of Commerce and Industry) criticized Toyota for its unilateral decision. Other auto companies had to catch up with Toyota by adding extra raises (Nikkei Sangyo March 24, 1997). Faced with criticism, Toyota’s president, Hiroshi Okuda, bluntly said that Toyota should not care about other companies or industries and should choose the best course for itself. He believed that in the days of globalized competition, survival of the fittest was the rule, and argued that for Toyota it was very important to motivate workers in order to make its work organization more competitive (Nikkei March 20, 1997).

While other strong firms have attempted to match Toyota wages, the more interesting impact is on weaker firms. In the traditional Shunto negotiations, more profitable companies specifically took the situation of weaker firms into account in setting wage levels, which allowed the latter to keep pace. But in uncoordinated competition, this becomes very difficult. As suggested above, uncoordinated competition in fact often drives weaker companies to introduce more individualistic performance wages in a straightforward attempt to reduce labor costs—and therefore not necessarily combined with measures to preserve traditional strengths of traditional management practices such as a continued commitment to secure, long-term employment. These trends increase the divide between stronger and weaker firms, but they also may feed back in ways that over time create new problems for the stronger firms. Recently, fewer and fewer young Japanese workers take seriously the promise and prospect of secure long-term employment. This trend has been exacerbated by the introduction of individualized performance-based wage systems and the loosening of a commitment by employers to long-term employment. To the extent that the expectations and therefore strategies of workers shift, Toyota and other stronger companies may not be able to motivate workers with the promise of secure employment in the future.

The effects of these trends on union coordination are also important in Japan. As discussed above, wage coordination through Shunto has been very useful for employers. But it should be remembered that Shunto was invented as a union tactic, and as in the other cases, new strains on the
union side are also contributing to the destabilization of Shunto coordination. For example, the Steel Workers Federation adopted an alternate-year wage negotiation in 1997, which in effect delinks wage bargaining in this sector from other industries. In addition, the Electrical, Electric, and Information Union (JEIU) endorsed performance-based wages in 1997, weakening the coordinating function of Shunto in a different way (Weathers 2003). One official of the JEIU in the 1996 Shunto commented, “We couldn’t stand our wage raises being used by unions in other industries as springboards to get raises higher than ours” (cited in Weathers 1999, originally Asahi March 9, 1996). It seems that unions in export-oriented sectors, which used to be central players in Shunto, are now playing a role in its dissolution. Moreover, and as emphasized above, in strong companies such as Toyota, workers enjoy better benefits, including higher raises, than in other companies and industries. Therefore, as in the other cases considered in this article, we can find a kind of labor-management cooperation in the core sector behind changing Japanese management practices.

To summarize, we may be able to say that, like in Germany and Sweden, instabilities in the traditional system are not produced by a neoliberal offensive against labor. Rather, they are generated by the policies of large, successful firms to pay workers well and to guarantee their employment. In the Japanese case these efforts have created pressures that weaker firms can often only address by retreating from traditional practices.

**Conclusion**

In the cases of Sweden, Germany, and Japan, market dynamics since the 1980s and especially the 1990s have introduced new strains into previously stable institutions of employer coordination. The new tensions are both more interesting and more intractable for defenders of the systems to address than a straightforward neoliberal offensive in which we would be seeing employers pressing for decentralization and deregulation and unions seeking to defend the system. Instead, in all three cases, we find that recent market developments have brought an intensification of cooperation between labor and management in some companies and industries that has complicated traditional forms of coordination (at higher levels) among employers and solidarity among workers on which these systems previously rested.

In the case of Sweden, the crucial break with peak-level bargaining reflected an intensification of cooperation between labor and capital in the metalworking industry in the face of shared market pressures. It was followed by a reconfiguration of bargaining that suited the needs of the resulting new power constellation—based on greater coordination across the industrial sector (and within industries between blue- and white-collar unions)—but at the direct expense of traditional forms of coordina-
tion premised on solidarities between public and private sector and low- and high-skilled workers. In Germany, intensified cooperation between labor and capital in large firms—mostly revolving around efforts to stabilize employment—has had deeply destabilizing collateral effects and operated in ways that complicate rather than consolidate continued coordination across different kinds of firms at the industry level. The Japanese case, finally, is also one in which current strains run through industries and across companies—as stronger firms combine traditional practices with new worker-incentive schemes in ways that make it difficult for weaker firms to sustain even those aspects of the traditional system they would prefer not to abandon.

The point of this article has been to explore the effects of recent developments on employer coordination in Sweden, Germany, and Japan. In each case we find that the varieties of capitalism literature are quite right to point out that contemporary market developments have in some ways intensified the interests of employers in particular kinds of (traditional) industrial relations institutions. Where this literature often falls short, however, is in viewing employers within a given national context as essentially homogenous in their interests and, as a consequence, in seeing all signs of intensified commitment to traditional institutions by firms as operating to stabilize these institutions. What we have shown, by contrast, is that the intensification of cooperation within traditional institutions in some industries and companies has in fact made it difficult for others to keep pace, and so we see a destabilization of the system that is brought about by precisely those forces that the VOC literature sees as sustaining the system.

While Sweden may have found a new equilibrium or at least a stable resting point for coordination for the time being (which is still very different from that in the liberal market economies), Germany and Japan appear to be still in a rather fluid state of renegotiation and flux. One reason for the divergence on this score may well be the role that the Swedish state played in stimulating and facilitating employer (re-)coordination. While Swedish industrial relations are governed by the principle of collective-bargaining autonomy and low state intervention (as they are de jure in Germany and de facto in Japan), the threat of a new and potentially quite powerful state mediation authority galvanized support for voluntary arrangements designed to facilitate the revival of employer coordination on new terms. In Germany and Japan, the state has so far been unwilling and/or unable to help unions and employers find a way out of the current, severe, collective action problems they confront. Despite such differences, however, a common trend across all three cases is toward new or more virulent forms of dualism—featuring firms or sectors characterized by intensified cooperation between management and labor, but facilitated and perhaps even underwritten by a growing gap between practices and outcomes within the new core and those outside it.
Notes

1. For helpful comments on earlier versions of this article, we thank Peter Hall, Charlie Jeffery, Bo Rothstein, Christa van Wijnbergen, and Nicholos Ziegler.
2. For a more elaborated version of these arguments see Thelen (2000, 2001).
3. In Hall and Soskice’s (2001) treatment, coordinated market economies include Norway, Sweden, Japan, Germany, Switzerland, and Austria, while liberal market economies comprise the Anglo-Saxon countries—Britain, United States, Ireland, Canada, and Australia.
4. These arguments are laid out in detail in Thelen (2000, 2001).
5. In three negotiating rounds subsequent to this, peak negotiations did take place. However, in each case these came about as a result of either direct government intervention or special circumstances (as in 1986, in the aftermath of Olof Palme’s assassination). Since 1993, there has never been peak bargaining along the old lines.
6. Increasing central bank autonomy also played a role in motivating employers to coordinate bargaining across the exposed sector. The Swedish Central Bank had been gaining independence since the 1980s, a trend that was subsequently (1998) written into the constitution. We thank Bo Rothstein for emphasizing this to us.
7. Indeed, *Verstadsindustrier* (VI) was the last to sign on to the deal in 1997, and some prominent firms in the association only reluctantly abandoned their demands for a more radical solution.
8. Neither the *Landsorganisationen* (LO) nor the peak-level white-collar bargaining cartel that once negotiated for white-collar workers has any role at all in wage bargaining any more (Kjellberg 2000, 555–556).
9. The commission was headed by Svante Öberg, former head of the Central Bureau of Statistics. Öberg clearly saw the 1997 industry agreement as a step in the right direction, but his proposals (not all of them adopted in the end) went further in stressing the link between wage formation and overall macroeconomic conditions and in imposing even stronger restrictions on industrial conflict (interview with Öberg in Stockholm, 1999).
12. In Denmark, the tradition of stronger mediation and a stronger role for the state more generally goes back to the 1930s. While Denmark, like other countries, has seen a decentralization of bargaining over the last decades, in that country continued high coordination across industries has been accomplished through a more powerful state mediation authority, but with strong supporting roles played by the peak trade union and employer confederations (see, e.g., Jorgensen 2004).
14. Unionization rates in Germany are also declining, not only in metalworking but across the board (Behrens 2003).
15. For a full analysis of current strains in Germany, see Thelen and Kume (1999) and Thelen and van Wijnbergen (2003) on which we draw here.
16. The shorthand distinction between small and large firms employed here is a simplification of a more complex set of divisions whose roots go back more to production strategies that are often related to, but not really reducible to, size differences (Thelen and van Wijnbergen 2003).
17. Works councils in Germany are formally independent from unions, and by law they cannot interfere with union wage setting. Thus the additional
benefits achieved were not “secured” through the central contract (nor could they be defended with a strike).

18. Research by Hermann et al. (cited in Hassel and Rehder 2001) notes that a majority of small firms stuck with a standard work week while over 80% of large companies abandoned this in favor of more flexible working times.

19. This was typical for the pattern-setting metalworking industry, but not true for other industries such as chemicals where social partnership since the 1970s has not relied on these periodic shows of force.

20. A change emphasized to me, especially by Dieter Kirchner, former head of the Metal Employers Association, Gesamtmetall (interview, 1999).

21. These OT-Verbände are founded by the employers associations themselves, and they are often housed in the same building and staffed with the same personnel. Partly this has been a rearguard action on the part of employer associations who otherwise would have lost all contact with these firms (interview with representative of metalworking employers for Berlin-Brandenburg). Partly it has evolved into an offensive strategy—a tool for putting pressure on the union to make-flexible contracts against the alternative of having to fight for separate contracts in each of the breakaway firms. Either way, the incentives are somewhat perverse because the creation of organizations with most of the benefits of traditional membership and minus the rigidities of the industry contract arguably hastens the exodus out of the employer associations that the OT-Verbände were in part meant to shore up.

22. This is not to mention the 22% of German establishments that make use of so-called opening clauses in centrally negotiated contracts that specifically allow deviation from industry norms, nor the reported 15% of companies that simply contravene contracts informally in one way or another (figures from 1999/2000) (Schulten 2001). The number of company-level agreements has also grown steadily, from 2,550 in 1990 to 6,415 in December of 2000 (Behrens 2002a).

23. See, for example, Frankfurter Allgemeine Zeitung (April 6, 1995); also Handelsblatt (March 24, 1999); and Offenbach Post (December 10, 1996), which quotes a representative of the union as saying, “Chaos reigns at Gesamtmetall; it is a catastrophe.”

24. One union functionary criticized the strike as “the biggest auto-goal the union has ever shot” (Süddeutsche Zeitung June 24, 2003, 1). Even in the midst of the conflict, the BMW works council was already thinking about ways to use flexible work times to make up for time and production lost during the conflict (Süddeutsche Zeitung June 25, 2003, 6).

25. Asked after the union’s defeat whether he was happy to have “broken the back of the union,” Kannegiesser replied that he considered “such statements nonsense. It is not our goal to break the union, but rather to achieve reasonable results. Unfortunately this was not possible in this case” (Süddeutsche Zeitung June 30, 2003, 2).

26. A survey from 2003–2004 of 500 managing directors in the metalworking industry shows that a majority “do not want to abolish industry-wide collective agreements, but they do want to create a great deal more flexibility within these agreements.” Employers complain about the German system, but as the managing director of Gesamtmetall, Werner Busch, put it, “According to our members, the collective agreement is considerably better than its reputation” (Funk 2004).

27. The 2004 agreement in metalworking is a case in point. This contract contains a clause allowing for plant bargaining to increase working-time flexibility by allowing for an extension of individual weekly working hours to 40 without overtime pay. Because workers in many companies routinely
worked more than the standard 35 hours anyway, the main effect is to reduce labor costs by eliminating the overtime bonus for these extra hours (Dribbusch 2004). Companies like Siemens and Daimler Chrysler seized the new opportunity to conclude plant-level deals to that effect (Die Zeit July 1, 2004, 19; Spiegel July 19, 2004), and many more such agreements are in the works.

28. For a full analysis, see Kume (1998).
29. Some scholars emphasize that a shared belief in lifetime employment plays a very important role in sustaining this system. See Chuma (1994); Milgrom and Roberts (1992); Sai (2002).
30. It must not be forgotten that although the Shunto framework is functional in many respects for employers, it actually began as a union tactic to raise wages.
31. These two employer associations merged into one big employer organization, Nippon Keidanren (Japan Business Federation) in May 2002.
32. The seniority wage system was originally a compromise between management, who wanted to make it more merit based, and unions, which wanted to keep it need based. Many companies have their own pay tables, consisting of detailed job capability classifications and ranks within each classification. The basic idea is that if a worker acquires skill, he or she can climb up the ladder and receive pay raises. Unions expected that most workers would climb this ladder according to seniority, while management hoped it could be selective in classifying individual workers and thus could motivate them effectively. In the 1980s, management tended to be less selective but gave automatic raises.
33. Nikkeiren chairman Hiroshi Okuda advocates “capitalism with a human face.” Although he is known as a committed reformer as a chairman of the board of Toyota Motors, he does not believe in liberal, Anglo-Saxon-type capitalism. This Nikkeiren stance is sometimes contrasted with Keidanren, which is believed to be one of the main forces pushing the Japanese economy in a liberal direction. After their 2002 merger, some worried that Keidanren's preference would prevail over Nikkeiren's, but it was decided that Chairman Okuda would be the first president. This means Nikkeiren preferences may prevail in the new organization, Nippon Keidanren.
34. This comment was made in a workshop on Legal Regulation of Employment sponsored by the Ministry of International Trade and Industry, June 6, 2001, Tokyo.
35. The preferences and behavior of young workers also plays a role. For instance, Matsushita Electric Industry Company introduced a new pay schedule not premised on long-term employment and was shocked when many young workers opted against it. Furthermore, many employers worry that better workers who can find better jobs outside tend to leave their companies, damaging the companies’ competitiveness through weakened worker commitment to the company, reduced cooperation within the work organization, and less investment in skill formation.
36. Labor economists found that companies that invest in research and development tend to employ more regular full-time workers with secure employment (Higuchi 2001, 341). Without secure employment, workers would not acquire the necessary skills for a given company, which would reduce the company’s technological advantage (Chuma 1994, 1998).
37. Moody’s upgraded Toyota’s long-term debt to Aaa in August 2003 (Nikkei August 1, 2003).
38. Ford Motor’s takeover of Mazda clearly also played a role, but Toyota's sales per employee were twice as large as that of Mazda (Nikkei Sangyo March 24, 1997).
39. The radical reform improved Mazda’s financial situation in the short run, but fell short of revitalizing the company.

40. It is easier to reduce bonuses than salaries. Furthermore, because the size of the bonuses became a topic of the Shunto wage negotiation in the 1990s, it has become more difficult to find a standardized wage level.

41. Toyota was believed to play the role of pattern setter, taking the national economy into account because its former president was then president of Keidanren, the most prestigious national employer association.

42. Honda, for example, which had increased its market share dramatically, tried to pay wages closer to those paid by Toyota, although its labor costs are much higher than Toyota’s. Nissan tried to pay large bonuses to motivate its workers against Toyota in 2001. This competition may create some problems in controlling labor costs even for Toyota in the future.

43. Even in very “Japanese” companies such as Matsushita Electric Industrial Company, the majority of newly recruited fresh graduates are not sure they will continue to work until retirement age. The more companies abandon an employment commitment, the more young workers, who are expected to be the core workforce, will lose confidence in the Japanese employment system. This concern seems to be why Hiroshi Okuda, former president of Toyota and now president of Nikkeiren, declared that companies are responsible for secure employment.

44. Much as the original Saltsjöbaden Agreement between Swedish unions and employers (in 1938) had occurred against the threat of legislation.

References


Managing the Bank-System Crisis in Coordinated Market Economies: Institutions and Blame Avoidance Strategies in Sweden and Japan

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Sweden and Japan represent two different positions regarding policymaking when faced with similar crises of the bank systems. Different institutional settings led the main actors to different paths of reactions in order to avoid blame. In the Japanese case, the very close relationship between private banks and the Ministry of Finance, in combination with the lesser degree of widespread perceptions of a system crisis, made it more urgent as well as possible to conceal the actual state of affairs for the politicians. Confronted with the threat of losing power over the financial administration to a new agency, the ministry postponed the reforms in order to conceal the deep financial problems. The institutional setting was different in Sweden. Deregulation had separated the government from the administration of banks. Among the public deteriorating economic conditions were easily connected to the banks. This brought about political unity. It was possible to put the blame on the banks and take the credit for the efforts to tidy up the mess without losing credibility.

Introduction

In the early 1990s, many developed economies were hit by a severe financial crisis. The boom in the world economy in the late 1980s, partly an effect of liberalized financial markets, gave rise to overvalued economies where expectations for growth rose constantly, boosting asset prices and bringing rapid credit expansion. However, the economic bubble burst in 1989 and the world economy was in recession by 1990. Facing a contraction in the economy, crashing real estate values, and share markets within a liberalized financial system, where strong international market actors played a newly important role, the financial systems of a number of countries in Europe and Asia threatened to collapse. Economic development in Sweden and Japan, both of which belong to a group of coor-
ordinated market economies (Hall and Soskice 2001, 18ff), fit this pattern. The crisis was substantial, and the financial systems in these countries were threatened when banks suffered huge credit losses.

Exceptional rates of credit growth and a prolonged economic boom followed Swedish credit market deregulation in the mid-1980s. The first sign of the crisis in the Swedish economy was the sudden drop in real estate prices in 1989. Prices fell 75% over the following five years, and three-quarters of about 40 real estate companies quoted on the Stockholm stock exchange went bankrupt. The value of the stock exchange was halved within three years. The first financial market actors affected by the falling values of assets and real estate were financial corporations. In September 1990 one of these, Nyckeln, experienced a type of bank run and declared that it faced a credit loss of about 250 million Swedish krona (SkR). Acute liquidity problems developed for several finance companies. Many went bankrupt: 200 out of 300 disappeared from the market. Financial companies competed with banks in the real estate market but were also bank customers. Thus, the crisis for financial corporations and real estate managers hit the banks as well. At first, “good money was thrown after bad” by banks in order to try to recoup their own investments and to support their customers. But the prices fell too far and for too long. Three big banks went into bankruptcy and all experienced severe credit losses. Acute problems for individual financial actors had developed into a crisis for the whole sector.

As in the Swedish case, the story of the bank crisis in Japan starts with a bubble economy in the late 1980s. And in a similar way, deregulation of the credit market played an important role. Removal of rent controls, increased access to formerly restricted markets as well as the creation of new markets, and relaxed rules for banks started a price war that led banks to “expand the riskier segments of their loan portfolios” (Kanaya and Woo 2000, 6; cf. Hanazaki and Horiuchi 2000; Kume 1999). This implied a focus on consumer lending and investment in real estate and small industry. Expectations for growth rose constantly, boosting asset prices and bringing rapid credit expansion. Loans were based on collateral and not primarily on projections of future profits. Credit standards were loosened concurrently with rising real estate prices. The highly overvalued market collapsed in 1990, and decreasing growth and falling real estate prices weakened the balance sheets of banks and other financial actors dramatically, even though Japan has not (yet) experienced a bank run comparable to what happened in Sweden (Krugman 1998).

Consequently, the stories of the bank crises in Sweden and Japan seem to share some important characteristics. A tradition of a politically regulated economy was not only followed by a phase of deregulation, but also by financial crisis and a crisis of the banking system. When the economic bubble burst, both countries saw massive credit losses.

Nevertheless, the executive governments of the two nations reacted differently to the same type of exogenous shock: an economic contraction
and subsequent crisis in the banking system. Swedish public policy was far reaching and quick. The government intervened in order to guarantee the survival of the banking system. In contrast, the Japanese government hesitated for many years to take over bad loans before finally implementing more limited policies. Where Swedish policymaking can be described as successful and was followed by fast economic recovery, the Japanese (and Asian) experience was much more painful (Kokko 1999, 81, 85; Rosenbluth and Schaap 2001; Schwerin and Vassiliouk 2001; Vogel 2001). In evaluations of the different policies, the Swedish path has been seen as “best practice” whereas Japanese management of the crisis has been looked upon as unsuccessful. In light of the growing literature on varieties of capitalism one could expect that these two coordinated market economies would have behaved in the same manner, exposed to the same events in the world economy. However, they did not.

Thus, Sweden and Japan represent two different approaches to policy-making for resolving the crisis of the banking system. In this article these differences are interpreted as different blame avoidance strategies. One strategy is to put the blame on someone else (shift or delegate blame) and try to take credit for dealing with the problem. Another way to escape the backlash from a crisis is to reduce the visibility of one’s own role in the event or to conceal the event, and simply postpone the (necessary) action (Hood 2002, 27; Pierson 1994, 21; cf. Weaver 1986, 385).

This article argues that these different reactions, the choice of two different strategies, to the bank crisis—and ultimately, the causes for successful versus unsuccessful crisis management—can be explained by differences in the institutional settings of the two countries. Although Sweden and Japan were long characterized by the state-led mode of capital financing, as is typical of coordinated market economies, by the beginning of the 1990s practice in the two countries had diverged. In Sweden, previous political decisions had resulted in a switch from a state-led to a capital-market-based banking system. This system of arms-length relations between government and industry gave both politicians and administrators within the executive extensive opportunities for “blame avoidance,” and thus incentives for “credit claiming” by responding to the banking crisis aggressively, even if this would require large sums of government money. In Japan, by contrast, and in spite of some deregulation, the executive bureaucracy was still highly intertwined with private banks and financial institutions. Consequently, employees of the Ministry of Finance had little incentive to point out their past mistakes to political leaders, and politicians would have been hard put to convince the public that banks and not government officials were to be held responsible for the banking crisis. Together, these disincentives led to hesitation and inaction, which prolonged the banking crisis and made Japan’s economic crisis ultimately more difficult to address. Whereas the blame avoidance literature has focused on politicians and voters, the case of the banking crisis makes it clear that executive bureaucracies face problems and incen-
tives related to blame avoidance as well. The degree to which a bank bailout is seen as reform rather than corruption is conditioned by public perceptions of the crisis, and of the links between politicians, bureaucrats, and banks. However, bureaucrats do not want to be held accountable by politicians either, as blame can implicate loss of power or reduced personal gains.

To be sure, although the magnitude of the banking crisis was considerable in both countries, the timing and development of the crises did differ. In Sweden, the economic impact was exacerbated by a run on the currency, making the crisis deep and sudden and leading to immediate effects on unemployment. This raised the prominence of the issue. The crisis in Japan was more gradual and extended and the effects on the public were not immediately as visible as in Sweden. The deep and open crisis came much later than in Sweden. This could possibly be connected to the size of the two political economies, which is very different.

As the following sections of this article will show, however, neither the timing of the crisis alone nor the size of the domestic economies can explain the reactions of the executive governments to the banking crises in Sweden and Japan. Instead, public perceptions, shaped by the relationship between politics and the administration in general, and by the institutions of the financial system in particular, set limits to the politics of blame avoidance in the two countries, and hence to the policy measures that could be employed to end the banking crisis. Although Weaver and Pierson are correct in their assumption that politicians try to avoid blame for economic problems and unpopular policies, we show here that the politics of blame avoidance—and the specific strategy of blame avoidance that was chosen—are shaped by institutional and perceptual constraints. Public anger is neither an insurmountable block to policy change, as implied by some versions of the blame avoidance thesis, nor infinitely malleable through elite persuasion, as seems to be implied by the newer emphasis on public discourse (Schmidt 2002, 169, 190). Instead, citizens form their opinions based on plausible interpretations of how the world works, and these plausible beliefs, or causal beliefs as Goldstein and Keohane (1993) call them, are shaped by the institutional settings in which citizens experience the world, both at the macro level, as in the case of banking institutions, and also at the micro level, as Rothstein (1998) has shown for the case of social welfare institutions. Public perceptions are indeed critical for policymaking, but they are formed within institutional settings.

The Swedish Case: Deep Crisis and Rapid Response

The Swedish crisis can be broken down into four stages: first the collapse of the asset and real estate markets, second the deep crisis in the financial
market (the bank crisis), third the currency crisis, and finally a deep crisis in the whole economy. The deregulation of the credit market caused exceptional credit growth and spurred a prolonged boom. At the same time, economic policy was expansionary. The Riksbank (the central bank) tried to cool the market, but its only weapon was persuasion. Reregulation was not seen as a real threat. Raising interest rates was not an option given that the Swedish kronor was part of a fixed exchange rate system. During this period, the finance minister was unable to slow the overheated economy. He was politically obliged to fulfill new demands and was unable to cut public spending. One distinctive feature of this heated economy was increasing, and speculative, investment in real estate. Financial corporations as well as banks began to invest in assets and especially in real estate (but also in shares) and used these as collateral for bank loans, while at the same time price inflation was rapidly pushing up real estate. A spiral ensued: rising prices created optimism and expectations of even higher prices which in turn spurred higher prices, and so on. A speculative bubble followed the economic boom.

The international business cycle peaked in 1989 and entered a recession in 1990. Several indicators show the magnitude of the crisis in Sweden. Total credit loss from 1990 through 1993 has been estimated at about SKr 200 billion (Englund 1999, 90; Kokko 1999, 82). All types of banks were affected: business banks, savings banks, as well as cooperative banks. Taken together, the losses (in terms of the value of lending) year by year were 1.1% in 1990, 3.6% in 1991, 7.6% in 1992, and 6.5% in 1993 (Larsson and Sjögren 1996, 150). Estimated credit losses for individual banks for this period show substantial variation—from 9.5% to 37%—demonstrating serious harm to the balance sheet. Three of the big banks—Nordbanken, Första Sparbanken, and Gota Bank—went into bankruptcy. Stock prices for the two biggest banks—SE-banken and Handelsbanken—fell 80%, and in the sector as a whole the value of bad loans far exceeded total capital (Kokko 1999, 82; cf. Bergström, Englund, and Thorell 2002; Englund 1999, 91).

Two policies combined impact of two policy changes in the 1980s exacerbated the financial crisis. First, abolition of capital controls (the last step in the deregulation of the financial system) had made it possible to speculate in the Swedish currency. Second, tax reform reduced marginal rates to 30%, but also made it harder for households to deduct mortgage payments from taxable income. (The earlier system was very generous and in combination with high inflation made it cheap to borrow money.) Combined with falling inflation levels and a desperate interest rate policy, these policies caused the real posttax interest rate to rise steeply. With support from the government, the Swedish central bank decided to defend the currency at nearly any cost and drove short-term rates to 40% or more. Rates peaked in September 1992 with overnight rates at 500%! From this extreme, the fixed currency was abandoned and the central bank let the krona float, bringing a huge depreciation in the exchange rate.
When tendencies for decreasing prices coincided with recession, credit losses accelerated. The determination to defend the fixed currency rate pushed the recession into a deep depression, raised unemployment to levels never experienced before, and forced many small companies with loans in the banking system into bankruptcy (which in turn made the credit losses even worse). The result was a deep, all-embracing economic crisis: parallel to the financial crisis, gross domestic product (GDP) fell 6% from 1991 to 1993, and manufacturing output declined dramatically, which in many instances resulted in plant closures. Unemployment rose to 12% and the public deficit to 12% of GDP (Bäckström 1998, 11; Kokko 1999, 83; Tranøy 1999, 13).

The main argument for implementing a rescue operation seemed to be to limit closures and bankruptcies, not to rescue individual banks. The central bank faced a system-wide crisis. Six out of seven big banks needed new and fresh capital at the same time that foreign lenders had lost confidence in Swedish banks and the Swedish currency was dramatically weakened. The total credit losses went far beyond what the central bank could manage as a “lender of last resort.” Problems for individual companies and banks had developed into a real threat to the whole financial system. According to the director of the central bank, the issue of state intervention had been discussed within the authority and with the government, as well as with the Social Democratic opposition, ever since one big savings bank ran into an acute liquidity crisis in late 1991. In September 1992, when one of the main commercial banks (Gotabanken) was threatened, the situation was explicitly and jointly perceived as a system crisis in the minds of the central bank, the Ministry of Finance, and the Bank Inspection Board (Bäckström 1998, 11; Dennis 1998, 75; Ingves and Lind 1998, 44; Söderström 1998, 647).

The policy measures adopted were threefold. First, when the government recognized the crisis, it also declared a general state guarantee that included all liabilities of all banks and some credit institutions (except for shareholders). This paved the way for fresh private capital in some cases as well as interest-free loans from the government. Second, a governmental board, Bankstödsnämnden (the Bank Support Authority), was established in 1993. This special government body, placed outside the Ministry of Finance as well as the central bank or the Financial Supervisory Authority, had the task of administering the state guarantee to the banks that applied for and needed help. At the same time, as it showed the true market values of the bad loans, it was a way to increase transparency. Third, the government bought out private owners in those banks that could not ensure a sufficient amount of private capital. This implied the use of a “bad bank” model. This meant that for Nordbanken and Gotabanken, the state set up special companies, Securum and Retriva, to process the bad loans, which enabled ordinary banks to fulfill their daily opera-
The state guarantee comprised over SKr 84 billion of credit, but the recovery was surprisingly fast and there was no need to use the entire fund. The banking sector became profitable as early as 1994. By 1996 the state guarantee as well as the “bad banks” was ended and by 1997 it was possible to end the activity of the Bank Support Authority. The total cost was SKr 35 billion (most of which was nonpayment of interest), that is, a far lower cost than what had been paid in the rescue operations (the costs for the actual operations altogether were estimated at SKr 65 billion) (Jennergren and Näslund 1998, 69; Söderström 1998, 647; cf. Bergström, Englund, and Thorell 2002; Caprio and Klingebiel 1996).

It is important to stress the significance of the way the crisis was politically handled and how the Bank Support Authority was created. When the aforementioned parties in the process—the central bank, the Ministry of Finance, and the Bank Inspection Board—agreed upon the “system-crisis interpretation,” the banking crisis became a matter for the Ministry of Finance. In its view, it was very important to counteract every possibility that the crisis could be used as a political weapon in the hands of the opposition. The recurrent question within the ministry was “What will happen in the event of a change of government?” (Ingves and Lind 1998, 46 [our translation]). The response was to incorporate the political leadership as well as the opposition as much as possible in the process of handling the crisis. The ministry also succeeded in its efforts to make room for two delegates from the opposition within the governmental board, for the same reason. The explicit argument for the arrangement of a specific board outside the ministry was the need for specific competence as well as time and resources not available at the ministry. However, another important reason was to protect the board from political forces within the ministry. The alternative, to locate the agency at the central bank or the Financial Supervisory Authority, was not viable because of the risk of conflict of interest (Ingves and Lind 1998, 46).

Economists looking back on the management of this crisis evaluate the actions taken as quite successful. Compared to other countries (United States, Japan, and most Asian countries), Sweden’s crisis management was unusual for its early crisis recognition and severe response. One scholar observed: “The error bias in most countries has been in the direction of ignoring the severity of the bank crisis with which they have been faced. In Sweden, by contrast, the error bias has been in the direction of overreaction” (Macey 1999, 46). Obviously, the quick and fundamental recovery cannot be explained solely by the political actions that were taken. Lower interest rates and the depreciation of the Swedish currency combined nicely with the boom in the information technology sector in the 1990s to improve international trade conditions, which increased Swedish exports. Thus, the recovery was partly the result of macroeconomic development. The success of asset management companies
(AMCs) in Sweden can partly be attributed to the fact that real estate assets were easier to restructure (than manufacturing assets) and “were a small fraction of the banking system, which made it easier for the AMC to maintain its independence from political pressures and to sell assets back to the private sector” (Klingebiel 2000, 21).

All in all, the “Swedish model” of bank crisis solution is widely seen as successful. In a Nordic comparative study, the Swedish approach was seen as the most successful solution: “The decision to adopt a comprehensive strategy enabled Sweden to weather a severe crisis, maintain the country’s credit rating, and minimize the costs of the restructuring program” (Drees and Pazarbasioglu 1998, 35). It has also been used as a yardstick of “best practice” in an international comparison. Suggestions of lessons to be learned from a 24-country study include most of the measures taken in the Swedish case (Drees and Pazarbasioglu 1998, 30, 35; Dziobek and Pazarbasioglu 1997, 10; Dziobek and Pazarbasioglu 1998, 13; Koskenkylä 2000; Paues 2001, 13, 16).

The Japanese Case: A Similar Crisis but a Different Response

As in Sweden, the Japanese crisis had its roots in a highly overvalued asset markets and huge credit expansion. When the markets collapsed in 1990, decreasing growth and falling real estate and land prices weakened banks and other financial actors dramatically. In April 1992, the Ministry of Finance (MOF) estimated the bad loans of the largest banks at 7–8 trillion Japanese yen (Nihon Keizai Shimbun April 24, 1992). By October the figure had grown to more than ¥12 trillion (Nihon Keizai Shimbun October 30, 1992). In June 1995 the MOF estimated that bad loans constituted 5% of all bank loans (¥40 trillion) and 10% of GDP. This figure increased still further as time went on and was ¥77 trillion in 1998 (Caprio and Klingebiel 1996, 18; Kume 1999). The economic growth rate fell dramatically from 1992, from 4%–5% down to 0.3% in 1993 and never over 1% up to 1995 (Blomström, Gangnes, and LaCroix 2000, 6; Pempel 1999, 918). There was also growing concern from early 1992 about bad loans and especially the activity of the jusen companies, financial companies founded by banks engaged in home mortgage lending.

The depth of the crisis became apparent somewhat later in Japan than in Sweden. Banks also tried to restructure nonviable loans and, according to one commentator, tried for several years to “disguise the losses through loopholes in the accounting system” (Nakamura 2000, 5). Nevertheless, as early as August 1992, Prime Minister Kiichi Miyazawa wanted to close the stock market and proposed to use public funds to wipe out nonperforming loans (Nihon Keizai Shimbunsha 2000b, 4–8). However, the MOF rejected the plan (Tahara 1998), and because politicians, apart from the prime minister and the minister of finance, were unaware of the banks’ financial difficulties, drastic action was postponed. However, some politicians began to associate the bad loans with the long-term economic
recession. In December 1993, when a coalition excluding the long-dominant Liberal Democratic Party (LDP) came to power, each government party (Sakigake-Japan New Party, Japan Socialist Party, Japan Renewal Party, and Democratic Socialist Party) as well as the biggest opposition party (LDP) announced policies for business recovery. They all insisted on using public funds to purchase land, which was security for bad loans, from financial institutions. In January 1994, representatives of the coalition parties agreed to establish an organization for purchasing land in order to help banks to wipe out nonperforming loans. But the representative of the Komei Party opposed the plan, arguing that public opinion would not allow the government to use public funds for helping banks. And more important, an MOF observer at this meeting persuaded the politicians that they should abstain from reform. He explained that big banks could wipe out nonperforming loans by themselves within two to three years. A new organization would not be required. Politicians accepted this explanation (Asahi Shimbun January 20, 1994). Consequently, the organization was not established and public funds were not used.

After several attempts to keep the insolvent financial companies alive, the government and banks were forced to liquidate them in 1995–1996 (Kanaya and Woo 2000, 24). However, the ministry seemed to have understood the crisis as concerning mainly the jusen companies, diverting attention from the problems affecting the entire banking sector. In 1996, when the bills related to the liquidation of jusen companies were discussed in the Diet, MOF officials explained to the politicians that the financial difficulties of banks were settled because the bad loans of the jusen companies had been wiped out. The explanation was false, but most politicians believed it and they took no measures to cope with the financial difficulties of banks after that (Nihon Keizai Shimbunsha 2000a).

The crisis worsened in the mid-1990s. Regional banks and credit cooperatives faced acute financial problems, and many had to close down. In 1997 several large financial institutions went into bankruptcy. Nissan Life Insurance was forced to suspend operations, and Sanyo Securities also ran into trouble. One big bank (Hokkaido Takushoku Bank) and a huge financial institution (Yamaichi Securities Company) followed by about 30 financial companies closed within the space of one year (Kanaya and Woo 2000, 28; Lee 2000, 13; Nakamura 2000, 5). Politicians at last became aware of the depth of the financial problems.

The government response to these problems has been described as hesitant and unsuccessful. In the 24-country comparison mentioned above, Japan belongs to a group of nine latecomers with respect to bank crisis reform for which it is not possible to evaluate completely the actions taken. This in itself implies one problem: the crisis began in the early 1990s, but it is not yet resolved. Japan is also mentioned in several other studies as an example of unsuccessful governmental management. Its policy of postponement is characterized as “too little, too late” (Mabuchi 2002; cf. Kanaya and Woo 2000; Kokko 1999; Kume 1999; Schwerin and
Vassiliouk 2001; Vogel 2001). A report by the International Monetary Fund summarizes the policy record:

Between 1990 and 1995, the authorities did very little to arrest the decline in the conditions of the banking system. . . . After 1995, even though it had become clear that banks’ problems had considerably worsened and a more systematic public intervention would eventually become inevitable, regulators hesitated to take strong action. (Kanaya and Woo 2000, 26)

This reluctance to act was not the result of misperception on the part of leading officials, the prime minister was obviously aware of the problems. As early as 1992 he suggested using public funds to wipe out all bad loans, and the establishment of an independent asset management agency. But the proposal did not get the necessary political support, not even from banks or business leaders. And the main opponent was the powerful Ministry of Finance. It persuaded banks not to ask for public funds (Nihon Keizai Shimbunsha 2000b, 11–12; Suzuki 2000, 13; Tahara 1998, 250–252; Vogel 2001, 1122). To stimulate growth, several fiscal packages were enacted up to 1995, including plans to support land prices and to assist financial corporations in trouble. Rather than taking the debts seriously and erasing the burden of the past, MOF plans aimed at keeping financial corporations alive resulted in injections of public fund, in anticipation of recovery in the real estate market. In reality, prices fell even further. This was combined with the rescue operations from the banks. In order to save their own monitoring reputations, the main banks tried to protect their borrowers, for instance, through lower interest rates with extended terms, and to conceal the huge losses. As some scholars have pointed out, “It was not uncommon for banks to capitalize unpaid interest and to open new credit lines in order for borrowers to repay overdue loans” (Kanaya and Woo 2000, 12; cf. Kokko 1999, 87; Suzuki 2000, 13). As a result of policies pursued on behalf of the MOF, politicians were unable to perceive the severity of the crisis until November 1997.

Various scholars look upon the open crisis of 1997–1998 as independent from the financial and economic crisis that hit other Asian countries at the same time. The Japanese problems are principally regarded as the result of the forbearance to act forcefully against the domestic crisis (Blomström, Gangnes, and LaCroix 2000, 7; Kanaya and Woo 2000, 28; Lee 2000, 13; Nakamura 2000, 5). Failure to act in the early phase made the later bursting of the bubble even worse. However, some new developments have followed. The Financial Supervisory Agency (FSA) has replaced the MOF and several regional bodies as the supervisor of banks. A revitalization plan has also been set in motion to reform the banking sector (Kanaya and Woo 2000, 31). The open crisis resulted in what is called the “Tokyo Big Bang” program, proposals mostly aimed at further deregulation of the financial sector to be fully implemented by the end of 2001. But it is still unclear if this means that all bad loans are gone or if some are still hidden (cf. Nakamura 2000, 7; Schwerin and Vassiliouk 2001).
To summarize, there are clear differences in the policy responses in Japan and Sweden to similar crises, for all that it is too early to assess the full impact of belated efforts to deal with the crisis made in Japan in the late 1990s.

What Explains Differences in Policymaking?

Three types of competing explanations might explain these differences. Economic explanations focus on the extent and timing of the crisis as well as specific features of the two economies. In contrast to economic explanations, which emphasize objective constraints and rational decision making, cultural and ideological explanations—as well as arguments based on political partisanship—focus on values, and thus on subjective preferences and interpretations. We argue that different institutional settings explain policy differences better than either of these two other theoretical approaches.

As mentioned above, the course of events up to the bursting of the bubble is similar in the two countries. In both cases, deregulation started a race for market share among banks, which anticipated rising prices on real estate rather than looking for profitable investments at a time of unparalleled growth. This led to insufficient checks on credit worthiness, and when the recession came in 1990, the real estate market collapsed. The subsequent course of events was also similar in the two countries, where dramatically weakened financial companies led to a weakened banking sector. Even the magnitude of the two crises seems to have been, at least to some extent, comparable. Figures on credit losses and the share of bad loans of all loans and of GDP are similar. The bank crisis in Japan was even looked upon as a comparable case in the Swedish parliamentary debate in 1992 by former minister of finance Allan Larsson.

Some parts of the two crises and surrounding conditions are obviously different. The difference between a small and a big country can have important consequences on the perceived magnitude of crisis. Sweden is a small, export-oriented country and, as such, very dependent on world markets. At the time of the crisis, a huge national debt and dependence on foreign creditors made dependence even stronger. Domestic financial instability had immediate effects on confidence in the Swedish currency among international financial actors. The banking crisis was linked to a currency crisis: there were times when billions of krona were pouring out of the country by the hour. Japan, on the other hand, is one of the world’s largest economies and an important net creditor to many Asian countries. Even if the bank crisis was deep, it was not self-evident that it was a threat for the whole economic system, as was the case in Sweden (cf. Kokko 1999, 81, note 1; Suzuki 2000, 2). However, the size of the economy cannot in itself explain why the two governments chose different strategies. Rather, size had an impact on visibility and intensity of the crisis and therefore on how the public perceived the deepness of the crisis. There-
fore, the two political elites faced different public perceptions, which constituted different conditions for political action.

It would also be possible to claim differences regarding timing (Kokko 1999, 81). Perhaps the reaction to the bank crisis was different because the state of the market changed during the 1990s. The worst of the crisis in Sweden was from 1990 to 1993, whereas the deep and open crisis in Japan apparently came as late as 1997–1998. However, a closer look shows that the crisis actually hit Japan in 1992. Decision makers perceived the crisis in 1992 and many insolvent financial companies were hit by a wave of liquidations in 1995–1996. The difference in timing is thus partly a result of policymakers’ reactions: Swedish policymakers intensified the public’s awareness of the crisis, but Japanese policymakers downplayed it, and through their reactions, delayed the perception of deep and open crisis into 1997 and 1998.

We argue that it is not the objective nature of the economic crisis that is most important but the way in which economic factors, such as the timing and intensity of the crisis, interact with public perceptions to set limits to blame avoidance strategies. Policymakers in both countries—the political wing of the executive in Sweden and the administrative part of the government in Japan—perceived the extent of the respective economic crises. Consequently, the critical difference lay not in the objective nature of the crisis, but rather in what kind of response public perceptions allowed the decision makers to sell to the public. The Japanese public was not prepared to accept that a huge crisis made it necessary for government money to be spent to correct decisions that government bureaucrats themselves had made. The Swedish public, on the other hand, was prepared to believe that it was a good idea to spend government money helping banks to correct bad decisions that the banks themselves made, because otherwise the whole economy would go under.

Explanations based on values and ideology are also inadequate for explaining the reactions of politicians and bureaucrats to the banking crisis. Both countries have a strong tradition of state intervention. The unusual presence of conservative governments in both countries during the acute crisis did not change this tradition. As Kato and Rothstein demonstrate in this volume, policy orientation has a tendency to remain even if, as in the Swedish case, the party in government changes. The arguments did not express certain conservative or liberal ideological motives in any of the cases. Even if the Swedish conservative government was an explicitly pro-market “newcomer” with ambitions to “make a difference” and did not have intervention as its first priority, it did not hesitate to take strong action in this matter. As a consistent pro-market actor, the conservative government could have relied on experts within the supervisory authority and the central bank and kept politicians out of it. The politicians, and the Conservative party in particular, had for years strived for an independent and strong central bank on the belief that politicians should not interfere in the financial market at all (Svens-
However, political intervention in response to the banking crisis was stronger than ever before, and to address the national crisis, the government even included its main political opponents, the Social Democrats, in the process. Strong intervention was a matter of political unity, with all parties blaming the banks. This unity made possible a quick and robust response.

Neoliberal ideology had a weak position also among Japanese political parties. Vogel (2001) states, “no Japanese political party has ever stood unequivocally in favor of economic liberalization, and no party is likely to do so in the foreseeable future” (1117). The party that one might expect to pursue liberal economic policies, the conservative LDP which dominated postwar Japanese politics, was in fact never a strong proponent of laissez-faire. The policies of the LDP governments had focused on symbolic matters, moving “much more cautiously in critical areas such as opening markets and making the regulatory process more transparent” (Vogel 2001, 1128).

As power over the decision in this case was in the hands of the administrative wing of the government, the MOF, and not of the political parties, the ideological explanation could still be relevant. Some observers argue that because of a commitment to fiscal soundness within the MOF, the ministry opposed injecting public money into financial institutions (e.g., Tanaka and Saito 1998). But several cases show that the MOF was not negative toward the idea of using public money per se. For instance, when Prime Minister Miyazawa attempted to inject money in order to deal with the bad-loan problem of the financial institutions in August 1992, the MOF opposed the proposal. At the same time, it complied with the LDP’s request to draw up a large-scale supplementary budget. While public money was not used for the financial sector, a huge amount of public funds was still spent for business recovery, especially public works (Kamikawa 2002). Conforming to demands from the LDP, the MOF injected public money to liquidate jusen companies (instead of the original plan of burden sharing among banks and agricultural cooperatives). The MOF acceded to this demand relatively easily. The ministry probably thought politicians would not blame it because they sought to use tax money in order to help their supporters in this case. However, the LDP laid the blame for using public funds on the MOF as the public strongly opposed this plan for liquidating jusen companies (Kamikawa 2002). Thus, the MOF was not opposed in principle to the idea of using public money to escape the economic crisis. Rather, it was afraid of being called to account for its failure in financial supervision.

From this section we have learned that differing public perceptions about the severity of the crisis did play a role. Differing public perceptions can be traced back to the different ways in which the crises unfolded. The severity of the crisis in Sweden was relatively recognized easily and rapidly. The run on the currency, banks going bankrupt and immediate increases in unemployment were obvious to most citizens. The crisis in
Japan was more gradual and extended, and the effects on the public were not as immediately visible as in Sweden. In Sweden it was soon explained publicly as a system crisis. It seemed hard or even impossible to sit and wait until the danger was over. This was not obvious in the Japanese case. According to some students of the Japanese crisis, there was false hope of a rapid recovery in the early 1990s. Government intervention was not perceived as inevitable until 1995. As deposits were supposed to be guaranteed (the so-called convoy system), however, without sufficient funds, the crisis did not develop into panic and the government “did not feel compelled to disclose negative information” (Alexander 1998, 15; cf. Kanaya and Woo 2000, 26). But in spite of similar circumstances, with comparable figures regarding the international crisis, bad loans, and decreasing growth, the two governments—party government and administrative wing of the government, respectively—described the situation differently. As we have seen, a small circle of decision makers (the MOF and Prime Minister Miyazawa) seem to have been fully aware of the crisis as early as 1992, even if the public lacked the full picture or serious discontent with banks as in Sweden. Decision makers in Japan hesitated because they feared panic would develop as a result of their actions. And as we will see, action would also have threatened the power of the MOF.

A convincing explanation for governmental reactions to the banking crisis must go beyond economics, ideology, and elite perceptions of the crisis to examine the interplay between the motives of self-interested actors, different institutional settings, and public perceptions. Conceived of as rational maximizers, political actors can be expected to claim credit for popular policies and to try to avoid blame when policies are unpopular. The chances of doing so, or the choice of a specific strategy, will vary with how different institutional conditions affect the chances for blame avoidance and the existence of political unity. Interestingly, both of these countries are characterized as coordinated market economies. Still, due to different political settings and institutional conditions, the main actors in Sweden and Japan chose different actions in order to avoid blame.

Institutional Setting and Blame Avoidance Strategies

Coordinated market economies are characterized as heavily dependent on nonmarket relationships in order for actors to coordinate. One of the salient features of these economies is that firms’ access to capital is mediated by political relationships based on sharing of information and protection against hostile takeovers. Sweden and Japan, both typical coordinated market economies, were long characterized by a state-led or administered mode of capital financing. On Zysman’s criteria these countries had state-led credit-based financial systems, at least up to the middle of the 1980s. The description of the Japanese case as “controlled competition” (Zysman 1983, 237) can be applied to Sweden as well, at least regarding the financial system. Big banks, as in Sweden, or groups
of firms grouped around big banks (keiretsu), were deeply involved in nonmarket relations with the state (Hall and Soskice 2001, 34f; Zysman 1983).

A common characteristic after World War II in states of this type was regulation of the credit market. The state “intervened forcefully to direct allocation of credit” in order “to finance projects and deploy programs that they deemed important for the general welfare of their nations.” These regulations “produced a degree of autonomy to pursue national ambitions” (Loriaux 1997, 6; cf. Blomström, Gangnes, and LaCroix 2000, 7; Pempel 1999, 911–915). Thus, initially, the Swedish and Japanese governments had close and institutionalized relations with the banking system. However, there were important differences in how far the subsequent process of deregulation was taken and how this influenced these relations. As we will see, reforms had consequences not just for economic development, but also for the dynamics of policymaking.

The Swedish Case. In Sweden, government relations within the financial sector were a type of state-led mode of capital financing, a type of non-market coordination, up to the mid-1980s. The arrangement was coordinated through institutionalized meetings between the bosses of the big commercial banks and the central bank. The system was set up in the early 1950s and started with a Social Democratic program, the Efterkrigsprogrammet (the After-War Program), in effect a far-reaching economic plan. The public sector and the housing sector were subsidized at below-market rates set by administrative decisions, and the market was guided by means such as placement requirements, lending ceilings, and emission controls. The system worked through “open-mouth operations” (Jonung 1994) rather than open-market operations, and close governmental monitoring was carried out through monthly, and sometimes weekly, talks between the central bank and major financial institutions on credit controls and interest rates. The system can be said to have been a part of a wider and more comprehensive system of nonmarket relations within several spheres, also including industrial relations and investment and industrial policy as well, the purpose of which was the pursuit of both growth and redistribution.

However, as in many other Western capitalist countries, the 1980s brought a new era in which monetary policy became more market oriented. This was ushered in partly by the authorities’ efforts to finance the steeply rising budget deficit with new instruments (treasury bills and bonds), which led to a growing and unregulated secondhand financial market. Another important cause was evasion, for example, a growing credit market outside the regulated market. Over time, the banks learned to get around state regulations, which became less and less effective. Simultaneously, evasion produced a growing “gray market” in which banks served as brokers and direct loans from seller to buyer were common. Big companies created their own finance departments.
Moreover, there was an ideological shift within Sweden’s Ministry of Finance and the central bank. Parallel to the growing debt, Keynesianism was undermined. As a consequence, the Social Democratic government and the central bank gradually deregulated the credit market, ending with the deregulation of exchange controls in 1990. The most important step, however, had been taken five years earlier: interest-rate regulation and quantitative regulations (loan ceilings) were abolished. For a while, representatives of the banks and the central bank still met, but far less frequently, and the state-led coordinating meetings lost importance. The banks became free to investigate credit ratings on their own (Drees and Pazarbasioglu 1998, 9; Englund 1999; Jonung 1994; Svensson 1996, 2001; Tranoy 1999).

In a comparative perspective, deregulation in Sweden unquestionably went further than in Japan (Hviding 1995; Jonung 1994; Svensson 1996). The ties between the government as well as the legislators and the banks were explicitly cut off, and suddenly the banks had to do the work of investigating credit rating and bank management on their own. Public inspection of the market was executed by the Financial Supervisory Authority, which, consistent with the Swedish practice of independent public authorities, exercised its duties independent of the government. We have seen how deregulation led to a race for market share among the banks and to poor risk assessment. As a consequence, when the bubble burst, the banks alone were attributed responsibility and blame.

Even if critical voices were raised against the former government over its decisions on deregulation, and on the timing of tax reforms and deregulation, no one could blame the politicians for the banks’ behavior. In terms of blame avoidance, this made it much easier for the government as well as its opponents to intervene. The state had not been a part of the inferior investigations into credit rating, even if it had in the earlier phase contributed to inadequate risk management through its tight command over the banks. All the main political parties were included in the discussions as the crisis developed, but were excluded from the actual management of the concrete solutions. This made it easier to jointly point to the faults of the banks.

This interpretation is also supported by an analysis of parliamentary debate relating to the decisions made. The essential finding is that a unanimous parliament expressed its disapproval of how the banks had acted. The entire political assembly—from the Left to the Right—isolated the banks and put the blame on them. Previous and present governments got their share of criticism, but the main burden was put on the banks. It is not surprising that Social Democrats (such as Leif Marklund) spoke about the failure of the market economy and irresponsible credits. However, representatives from the nonsocialist parties were explicitly critical as well. Minister of Finance Bo Lundgren (later the leader of the Conservative Party) talked about “unskillfulness and incompetence in the bank sector . . . a sector that lost contact with reality.” Other bourgeois repre-
sentatives cited “weak and poor management during the 1980s” (Rolf Dahlberg, Conservative Party) and “a criminality of never beheld extension” (Bengt Harding-Olsson, Liberal Party). Beside the attack on banks and bank auditors, both political blocs explicitly criticized the Bank Inspectorate and the Financial Supervisory Authority, all agreeing with the Conservative representative “on the bad functioning of financial inspection” (Dahlberg, Conservative Party).

Despite this political unity and the common understanding of bank failures, the parties nuanced their arguments differently. The nonsocialist majority paid most attention to the political causes of the unfortunate situation for the banks, namely deregulation and the bad timing of tax reforms, and the lack of austerity in economic policy, thereby placing blame on former Social Democratic policies. Minister of Finance Lundgren stressed the fact that “the necessary and desirable deregulation took place in a setting consisting of high inflation and high marginal taxes.” The Social Democrats considered the roots of the crisis to be deregulation in combination with the economic boom. However, they stressed the shared responsibility of all political actors for these events and emphasized that reforms had been carried out in the belief that the market could handle the situation (Birgitta Johansson, Social Democratic Party). Nevertheless, “it didn’t. It shows that the market forces completely failed, which is the reason for the huge crisis” (Marklund, Social Democratic Party). The former Social Democratic minister of finance, Allan Larsson, actually raised Japan as a comparable case with credit losses the same size as those in Sweden. He pointed out that the common denominator was deregulation and not economic policy. The political unity even included the Left Party, which, with some objections on ownership, noticed the need for political measures “after the delirium of the 1980s” (Rolf L. Nilsson, Left Party). Thus, besides disputes over former policies, disagreement about golden parachutes, and bank ownership in the future, heavy criticism of the banks united the political blocs and was a good foundation for unified action. All actors joined together to put the blame on the banks. Any further blame was directed first and foremost to the Financial Supervisory Authority, which had been too weak toward the banks. Similarly to the banks, this actor was disconnected from the government and political parties.

The records of parliamentary debates show that the decisions of the parliamentary committee—the creation of the bad-bank model and state guarantees—were unanimous. The Social Democrats emphatically supported the government’s actions in order to maintain “the confidence from around the world in our financial system” (Allan Larsson, Social Democratic Party). The threat facing the economy united the Social Democratic leadership and the nonsocialist government in a crisis settlement that included decisions to intervene in the bank sector. The chairman of the Social Democratic Party, Ingvar Carlsson, reflected on the decision to join the overall crisis settlement: “We did it because no government in the
future—whether nonsocialist or Social Democratic—is going to realize its ideas, visions, or expectations if we don’t set the economy in order again. This is a common fundamental condition.”

Even if there was disagreement over how to interpret the background to the problems, the parties cooperated well in order to solve the acute bank crisis. The political opposition gave the government credit for its openness and extensive information about the details of planned actions. The appointment of a leading Social Democrat, the former Vice Prime Minister Odd Engström, as the chairman of the new board, the Bank Support Authority, can be regarded as symbolic of the political unity. In order to reach solutions, the government and the Social Democrats had come to a binding commitment to discuss every single question (Minister of Finance Lundgren and his predecessor, Larsson). The decision to appoint Odd Engström together with an official from the MOF (Ingves) was a joint decision: “We have jointly appointed a management we both have great confidence in” (Carl Bildt, Conservative Party, Dagens Industri, February 24, 1993). Thus, all participants could agree on the fundamental problems in the financial sector. Even though traditional divisions between the political blocs persisted, there was a good foundation for political unity behind the decisions. The MOF deliberately designed the process to prevent a political struggle. An attack on a political opponent would certainly backfire and negatively affect the policies as well as support from voters.

However, an explanation of blame avoidance ought to consider a mechanism between politicians and the electorate. Hence, the theory of blame avoidance starts from the premise that public opinion and attitudes are crucial. To intervene in the economy and still be able to avoid blame, the government as well as the political opposition had to consider public support for political action and trust in the financial sector. It was a blessing in disguise that the events of the 1980s not only resulted in a huge crisis, but also produced scapegoats. In this sense, Sweden was simply lucky. However, the promptness and political unity of the decisions made—in which the Social Democratic Party joined the government—can be understood given the drastic deterioration of public confidence toward the banks.

It seems obvious that politicians were aware of public opinion about the crisis and the banks’ behavior. Several parliamentarians, from the Left to the Right, took public mistrust of the banks as an opportunity to stress the importance of legal actions toward criminal activity among bankers. For instance, Minister of Finance Lundgren sympathized explicitly with “the anger and mistrust of the citizens” and pointed out the need for holding the boards of the banks accountable for mismanagement. Taking strong measures against the banks would be a popular thing to do.

Furthermore, the change in attitudes did not occur only in the eyes of the political representatives; it was a real change. At the end of the 1980s, after a long and sustained phase of prosperity, the banks seemed to be
among the most popular and trusted institutions in Swedish society. Public support of the banks was strong (Elliot 1993). According to a study on how the media covered the banking sector from 1985 up to 1990, critics were rare. The leading journalists were, with only minor exceptions, happy about the “brave new bank-world” and positive about deregulation. One bank manager—the director of Nordbanken, the bank that later on was worst off—was explicitly treated as a hero. A leading financial magazine exclaimed, “Hurrah for the heavy boys!” (Hadenius and Söderhjelm 1994, 107). However, there was a substantial drop in popular support as early as 1991. The popularity of the banks fell from a position comparable to the highly appreciated public health care to a position where the majority of the public viewed them negatively. By the fall of 1992, the drop in confidence was almost a disaster; there had been a decrease of 85% in two years. The banks had become the most mistrusted institution in society. It is important to note that the explicit discontent was the result of a trend that started more than a year before the financial reforms were launched. The political decision makers did not create the mistrust among ordinary people. Thus, politicians could make their decisions in the knowledge of the banks’ declining support among the public.

The public debate and articles in the daily and specialist press contributed to the picture that reached the public at large and created a “public opinion.” However, the views presented in the media more or less reflected political debate in the parliament. Irrespective of political persuasion, the dominant view was the story of deregulation, the bad timing of the tax reform and huge credit expansion, and the enormous growth of the real estate market followed by a crash—for most of which the banks got the blame. An economic analyst stressed, “the banks have themselves to blame,” and pointed to the aggressive race for market share, rather than profitability, and poorly managed risk assessment (Dagens Industri January 26, 1991). Even if the roots of the crisis lay in the policies of the 1980s—“deregulation and the economic policy of the 1980s created a financial frenzy many banks could not resist” (Svenska Dagbladet March 31, 1992)—several articles stressed that governmental action had been necessary to save the financial system. The main burden of guilt was put on bank managers and the inadequacy of internal auditing. The bank crisis was seen as self-inflicted (e.g., Svenska Dagbladet April 3, 1993). A leading financial magazine even spoke about market failure (Dagens Industri September 15, 1992).

Apart from the banks, blame was put on the Financial Supervisory Authority and its management. Severe criticism came from several directions. The former Social Democratic minister of finance, Allan Larsson, who certainly had the incentive to point to administrative rather than political failure, wished for a stronger authority. Indirectly, the central bank was blamed for worsening the crisis. It is interesting to find representatives of the government, the prime minister (Carl Bildt), as well as the minister of finance (Lundgren), among critics of the “independent”
central bank. Another “accused,” a former bank auditor, pointed to the Financial Supervisory Authority as well. It had been “completely toothless and lacked knowledge as well as influence over the internal audit within the banks” (Per-Olof Palmgren, Svenska Dagbladet April 3, 1993).

In the initial phase, the banks themselves tried to defuse the idea of a crisis. Later on, some bank representatives found it “unfair to put all the blame on us” and emphasized the importance of the huge government subsidies to the building industry and the political responsibility for the state of the Swedish economy (e.g., Veckans Affärer October 9, 1991). The criticized manager of the Financial Supervisory Authority stressed the responsibility of the banks, but he also blamed the central bank as well as the political leadership. He claimed, “the Financial Supervisory Authority handled the crisis quite well, but admits the central bank and the former inspection should have done a better analysis and warned about the risks of a credit expansion” (Veckans Affärer March 25, 1992). However, on the whole “public opinion” seemed to follow the perspective of the government. Explicit blame of the government occurred but was sparse (e.g., SAF-tidningen August 28, 1992). The heroes of the 1980s now stood in disrepute and politicians were highly praised for their prompt action.

The Japanese Case. In Japan, by contrast, politicians in the Diet were not even able to perceive the severity of the crisis until November 1997 because the MOF, the administrative wing of the government, succeeded in drawing a veil over it. For instance, the MOF seemed to have portrayed the crisis as mainly a matter of the jusen companies (house-loan companies), diverting attention from problems afflicting the entire banking sector, in order to escape blame from the public and from political parties. This could be done partly because financial oversight was left in the hands of the MOF. Bank managers also concealed the scale of the crisis in order to keep their positions. Of course, it is also very important that Japan is one of the biggest economies in the world. However, the crucial mechanisms that made it possible to choose a strategy different from that in Sweden, “forbearance policies” and concealment, rested upon the different relationship within the government and between the state and the banks.

The ability of the MOF to conceal problems and postpone responses rested on its strong political position, with far-reaching control over the treasury and macroeconomic policy, within a system of ministerial government. In combination with ties to the previously dominant LDP, this gave the ministry an autonomous role in economic policymaking (Cerny 2001; Iwanaga 1991, 201; Schwerin and Vassiliouk 2001). As the permanent party of government (from 1955 to 1993), the LDP had delegated financial policymaking as well as financial policy implementation to the MOF for three reasons. First, financial policy is a field of high specialization. To acquire full understanding of this field involves a considerable cost. Hiroshi Mitsutsuka, minister of finance from November 1996 to
January 1998, said he thought the experts of the MOF would properly manage the financial problems in the end (Karube and Nishino 1999). Second, banks and securities firms, both of which are important backers of the LDP, were opposed to each other in the market. Siding with one group or the other was not expected to increase “net support” for parliamentarians. Banks, at least the big ones, have made large contributions to the LDP since its formation in 1955. Securities firms give less than banks in publicly reported annual donations, but probably more through the “back door.” It is widely alleged that securities companies tip off politicians on good stock purchases, effect a share price increase through concentrated sales efforts, and tell the politicians when to sell for a handsome capital gain before the stock drops back down (Rosenbluth 1989, 35, 38).

The third reason for giving extensive powers to the MOF was the risk to politicians of managing individual financial institutions. As one politician said, “an easy involvement would cause suspicion of insider trading” (Karube and Nishino 1999, 349). The events of December 1994 are illustrative. When the Tokyo Kyowa Credit Cooperative and Anzen Credit Cooperative went bankrupt, the close relationship between the chairman of one of these and the politicians of the biggest opposition party, New Frontier Party, was disclosed. One of the politicians was arrested, and another resigned from his position as a member of the Diet. It is not hard to see how the public came to look with suspicion on relationships between politicians and managers of financial institutions. Therefore, politicians took a prudent attitude toward intervening in the management of individual financial institutions. In addition, the managers of big banks tend to avoid becoming close to individual politicians because they fear the politicians may exploit bank money or intervene in bank management (Inoguchi and Iwai 1987).

The MOF took advantage of the politicians’ lack of concern about financial policies. Public funds were made available too late not because politicians hesitated to take the initiative, but because they did not recognize the depth of the financial problem. The reason the MOF concealed the seriousness of the financial crisis from the politicians instead of reporting it rests on the particular relationship between the MOF and the banks.

In Japan, the government, and above all the MOF, was still an integrated part of the banking system even in the 1990s. One sign of this was the system of “administrative guidance” in which banks and other firms regularly consulted with their supervising ministries. During the drafting of laws concerning financial institutions, it was not unusual for several dozen industry representatives to visit relevant ministry divisions every day (Grimes 2001, 44; cf. Cerny 2001, 6). Moreover, MOF officials and the employees of banks and securities companies involved with the MOF (called “MOF tan”) had close relationships and exchanged information. MOF tan cooperated with officials of the MOF Banking Bureau in designing policies (Amyx 2002; Kishi 1996).
The close relationship between the MOF and related industries is especially visible in the system called “descent from heaven” (amakudari). This institutionalized system is particularly notable in the financial sector where, as certain scholars have noted, senior bureaucrats in the MOF and the Bank of Japan receive high-level appointments in banks when they retire. For instance, in October 1999, 17 retired MOF officials were chairmen of regional banks and second-tier regional banks, 43 were chairmen of credit associations and credit cooperatives, and 626 worked at companies and associations related to money and banking (in 1997 this figure was 812) (Tsutsumi 2000). These appointments were intended as “rewards for retiring officials and sometimes as part of the authorities’ response to arrest the worsening of distressed banks” (Kanaya and Woo 2000, 26; cf. Cerny 2001, 7; Hagström 2000, 11; Suzuki 2000, 15).

The personnel management of government ministries in Japan relies on amakudari. The practice of retiring some career bureaucrats before they reach retirement age hastens the promotion of the younger generation and motivates them to work hard. The system presupposes that government ministries have many positions in which to place former staff members. Furthermore, career bureaucrats who perform well are promoted to high ranks in their government ministries and are found positions with high salaries. In short, because amakudari widens the gap between their salaries, it motivates career bureaucrats to make an effort to perform well (Inatsugu 1996). Government ministries, where salaries are lower than in major private companies, are able to recruit the best university graduates because of the promise of amakudari. An MOF official declared that superior students would not join the ministry if its retiring officials were not able to find second jobs (Bungei Shunju, July 1999). Consequently, it is critical for the MOF that amakudari to private financial institutions, which can pay high salaries, is maintained.

Openness about the banking crisis threatened the practice of amakudari. In December 1995, the government proposed a plan for the seven insolvent jusen companies. However, the public strongly opposed, so politicians in the coalition government parties—the LDP (back in government after one year out of power), Japan Socialist Party, and Sakigake—laid the blame on the MOF for using public funds. They began to argue for a breakup of the MOF to remove financial administration from the ministry by establishing a new agency (cf. Kato and Rothstein 2002; Pempe 1999, 909). The parties in government saw two reasons for breaking up the MOF. First, many former MOF officials held amakudari appointments in jusen companies, and these firms were perceived to be under the direct control of the MOF. Second, the MOF was severely criticized for its close business connections that had led to corruption and the concealment of fraud. There was a persuasive case to be made that the MOF was an inappropriate agency to supervise and inspect financial institutions and should be stripped of the function of financial administration.
We believe the MOF resisted the separation of its financial divisions to keep the *amakudari* system in the financial sector. While the fiscal divisions of the MOF gave the ministry leverage over political and administrative institutions, it was the financial divisions that gave it power over financial institutions. Former MOF officials were able to find second jobs in the financial sector thanks to its jurisdiction over the sector. Financial institutions had nothing to gain by employing retired officials who had no relationship to their firms. Consequently, if the financial divisions had been separated from the ministry, it would have become difficult for ministry officials to find second jobs in the financial sector. The strong interest of the MOF in keeping authority over the banks led it to conceal the real situation of financial institutions from the politicians and to postpone the problem.

Thus, the institutional setting in Japan brought about another blame avoidance strategy, the combination of concealing and postponing. Because the connections between the MOF and the banks were strong, when the bad-business conditions of banks were revealed, not only the management of the banks, but also the MOF was called to account for them. When politicians, the media, and the public perceived the bad-business conditions of banks, they sought to remove the functions of financial administration from the MOF, which had not dealt with the problem of nonperforming loans. Furthermore, the LDP mistrusted the MOF, or at least had distanced itself from the ministry, because the ministry had had a close partnership with the Japan Renewal Party in the non-LDP coalition period (Kato and Rothstein 2002; Mabuchi 1997). Accordingly, the MOF perceived the crisis not as a systemic crisis but as a crisis in one division of the MOF. It concealed the financial difficulties of banks from politicians to prevent them from dividing the ministry because of the threat of “Ministry of Finance bashing” (Kamikawa 2002). In fact, the LDP, back in government, tried to merge some government-run financial institutions under the jurisdiction of the MOF. The intention was to reduce the incidence of MOF officials getting second jobs (*amakudari*), in revenge for the ministry’s cold treatment of the LDP when the party had not been in government. In particular, it was common for the position of governor in private financial institutions to be reserved for retired administrative vice ministers. Thus, reducing the number of government-run financial institutions meant depriving MOF officials of *amakudari* posts (Shiota 1995). In Sweden, politicians wished to avoid blame from the voters for the crisis. In Japan, bureaucrats tried to avoid blame from the politicians in order to prevent painful administrative reforms.

In addition, the Japanese public consistently opposed the use of public funds to solve the financial difficulties of banks. Unlike in Sweden, the public turned against politicians and the state rather than attacking the banks. Everyone knew there were strong connections between the MOF and the banks, and that the banks contributed money to the LDP. Conse-
quently, the public suspected that the MOF and LDP politicians wanted to assist the managers of the banks by using tax money as financial support. These suspicions were confirmed. When the government decided that two credit cooperatives should go bankrupt and their operations were taken over by Tokyo Kyodo Bank (a new institution that received its funding from the Bank of Japan and all private banks in Japan), it was revealed that Harunori Takahashi, chairman of Tokyo Kyowa Credit Cooperative, had given lavish attention to two elite MOF officials. He also had close connections with some politicians. Moreover, it was disclosed that employees of banks and security companies (MOF tan) also gave lavish gifts to many other MOF officials (Nihon Keizai Shimbunsha 2000a).

Two features distinguished the Japanese case from that of Sweden. First, politicians (as well as the media and the public) perceived the tight relationship between private banks and the MOF as a grave fault of the MOF. For instance, in November 1997, when Yamaichi Securities Companies went bankrupt, some influential LDP politicians blamed the MOF (Nishino 2001). Therefore, the MOF concealed the seriousness of financial problems from politicians for fear that it might be called to account and politicians might decide to remove its functions of financial administration. The MOF was successful in concealing the depth of the crisis from the politicians, which meant that the crisis was allowed to get worse.9

Second, the Japanese economy is so big that the MOF could postpone the serious effects of financial distress. This gave the ministry the opportunity to conceal the extreme financial difficulties from politicians until November 1997. This is also supported by an investigation of growth in Japan that observed that “despite the severe collapse of asset prices in the nineties, negative shocks to private consumption proved to be relatively small” (Ramaswamy and Rendu 2000, 276). In addition, despite the financial crisis, unemployment was still low during the 1990s, which helped hide the severity of the crisis from the public. Low public concern, at least in comparison to the Swedish case, together with institutional interdependence made the postponement strategy possible.

The common view is that this system of interdependence increased the power of banks vis-à-vis the government. Interdependence develops, fostering “conflicts of interest and retardation of action by the supervisors” (Kanaya and Woo 2000, 26; cf. Suzuki 2000, 16). Furthermore, individual banks and the Japanese Bankers Association are important donors to the LDP and its election campaigns. This makes the banks even more influential. Together with the so-called convoy system of bank ownership, where all banks were tied to each other and thereby ultimately in the same liquidity situation, this bank domination leads to governmental hesitance and regulatory forbearance (Alexander 1998, 14; Kanaya and Woo 2000, 21, 27; Suzuki 2000, 10).10

However, irrespective of which actor had the upper hand in the relationship or the role played by the LDP, there are still differences in how
different institutional settings created opportunities for different strategies of blame avoidance. In institutionalized systems of interdependence in which the state and banks are closely tied, a reform that leads to an open crisis clearly puts blame on political leaders. Confronted with the threat of dismemberment of the entire organization, the rational strategy for the MOF was concealment and postponement. The political answer to the economic transformation and events of the 1990s were, as Pempel (1999) points out, referring to the LDP as the important actor, “a series of moves that were ‘politically compatible’ with minimizing the economic pain on key constituents” (927).

Conclusions

We began this article by presenting a puzzle. Confronted with financial and banking crises of the same magnitude and characteristics, the Swedish and Japanese governments acted completely differently. Why? Our conclusion is that because of different institutional settings, the main actors in Sweden and Japan chose different actions in order to avoid blame. It was not a case of different ideologies or different perceptions by the main decision makers of the magnitude of the crisis.

In Sweden, deregulation had gone farther than in Japan and had separated the government from bank administration as well as currency policies. The public readily connected deteriorating economic conditions to the bad management of banks. When the crisis became apparent, the separation of government and financial administration was a blessing in disguise. Even when the government was forced to act, this situation brought about political unity. The promptness of and political unity behind the decisions—when the Social Democratic Party joined the government—can be understood against the backdrop of the drastic deterioration of public confidence in banks. It was possible for the government to put the blame on the banks and take the credit for the (very costly) efforts to resolve the crisis. Government as well as opposition could point to the banks, a passive Financial Supervisory Authority that had failed to do what it was supposed to do, as well as an evil surrounding world and thereby disconnect themselves from the acute crisis. None of the main political actors was directly linked to bad-bank management, and the central bank proudly declared its sovereignty over currency policy. The more widespread public perception of a threatening system crisis in Sweden, which no political leader tried (or even had the opportunity) to conceal, led to quick and undivided support behind far-reaching crisis packages (according to some, these packages even overreacted).

With a less visible crisis, the important actor in Japan, the MOF, chose a strategy of concealment and postponement. This reflects (at least) two important institutional factors. First, there is a very close relationship
between private banks and the MOF in Japan in the form of “administrative guidance.” A reform that leads to an open crisis clearly puts the blame on the political leaders, and the public looked upon proposed reforms with suspicion. A rescue operation would have turned the public against the government as well as the dominant party, together with the banks. Second, the MOF was threatened with a loss of its former power. Confronted with the threat of dismemberment of the ministry, when leading LDP representatives suggested creating an entirely new agency for financial administration, the rational strategy was concealment and postponement. A distinguished student of these events remarked, “politics has shown undeniable impressive powers of resistance” (Pempel 1999, 927; cf. Cerny 2001). Such resistance rests on another crucial institutional factor that contributes to the explanation for different actions in Sweden and in Japan: organizational differences between the competent authorities.

In Japan, the MOF, part of the administrative wing of the government, had jurisdiction over both fiscal and financial affairs. While the fiscal function of budget preparation was considered the main function of the ministry, supervision and inspection of financial industries were considered secondary functions. The finance divisions were ranked low in the MOF. Therefore, when fault in the financial administration became clear, it was possible to argue for separating the finance divisions from the rest of the MOF. The failure of financial policies would justify dismembering the ministry. In other words, because the MOF had multiple functions, it offered politicians the means of punishing it. For politicians, in order to avoid blame from the public, it was rational to blame the MOF when the management problems of financial institutions were revealed. Furthermore, politicians would be able to punish the ministry by separating the finance divisions from it in order to appease the anger of the public if they had to inject public money. Moreover, “the separation of fiscal divisions and financial divisions” (zaikin bunri) would be a penalty to the MOF that was thought to change the stance of financial policy from the existing “convoy system” to a market-oriented policy of an objective and transparent nature. In order to develop financial policy specialists, it was persuasively argued, the MOF should be reformed and a new supervisory body of the financial industry should be established. The separation of fiscal divisions and financial divisions was not merely “Ministry of Finance bashing” but could also be argued for on sound economic grounds.

Therefore, when the errors in the finance divisions became clear, the institutional arrangement of the MOF became an issue and made the argument for the separation of finance from the MOF more persuasive. The ministry, which resisted dismembering, was unable to admit there had been a failure in financial administration. In this way, the institutional arrangement of the MOF, which had jurisdiction both over fiscal and finance divisions, fixed its strategy.
Why did the MOF insist on keeping its authority over the financial industry? A standard explanation may be the bureaucratic instinct for authority expansion or authority defense. However, this explanation is not completely persuasive. Elite bureaucrats would not like to carry out unpopular policies such as processing collapsed financial institutions (cf. Dunleavy 1991, 200–209). We think the MOF continued to resist the separation of financial divisions to keep amakudari in the financial sector. While the fiscal divisions gave the ministry leverage over political and administrative institutions, the financial divisions gave it power over financial institutions. If the financial divisions had been separated from the ministry, it would have been difficult for ministry officials to find second jobs in the financial sector.

In Sweden, in contrast, the process of deregulation had already divided different areas of authority when the crisis struck. The Ministry of Finance had jurisdiction over fiscal policies, monetary policy lay in the hands of the central bank (independent from the government and only indirectly responsible to the parliament), and control over banks was the task for the Financial Supervisory Authority. Even if the central bank and the supervisory authorities were partly blamed for the financial crisis (the former for contributing to the crisis by deregulation and the latter for inadequate control), they did not need to worry about their organizations being dismembered. In fact, criticism of the Financial Supervisory Authority would likely lead to more resources in order to strengthen its competence in the future. Moreover, none of these agencies needed to preserve an institution like amakudari in the financial sector. Therefore, the incentives to hide the seriousness of the financial crisis were not as strong as they were for Japan’s MOF.

Some general conclusions can be drawn with relevance on the debate on varieties of capitalism. First, it is clear that the grouping of countries into coordinated or liberal market economies lumps together countries with quite different political institutions. A lesson learned from this study is that politics in coordinated market economies is not always identical. Important differences exist among these countries in how they react to new problems and readjust their institutions. Second, the institutions of coordinated market economies have consequences not just for economic growth and development, but also for the political dynamics of policymaking. One of the salient features of coordinated market economies is that firms’ access to capital is mediated by political relationships based on sharing of information and protection against hostile takeovers. While the literature on coordinated market economies has described some of the economic benefits of these relationships, it has neglected the political costs. If these investments go wrong, political actors are held accountable. Consequently, an unintended effect of this public accountability may be not better government management of investment decisions, but hesitation of governmental actors in confronting bad investment decisions and redressing their effects.
Notes

1. The following paragraph relies on work by Drees and Pazarbasioglu (1998); Englund (1999); Kokko (1999); Koskenkylä (2000); Larsson and Sjögren (1996); Paues (2001); and Tranøy (1999).

2. The following section covering the development of the crisis relies on Englund (1999); Kokko (1999); and Tranøy (1999).

3. Koskenkylä (2000) and Pesola (2001, 14) show how the crisis developed in all Nordic countries and was the result of the interplay between macroeconomic shocks and the huge loan losses that were the end result of “the banks’ fierce competition for market share.” Drees and Pazarbasioglu (1998, 1, 7) point to factors (such as delayed policy responses, characteristics of the financial system, and inadequate risk management) contained and shaped by the regulated financial system that were set free by deregulation. Cf. Englund (1999), who claims that “deregulation probably only played a minor part in triggering the general boom in the late 1980s” (Pesola 2001, 95). There is a parallel debate on the Japanese case where studies on deregulation point out that it is doubtful whether the cause of excessive risk taking was financial deregulation. According to Hanazaki and Horiuchi (2000, 64), “the deregulation of the 1980s was cosmetic rather than substantial.”


6. Support is measured as the balance between positive and negative responses, where the maximum value is +100 (entirely positive) and the minimum is –100 (entirely negative responses) (Elliot 1993, 17; Holmberg and Weibull 2002, 35). The changes over time are particularly distinct regarding banks compared to other sectors.

7. The search engine Affärsdata found 192 articles in the most important newspapers and financial magazines on certain key subjects (bank crisis, financial crisis, property crisis, currency crisis) for 1990–1995.

8. In 1995, it was revealed that MOF career bureaucrats were lavishly entertained by the chairman of Tokyo Kyowa Credit Cooperative. It was also reported that a trader for Daiwa Bank in New York had hidden trading losses of $1.1 billion from U.S. bank examiners over an 11-year period. Daiwa’s chairman informed the MOF Banking Bureau chief but ministry officials did not inform bank examiners at the U.S. Federal Reserve until after the scandal had broken. The MOF was accused of trying to conceal the crime from U.S. authorities (Grimes 2001, 185–186).

9. Some characteristics of the electoral system also seem to have worked in the MOF’s favor. At least up to 1994, the electoral system with multimember districts resulted in “intra-party competition for votes and campaign funding led majority party politicians to cultivate personal support networks (koenkai) at the expense of a coherent party platform” (Rosenbluth and Schaap 2001, 31; cf. Calder 1997, 39). Consequently, this prevented joint political action against the MOF.

10. Under the convoy system, good banks were supposed to help bail out bad banks. Moreover, shareholders had a weak position relative to managers. However, according to some students, the old convoy system broke down simultaneously with deregulation (Hoshi 2002). In the words of Pempel (1999, 921), the system was replaced with a “‘Noah’s Ark System’ in which a few are saved but many are left to drown.”
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Government Partisanship and Managing the Economy: Japan and Sweden in Comparative Perspective

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It is generally taken for granted that countries governed by leftist governments expand social policies and have an affinity for active fiscal policy that implies higher tolerance of deficit-ridden budgets. In contrast, conservative governments are taken to be less likely to favor welfare expansion, especially when it has negative fiscal consequences. We challenge this conventional wisdom by comparing the reactions of the Swedish and Japanese governments to economic crises during the 1990s. The puzzle is that the Social Democratic governments in Sweden were able to reduce ballooning budget deficits and thus bring the economy back into balance, while still having one of the largest public sectors in the developed world. In contrast, the conservative Liberal Democratic Party governments in Japan have been unable to redress their deficit problems despite having one of the smallest public sectors among the Organisation for Economic Co-operation and Development countries. We argue that this can be explained by taking into consideration that governments’ tax and spending policies are influenced by bureaucratic structures and institutionally driven public beliefs. By comparing Japan and Sweden, we show how political parties actively seek to make their policy stances permanent by structuring taxation and expenditure policies to create institutionalized support for their policy preferences.

Introduction

It is conventional wisdom among students of partisanship that a government’s political leaning is an important factor in explaining the cross-national variation in the size of governments. A country governed by leftists is supposed to have a political dynamic that is diametrically opposed to one governed by conservatives. Based on core support from highly organized labor, the leftist government expands the welfare state in pursuit of income equality and has an affinity for active fiscal orientation that often means more tolerance of deficit-ridden budgets. In con-
trast, conservative governments that are more susceptible to business interests, and thus oriented toward fiscal conservatism, are typically less concerned to achieve income inequality and welfare expansion (Boix 1998; Garrett 1998; Hicks 1999; Huber and Stephens 2001; Iversen 1999; Swank 2002).

In light of this conventional wisdom, the reactions of Swedish and Japanese governments to economic crises in the 1990s are particularly puzzling: Social Democratic governments in Sweden were able to reduce ballooning budget deficits, which they twice inherited from center-right governments and bring the economy back into balance, while conservative Liberal Democratic Party (LDP) governments in Japan have been unable to redress their budget deficit problems. Moreover, just how little partisanship explains about governments’ fiscal and expenditure policies is illustrated by the experiences of the opposition parties that finally toppled long-term rule of the dominant parties in these two nations. Center-right coalition governments in Sweden—which came to power with programs of cutting back on public expenditure—ended up greatly expanding the public sector by increasing budget deficits (both in 1976–1982 and in 1991–1994). In Japan it was the center-left opposition—after many years of pushing for increased public expenditures—that fought the dominant LDP efforts to balance the budget by raising taxes in the 1980s. However, in the 1990s the opposition parties came to criticize the LDP coalition government’s fiscal expansion as a lax attitude to spending. Thus, despite radical changes in government partisanship, patterns of government expenditure remained stable in the two countries. At the same time, when the dominant parties returned to power, it was the purportedly “big spending” Social Democratic Party that both in the 1980s and 1990s balanced the budget in Sweden, whereas the supposedly prudent LDP was unable to either balance the budget or pump up the economy. How, then, can one explain both the stability of these expenditure patterns and the divergent reactions to crisis in public finances? After all, budget deficits should be much easier to handle if taxes are already comparatively low corresponding to a low spending level, as in Japan.

We argue that the link between partisanship and the character of government spending drawn in the literature is too simple. Governments’ tax and spending policies are influenced by bureaucratic structures and institutionally driven public beliefs. Political parties actively seek to make their policy stances permanent by structuring taxation and expenditure policies to create institutionalized support for their policy preferences (Rothstein 1998; Steinmo and Thelen 1992). In Japan, this meant severely limiting the institutional means for generating revenues, so as to create fiscal pressures against expanding public expenditures, particularly the redistributive ones. Instead, deficit financing through bonds was more conducive for distributive policies like construction projects in favored LDP electoral districts. In Sweden, taxation (high communal and consumption taxes, and social insurance contributions graduated accord-
ing to income) was intentionally put in place to raise large revenues for Social Democratic redistributive purposes. By institutionalizing most social policies as universal programs, the Social Democrats have managed to secure broad public support for high levels of public spending (Svallfors 1997).

The ability of political leaders to pursue strategic ends through fiscal policies is not unconstrained, however. Instead it is limited by what the public considers legitimate. These “public beliefs” in turn are very much shaped by previous patterns of policy and, in particular, by the individual experiences of citizens in dealing with government bureaucracies responsible for delivering services and benefits (Kumlin 2004). In Sweden, the universalistic character of social policies meant that not only did citizens directly receive social benefits, but also saw the processes of benefit allocation in accordance with fair procedures (Kumlin 2004). The reason for this is that universalistic policies can be implemented without any stigmatizing process of means or needs testing (Rothstein 1998). That is, in contrast to standard arguments about political support for universal welfare states, it is not interest alone—but also the standards of fairness and legitimacy that are forged through the administration of public programs—that leads to strong public support for the universal welfare state (Kumlin 2004; Svallfors 1997). In Japan, on the other hand, a minimal welfare state and previous policies of directing government funds to special interests (e.g., in the form of construction projects and rice subsidies) meant that the majority of citizens did not consider public expenditures to be particularly useful or legitimate; neither interest in universal benefits nor a sense of social justice led to public support for government expenditures (Kato 2003). These differences in public beliefs meant that the Social Democrats in Sweden were able to convince the public that increased taxes and cuts in benefits were plausible measures to eliminate deficits and so guarantee the long-term viability of the Swedish welfare state (Steinmo 2003). In Japan, by contrast, arguments about the need to raise taxes to cover government deficits were met with skepticism (Kato 2003). Thus, the structure of government revenues and expenditures creates recursive effects that explain both the stability of these patterns and responses to economic crisis.

We argue that these institutionalized political processes qualify the ideological influence of parties in power. To demonstrate this, we compare Sweden and Japan, which have long been governed by the same incumbents and have distinct traditions of government partisanship. Since 1932 the Social Democratic Party (SAP) has been in government and held the prime-ministerial post for all but nine years. Except for one year out of office, Japan saw the long-term rule of the LDP for 38 years from 1955 to 1993, and the LDP has since continued its rule as a minority or coalition government. Despite this similarity, the governments of these countries are very different in other aspects. Whereas Sweden has one of the largest governments in the world in terms of public expenditures and
total tax revenue as proportions of the gross domestic product (GDP), the Japanese government is by these measures usually the smallest or second smallest among the 18 Organisation for Economic Co-operation and Development (OECD) member countries. Moreover, Sweden has had one of the highest social security expenditures, whereas Japan has had one of the lowest.

Both countries experienced recession in the early 1990s and the subsequent interruption of the rule of a dominant partisan camp. Although a deep recession might be expected to have an adverse effect on the influence of long-term incumbents, in these cases the predominant party’s policy orientation increased its influence over other parties’ policy positions after the interruption to the hegemony. In Sweden, the conservative and centrist parties, which had been in power in the early 1990s, could not cut public expenditures effectively, and the Social Democratic approach was restored after the SAP returned to power. In Japan, the LDP-centered government was forced to implement fiscal expansion to cope with the recession, but ironically, the opposition parties, which had opposed the past austerity policy sponsored by the LDP, criticized fiscal expansion financed by deficit bonds.

The most important difference between these two cases is that the predominant party’s response to the economic crisis had divergent consequences. Sweden has not only recovered from the recession, but managed to eliminate its budget deficits during the late 1990s. In contrast, the Japanese government was slow to respond to the recession, and budget deficits and debts have grown as a result of delayed fiscal expansion. We argue that the different economic responses were, respectively, the reflection of the entrenched Social Democratic strategy of maintaining both high tax and expenditure levels to avoid deficit finance, and of the conservative strategy of controlling revenue raising so as to oppress spending pressure. The absence of an effective revenue-raising measure in Japan resulted in a revenue shortage that has led to increasing deficits and a lack of fiscal discipline, whereas the high tax levels in Sweden sufficed to finance high expenditures (Steinmo 2003). Sweden was thus more fiscally disciplined than Japan, despite the much larger size of its public sector, and Japan failed to avoid looming deficit finance, despite the advocacy of a small government.

The above contrast serves to extend our argument about the limited role of government partisanship and thus supports the importance of an institutionally driven political logic behind the partisan rhetoric. In Sweden, financial resources available from high tax revenue allow generous public spending, whereas the restraint on the level of taxation resulting from an ineffective revenue machine is responsible for expenditure cuts in Japan. This contrast implies a political logic not predicted by the conventional understanding of distinct fiscal orientation. The Swedish strategy to secure enough revenue to avoid unhealthy deficits is based on the belief that deficit finance eventually damages the legitimacy of the exten-
Sive welfare state. As a result, the fiscal stringency of the Swedish welfare state is in direct opposition to the deficit financing that is considered both a hallmark of Keynesianism and is a prime force behind the expansion of the public sector. Here, a balanced budget goes hand in hand with a large public sector. In contrast, the Japanese strategy takes the risk of repressing revenue to rule out the possibility of lax spending. Usually, fiscal conservatism means a balanced budget and is thus often associated with a small-sized government in which securing tax revenue to finance expenditures is more readily expected. A low level of spending is considered imperative in maintaining a sound budget. In Japan, a low level of tax revenue (the lowest among 18 OECD countries) has been institutionalized into the existing tax system. This repression of tax revenue was supposed to be used to control spending, but has in fact resulted in looming budget deficits.

The Two Countries Compared

Sweden

Until the late 1980s, Sweden was considered by many of the political center and left to be a success in combining economic growth and international competitiveness with social equality. “The Swedish Model” was understood to mean “capitalism with a human face” and a midpoint between full-fledged, market-oriented capitalism and Soviet-style, state-dominated socialism (Rothstein 2002; Shonfield 1965). Together with a number of other small European states with open economies, Sweden seemed to have found a special way of establishing a peaceful system of industrial relations and, at the same time, a willingness to restructure its industries to be competitive in international markets (Katzenstein 1985). This model had several ingredients—among the most prominent were a generous and encompassing social insurance system, an extended system of mostly universal social services, and a pattern of close, corporatist-style collaboration between the labor–market partners and the state, especially on labor–market policy (Hedborg and Meidner 1984). A central part of this model, from the mid-1960s onward, was to increase gender equality through programs that would increase female participation in the labor force (Lindvert 2002).

The Limited Role of Keynesianism. Until the mid-1970s, public finances had been characterized by two main principles. One was a steady increase in taxes/public spending, and the other was a conservative fiscal policy. Public debt was kept very low, and budget deficits were small or non-existent, depending on whether the public pension funds were counted in the budget (Jonung 1999). Although now and then referred to in the political debate, Keynesianism in practice played a very minor role in Swedish politics up until the 1970s (Blyth 2002). Even then, it was with
quite some hesitation the government started on a Keynesian route. The legendary Social Democratic minister of finance, Gunnar Sträng (who held that post from 1957 to 1976), was known for his ability to explain the need for higher taxes and budget discipline to the Swedish electorate in a very convincing way. In his last budget, presented in 1975, the deficit increased from a meager 3 billion Swedish krona (Sk) to about Sk 12 billion (out of a total of Skr 600 billion in government spending). Although this increase in the public debt was, by international standards, very modest, Sträng publicly announced that he considered this a disturbing situation that needed to be carefully monitored during the following years. At the traditional yearly debate about the public budget organized by the Swedish Confederation of Economists, he was mocked by several of the most prominent Swedish economists for not having understood the basic principles of Keynesian economics (Ekonomisk Debatt 1976). Increasing the public debts during an economic downturn was, according to established wisdom among academic economists, the right thing to do (Lindvall 2003).

When the center-right parties won the 1976 election and formed a coalition government, their first budget increased the deficit from Skr 12 billion to Skr 40 billion (Government Bill 1976, 77:100, pp. 107–147). This was a considerable step, and can be explained by a very simple electoral logic. The center-right parties had promised in the intense election campaigns in 1973 and then again in 1976 not only to cut taxes but also to preserve the comprehensive and generous system of social services, active labor–market programs, and the universal social insurance system. In many ways, the two center political parties that formed the majority of the coalition government had been criticizing the Social Democrats from a position farther to the left, arguing that fiscal policy had not been Keynesian enough in the early 1970s (Jonung 1999). Especially during the economic downturn in 1971 and 1972, the center parties criticized the Social Democrats for being too fiscally conservative and not stimulating the economy with Keynesian expansionary fiscal policies (i.e., under-balancing the budget). Campaign slogans referred to the “two lost years,” and they accused the Social Democrats of causing an increase in unemployment (Lindvall 2003).

The Social Democrats were politically very vulnerable to this type of criticism, and to explain why, it is necessary to make a historical turn. A large part of the Social Democratic legacy in Swedish politics rested on the myth that the Keynesian policies that the party had launched in 1933 had rescued the country from massive unemployment after several center-right coalition governments had mismanaged the economy (Linderborg 2001). This policy was established in 1933 after an unexpected deal was made between the Social Democratic government and the Farmer’s Party.

As has been shown by Nils Unga and other historians, the Social Democrats’ budgets during the 1930s were not especially Keynesian. Pri-
vately, leading Social Democratic ministers made clear that they did not believe in expansionary economic policies (Unga 1976). The actual explanation of how the crisis of the 1930s was overcome was a different one, but in the “collective memory” the story that the Keynesian economic policy launched by the Social Democrats in 1933 had saved the country became an established fact, probably equal to the New Deal policies launched by the Roosevelt Democrats of the 1930s (Rothstein 2005). It also became an established fact because the Social Democrats themselves skillfully manufactured this myth for the consumption of the Swedish electorate (Linderborg 2001).

Caught in the Myth of Full-Employment Policy. The political result of this “making of history” was that both the Social Democrats and the center-right opposition parties were caught in a political legacy. The legacy meant that several things were considered as part of the tools that any government had at hand that could be used to steer the economy. The first was that the government had economic measures to create full employment. Second, it was believed that economic downturns could be handled by selective fiscal and monetary policies (Blyth 2002; Jonung 1997; Lindvall 2003). The political logic that these beliefs implied was that if unemployment increased, the government was to blame because the measures to create full employment did, in fact, exist. This meant that neither a Social Democratic nor a center-right government could maintain political credibility if it argued that it lacked measures to fight rising unemployment (Garme 2001; Lindvall 2003). The result was that both sides of the political spectrum portrayed themselves as being foremost in protecting the Swedish electorate from economic downturns.

When the first oil crisis hit the Swedish economy in the early 1970s, the political legacy described above made it impossible for the Social Democratic government to use constraining economic measures. Instead, caught in a “collective memory” of its own production, which suggested that the government had the necessary measures to protect the Swedish economy from unemployment, it had to abandon its fiscal conservatism and stimulate the economy through Keynesian policies. The politically interesting thing is that the center-right opposition parties criticized the Social Democrats from what would traditionally be considered the left, arguing that they should do much more to stimulate the economy and fight unemployment (Jonung 2000).

A typical result of the policy legacy described above was the 1976 electoral slogan of the Center Party, the main opposition party, to which the future prime minister, Torbjörn Fälldin, belonged. The slogan stated the need to create 400,000 new jobs, an increase of 15%. It should be mentioned that the Center Party was the former Farmer’s Party, which had made the famous “horse trade” deal with the Social Democrats in 1933. Thus, in its self-image, the Center Party had a strong role in the “myth making” about how the Swedish economy was saved in the
1930s by the government’s use of Keynesian economic policy (Rothstein 2005).

In a system in which a large part of the workforce was employed in publicly financed social services (such as day care, care for the elderly, etc.), it was politically very difficult to cut public spending, even for a center-right government, because this would have increased unemployment, at least in the short run. Such a policy would also have been politically difficult because it would have been considered a backlash against the Swedish policy of gender equality in two ways. Firstly, many women worked in the publicly financed social services, and second, these very services made it possible for women with children to work because they provided day care and care for the elderly (Lindvert 2002). Politically, it was not feasible to go against this policy, especially because one of the parties in the center-right coalition was ideologically strongly committed to it.

In addition to the problematic fiscal situation caused by the combination of tax cuts and, to some extent, increased public spending on traditional Social Democratic programs, the new center-right coalition government that came to power in 1976 had to handle a severe crisis in many of the traditional Swedish manufacturing branches, such as the steel and the shipyard industries. Instead of letting “the market work,” the center-right coalition government was trapped in a political logic by its earlier promises to increase the number of jobs and keep unemployment low. As “newcomers to power” (Garme 2001), they adopted a policy that was against their own ideals and started to subsidize failing industries on a large scale. The result was that budget deficits increased steadily during the rest of the 1970s. When a few voices started to criticize this fiscal policy, three of the most prominent academic economists in Sweden (Assar Lindbeck, Erik Lundberg, and Bertil Ohlin) in 1978 directly called on the government to continue with deficit spending (Jonung 1999).

A year later, the first debate about the budget deficit problem was initiated, leading the center-right government to launch a few cuts in public spending. However, largely because of divisions between the parties in the coalition, this did not result in dramatic cutbacks. However, some cuts had a considerable impact on the political discourse, mostly because of their symbolic character. It is noteworthy that one of the major discussions that took place between the Social Democratic and the Moderate Party during this period was about the latter’s suggestion to cut subsidies to children’s soccer-training teams, which the Social Democratic candidate for prime minister, Olof Palme, questioned (Dagens Nyheter August 22, 1982).

In 1982, the Social Democrats launched a successful electoral campaign built on a critique of these cuts in social services and the social insurance system. Back in government in 1982, the Social Democrats initiated a major devaluation of the Swedish currency (it fell 16%) to boost the
international competitiveness of Swedish industry. This policy proved to be successful, at least initially. With an economic boom during the latter half of the 1980s, Sweden had (compared to the other OECD member countries around 1990) very stable public finances—a very low level of unemployment (around 1.5%), and along with Denmark, the highest levels of taxes/public spending as a proportion of GDP (Lindvall 2003). Budget deficits had largely been dealt with by increasing taxes instead of cutting expenditures. To summarize thus far, when, for the first time in 44 years, a center-right coalition government was able to replace the Social Democrats, it did not alter—at least not to any considerable degree—the level or the structure of public spending. Instead, the welfare state in many ways expanded during 1976 to 1982 when different center-right coalition governments ruled.

The huge public debt that had accumulated during the years of center-right government can be explained by several factors. First, the dominance of Keynesian economic theory, at least until 1979, both among politicians of the center and Right, and academic economists. Although never actually used, it seems as if the ideology behind Keynesianism took a life of its own among academic economists and many policymakers. The former have, for special historical reasons, always had a strong position both in the public debate and as advisers to the government (Jonung 2000).

A second factor was the political weakness of coalition governments. Each party took charge of the ministries/sectors where it had the most interests, thus making cuts in spending difficult. The Moderate Party took charge of the Ministries of Defense and Police, the Center Party (with very strong ties to the farmers’ movement) took charge of the Ministry of Agriculture, and the Liberal Party took charge of the Ministry of Social Affairs. Moreover, in a coalition government, it seems that the authority of the minister of finance is weaker than in a one-party government. Third, these governments were caught in their own policy legacy stating that the government had the requisite measures to create and maintain full employment. Last, the two most prominent parties in the center-right coalition that took power in 1976 did not have an alternative to the universal and encompassing social insurance and social service programs that the Social Democrats had established. On the contrary, in many areas, they had been overbidding the Social Democrats in generosity with the taxpayers’ money (Jonung 1999). When it came to spending, they did not have an alternative that would have meant lower levels of spending. This institutional logic of this political system will be explained below.

In 1991, the Social Democrats were again voted out of power and replaced by a center-right coalition government. As the “Moderate” or Conservative Party had become the largest of the three bourgeois opposition parties in the period intervening since the last bourgeois government of 1976 to 1982, it could nominate the prime minister.
Consequently, the 1991 bourgeois government was, in many ways, more market oriented than the previous center-right government. The neoliberal ideology of Thatcher and Reagan had made quite an impact on the Swedish discourse during the 1980s. Most prominent academic economists had abandoned Keynesianism in favor of the monetarist economic policy launched by the so-called Chicago School, and this was certainly true of those who acted as advisers to the center-right parties when they formed their economic policy just before the 1991 election campaign. Thus, in 1991, the new center-right coalition government was much more inclined to launch a major systemic change (systemskifte) in Swedish policy, especially regarding the level of public spending, than had been the case in 1976. Its economic policies were directed at long-term structural measures to increase investment, make the system more friendly to economic entrepreneurs, cut back union power, and lower taxes and public expenditures more generally (Government Bill 2000/01: 100, bill. 5).

A year after seizing power, the new government was faced with the worst economic crisis to hit Sweden since the 1930s. The background to this crisis is a complicated story, but it is safe to say that a large part of it was because of internal factors, such as lack of control of the wage-formation process and the resultant inflation. Unemployment rose sharply and reached almost 12% in 1993, placing heavy demands on public finances through increased unemployment benefits and lower tax revenues. This level of unemployment was unprecedented in post-war Sweden and had a huge impact on the social insurance system. Thus, the pattern of 1976–1982 was repeated, and the political result was again the same: a center-right market-oriented government had to step in to bail out failing companies at the expense of the taxpayers (Garme 2001).

Another cause of the economic crisis had to do with Swedish monetary policy. To establish credibility following the many devaluations of the krona that had taken place in the 1980s, both the Social Democrats and the center-right parties had decided to make the krona a so-called “hard” currency by placing it in the European Currency Union. This was in large part a policy coming from the so-called Chicago School of economics. The idea was to create trustworthiness for the agents in the labor market so that the government would not step in and correct “irresponsible” wage increases by devaluating the currency (Lindvall 2003). What happened, however, was that this policy impressed neither the agents in the labor market nor the international financial markets. In the fall of 1992, a wave of speculation against the krona started. Other countries had experienced the same and been forced to let their currency float. However, to defend the “hard” currency policy, the Swedish government waged a very costly fight that climaxed in interest rates of 500% imposed by the Swedish Central Bank in a desperate but ultimately unsuccessful effort to defend the krona. In November 1992, the center-right govern-
ment had to give in and let the krona float on currency markets (Jonung 1999; Lindvall 2003).

The Institutional Logic of Universalism. The political implication of this defeat was that a central part of the economic policy of both the government and the Social Democratic opposition had to be abandoned. The acute crisis that had been caused by the combined effects of the costly defense of the currency, the crises in the financial system, and the rapid increase in unemployment resulted in sky-rocketing public debt. In just two years Sweden went from a very stable public financial situation with a budget surplus to having a budget deficit that made politicians and experts fear that public debt could spiral out of control. During the currency crisis, the center-right government had invited the Social Democratic opposition to be part of a political deal that would increase trust in the krona by cutting public expenditures. The price the Social Democrats asked was that the main parts of the social services system be spared, and the bulk of the cuts made in the social insurance system. Although some of these cuts were considerable, the basic universal structure of the system was left intact. As an example, unemployment and sickness insurance were cut from covering 90%–75% of the median wage. To summarize, it seems reasonable to say that whatever plans the center-right government had for changing the level of taxation and public spending, they were never implemented because of the three economic crises it was forced to confront. However, it is noteworthy that the center-right coalition government never launched a plan for a radical change that would have altered the basic universal structure of the social insurance and social service systems (Lindbom 2001). On the contrary, the Liberal Party in the coalition, in charge of the Ministry of Social Affairs, strongly defended this system. One has to ask why a center-right government never managed to challenge the high-tax-and-spend Social Democratic welfare state. This institutional logic can be described as follows. The Social Democratic welfare state was institutionalized in a way that made it politically very difficult for a center-right government to challenge its basic principles. The main logic behind this is that a great part of the center-right parties’ electorate had over the years become the beneficiary of, and to a large extent dependent on, these policies. In constructing many of their social service programs as universal, the Social Democrats had deliberately included the large middle class. The effect is that these programs have in the public discourse been considered not as merely catering to the needs of “the poor” or “the working class,” but as conferring social rights and benefits on the whole population (Rothstein 1998). For the income-maintenance programs in the social insurance system such as the Supplementary Pension scheme, the Social Democratic strategy in the 1950s was to make them favorable not only to low-income earners but especially to the middle class. In this way, the Social Democrats have been particu-
larly skilled in institutionalizing solidarity “from above” (Svensson 1994). In some areas of the welfare state, such as the day-care system, it was actually middle-class and professional families who benefited the most, because they made more use of the system than working-class families.

It is not that Swedes, or for that matter Scandinavians, are “by their nature” more inclined toward solidarity or equality than other people. Instead, the universalistic principles of the major part of the welfare system institutionalize political support for high levels of taxation (Kumlin 2004; Svallfors 1997).

In sum, there are at least two reasons why the center-right coalition governments have not been able to present a viable alternative to the high-expenditure type of Social Democratic welfare state in Sweden. First, large parts of their “traditional” electorate benefit from the programs (Korpi and Palme 1998). Second, because the programs are, for the most part, constructed in a universal way, they are not as easily attacked as, for example, the type of welfare programs that have characterized the U.S. or the British type of welfare states (Rothstein 1998). The result is that the political discourse will be very different in these countries, not because there is something peculiar about Swedes, but because the political institutions of their welfare state are different (Schmidt 2000).

Usually it is parties of the left that are thought to be in favor of Keynesianism, whereas center-right parties are thought to be fiscally conservative. If we leave rhetoric aside, the Swedish case shows that the opposite has been true when it comes to economic practice. The center-right governments of 1976–1982 and 1991–1994 created huge budget deficits, while Social Democratic governments have been fiscally conservative. Or as it was formulated by current Social Democratic prime minister, Göran Persson, in a phrase that got great attention in the public debate, “He who is in debt is not free.”

Japan

Before the 1990s, scholars and policy experts viewed Japan as a successful case of economic development and management. Its economic strength was demonstrated by outstanding growth and industrialization in the 1950s and 1960s, followed by a relatively good economic performance (i.e., low unemployment and more stable growth rates) in the 1970s. In the 1980s, the international competitiveness of its manufacturing products caused intense trade friction. In contrast to the Swedish case in which Social Democratic rule and strong labor interest representation led both to a universal welfare program and active labor-market policy, Japan has been known for conservative rule that was regarded as a full-fledged case of one-party predominance from 1955 to 1993 (Pempel 1990). Weak labor representation during the long-term conservative rule has led some to characterize the Japanese case as “corporatism without labor”
(Pempel and Tsunekawa 1979). Japan’s welfare state has remained small compared with other industrial democracies, despite labor’s apparent gains, such as wage increases and better working conditions (Kume 1998). In this regard, uninterrupted economic growth was an important factor in ensuring continued public support for the incumbent LDP, at the same time that LDP policies aimed to foster economic growth rather than social redistribution (e.g., see Inoguchi 1990; Yamamura and Yasuba 1987).

The bubble economy of the late 1980s first appeared to reaffirm the advantages of the so-called “Japanese style” of capitalism. However, the bubble burst, and the subsequent economic downturn began in 1992. This recession was first regarded as a short interruption to good economic management, similar to the one immediately after the oil shock in the early 1970s. Yet, seen in retrospect, the recession of the 1990s and beyond has had very different effects than that of the 1970s. Whereas the ability of LDP governments to manage the recession of the 1970s enhanced the reputation of the “Japanese model,” inability to manage the recession of the 1990s has called the model itself into question. International and Japanese interpretations of government and business practices changed over the course of the 1990s: some practices that were once seen as strengths are now seen as weaknesses. Japan’s industrial structure and business practices, such as the *keiretsu* (vertical organization), seniority system, and the male breadwinner type of lifelong employment that had once been praised, are now considered to lack flexibility and prevent adjustments to new solutions. The economic downturn has made it difficult to maintain the fine balance of welfare and capitalism. The increasing unemployment rate reflects the failure to secure jobs by male breadwinners, whose incomes are critical to maintain household incomes. An increasing number of private enterprises were unable to pay employers’ social security contributions resulting from worsening business conditions and have withdrawn from the salaried workers’ pension systems. The banking system and the system of allocation of industrial funds, once praised as the reasons for flexible industrial development, have become the focus of public criticism as the number of failing financial institutions has increased.

In the context of economic stagnation, both elite and public perceptions of economic and fiscal policy have undergone a dramatic realignment. As late as 1996, the LDP policy position was one of low deficits and low taxes, whereas the political opposition supported higher deficits in order to finance consumption programs. After 1998, however, the policy positions of these parties had realigned: by the end of the decade the LDP had shifted its position to supporting higher deficits in order to stimulate the economy, whereas the opposition now criticized deficits and expressed a conditional support for tax increase that could be used to lower the deficits. Combined with the breakdown of LDP dominance and consequent shifts in the stability and partisanship of government, these shifts
in policy stances have—in stark contrast to the Swedish case—made cooperation between government and opposition to tackle both deficits and recession extremely difficult.

The following sections will detail the historical development of government instruments as well as public perceptions of deficit financing and patterns of government expenditures in Japan.

From High Growth and Low Deficits to Deficits Bonds: The Impact of the 1970s Recession. During the LDP’s period of predominance from 1955 to 1993, the opposition parties demanded more active fiscal policy and increased government spending on social programs. The LDP maintained the fiscal conservatism and this incumbent’s position went hand in hand with the Ministry of Finance (MOF). During the period of high growth when the Japanese government experienced steady increases in revenue, the governing LDP was happy to delegate the details of budget making to the powerful MOF. As long as the preferred programs and spending for their constituencies were financed, the LDP politicians had little incentive to intervene in the details of the budget. Instead, this was left to the bureaucracy in the MOF. The first oil shock and its subsequent effects in the early 1970s terminated this happy marriage of convenience between the LDP and the MOF bureaucracy. Tax revenues dropped at the same time as global economic growth slowed. The ensuing revenue shortfall required one of two solutions: either high levels of general expenditures coupled with increased tax revenues (as in Sweden) or more targeted spending that could be financed by deficit bonds. LDP government first attempted the “Swedish” solution. They fought the recession with active public spending and controlled high inflation by tightening the budget. Next, these governments moved to increase taxes to eliminate budget deficits. However, in 1979—when the Japanese economy had survived two oil shocks and boasted the best performance among industrial democracies—the government’s proposal to introduce a new value-added tax met formidable opposition from the general public, from opposition parties, and even from incumbent LDP Diet members. Consequently, from the mid-1970s to 1990, Japanese policymakers chose the second route: continued deficits funded by deficit bonds.

Austerity in the Early 1980s. The end of the period of high economic growth not only terminated the marriage of convenience between the LDP and the powerful MOF bureaucracy, but it also made it harder for the governing LDP to take the credit for rapidly increased public prosperity. It was no longer possible to use public spending, financed by increasing tax revenues, to achieve compromises and consensus among conflicting social interests. Instead, public opinion criticized budget deficits as wasteful of taxpayers’ money. In 1981, Prime Minister Zenko Suzuki thus advocated an austerity campaign, “a fiscal reconstruction without a tax increase” instead of the new tax that his predecessor, Masay-
oshi Ohira, had proposed. This campaign was rapidly politicized and Yasuhiro Nakasone, who followed Suzuki as prime minister in 1983, developed it as his major political agenda (see Kato 1994, ch. 3). Thus, despite having the lowest tax level of all 18 OECD member countries, the Japanese policymakers were more concerned with controlling spending pressures than with improving the revenue-raising power of the tax system.

In the event, the austerity campaign of the 1980s did not succeed in solving the problem of government deficits, but it did change the subsequent discourse and perception of the government’s budget and financial policies. Any attempt to increase taxes became politically very difficult. For example, it was not until 1989 that the consumption tax (a Japanese version of the value-added tax) was introduced, and even then at the very low rate of 3%. Although already recognizing the problem of budget deficits, strong public antipathy toward tax increases inevitably increased the policymakers’ inclination to control the size of government rather than increase taxes, and more voters came to accept the necessity of cutting public expenditures (Kato 1994, ch. 3). Both the revenue mechanism and public beliefs were thus diametrically opposed to those in Sweden: new sources of tax revenue were ruled out, and deficits were to be controlled by minimizing government expenditure.

Policy and Political Realignment in the 1990s. The 1990s started with the Japanese economy booming. An upsurge in tax revenue from the late 1980s had solved the government’s budget deficit problems. After experiencing a peak—epitomized by record-high stock prices in January 1990—the economy rapidly cooled down between February 1991 and October 1993. The Japanese government had underestimated the adverse effect of the bursting of the financial market bubble on economic growth. A close examination of both a 1992 fiscal stimulus package and new comprehensive economic measures (sogo keizai taisaku) in 1993 indicates that the Japanese government hesitated to “prime the pumps” at full speed. For example, although the economic crisis package in 1993 included the largest expenditures the government had ever implemented (18.2% of the initial general account budget that year), the major part of it had already been earmarked for the Fiscal Investment Loan Program (FILP), and could not be considered as new spending.

The year 1993 was a period of major political changes in Japan: the LDP had broken up in June and was out of power after the July general election. Subsequently, a non-LDP government was formed for the first time since 1955. It excluded only the LDP and the Communist Party, and included other parties broadly from the Left to the Right. The new prime minister, Morihiro Hosokawa, initiated urgent economic spending measures in September 1993, but the deepening recession resulted instead in an increase in public demand for tax cuts. In the coalition government, the politicians who supported deregulation and small government (e.g.,
the Japanese Renewal Party) advocated cutting taxes, and those who supported a larger role for government also welcomed a tax cut to cope with the recession. As a result, it was announced in February 1994 that a very large income tax cut was to be financed by temporary bonds.6

Serious consideration of how to eliminate the long-term gap between revenue and expenditures was thus once again avoided. However, the revenue shortfall reached dangerous levels, not only in the 1993 fiscal year budget but also in the following years. At a midnight press release in February 1993, Prime Minister Hosokawa proposed a tax increase—the introduction of the People’s Welfare Tax, in fact the consumption tax renamed and with its rate increased from 3%–7%. The proposal was immediately blocked by opposition inside the governing coalition, and the income tax cut was implemented without revenue enhancement (see Kato 1997a, 1997b). The disharmony that surfaced between those who supported a tax increase to lower deficits and those who advocated active fiscal stimulus at the expense of budget deficits eventually led to the breakup of the non-LDP governing coalition in the following April.

This incident symbolized a stalemate in fiscal policies. After the politicization of the austerity campaign in the early 1980s, the advocates of small government became enthusiastic about finding a deficit solution and tended to support a tax increase for this purpose, whereas the advocates of an active and large role for government were more lenient about deficit bonds and a tax cut. The recession increased the political pressure to cut taxes, and certainly did not improve chances for a tax increase. Thus, the best hope to restrain budget deficits was to wait for a revenue increase as a result of the (hoped-for) economic recovery from the recession.

Because of the rapid appreciation of the yen, the two 1995 fiscal year economic packages eventually almost doubled the issuance of bonds. In 1996, a sign of economic recovery—the annual growth rate of GDP recovered to 2.4% without a sign of inflation or deflation—encouraged then Prime Minister Ryutaro Hashimoto of the LDP, who had formed a cabinet in January, to tackle budget deficits. With a new mandate from the electorate in the 1996 general election, Prime Minister Hashimoto enacted a bill in 1997 to reduce the budget deficit ratio of both local and national governments to 3% of the GDP and eliminate the issuance of deficit bonds by 2003. With signs of economic recovery, the consumption tax increase was made effective in April 1997. Later that year, however, stagnant domestic consumption raised suspicions about the robustness of the Japanese economic recovery. The unhealthy condition of financial markets worsened the recession: in November there were two much-publicized bankruptcies of major financial companies, and it was obvious that the financial crisis was far from over. Only deficit bonds could finance public funds and save the deteriorating financial firms through the public Deposit Insurance Corporation. Facing a global economic downturn triggered by currency crises and stock market collapses in East Asia, the
government decided to cut the income and inheritance taxes in the supplementary budget of the 1997 fiscal year. Financing the tax cut with deficit bonds was the first sign of retreat from fiscal consolidation by Prime Minister Hashimoto. The original budget of the 1998 fiscal year, made at the end of 1997, had adhered to some requirements in the financial reform bill: general expenditures decreased for the first time in 11 years. But the upper limit on the issuance of deficit bonds was increased and reached the highest level among major industrial democracies.

In April 1998, the LDP-centered government finally abandoned the priority of fiscal consolidation. The revised bill enacted at the end of May postponed the target year for the elimination of deficit bonds from 2003 to 2005, and lifted the upper limit on social security expenditures. On April 24, the government publicized a comprehensive economic measure (sogo keizai taisaku) that included a special reduction in income tax beginning in the 1998 fiscal year, and high expenditures on public works. In the election of the House of Councillors in July 1998, the LDP failed to get the same number of seats it had had in the 1995 election. Together with the deepening recession, the disclosure in January 1998 of a collusive relationship between the MOF, the Bank of Japan, and the private sector was a severe blow to the government. Subsequently, the LDP formed a coalition with the Liberal Party whose members were defectors from the LDP and thus supported fiscal consolidation. The coalition of the two conservative parties was joined by the Komei Party in 1999. After the defection of the Liberal Party from the coalition in April 2000, the LDP, Komei Party, and the Conservative Party—a splinter party of the Liberal Party—formed a tripartite coalition.

The recession became closely intertwined with looming government deficits. The Obuchi cabinet advocated fiscal expansion, but despite economic measures and stimulus packages, instead of boosting the economy the government succeeded only in drastically increasing the accumulated amount of deficit bonds. In March 2000, the government reported that the growth rate of GDP had been 0.5% in 1999, but the unemployment rate reached a peak of 4.9% in February of that year.

The shift in the Japanese debt level was outstanding among other industrial democracies, most of which had decreased their level of debt in the 1990s. Moreover, in the 1990s Japanese annual budget deficits, combined at the local and national levels, amounted to almost 10% of the GDP. An important reason for this was the low level of taxes. In the 1990s, Japan was the only country among 18 OECD countries that consistently reduced its total tax level. The government has had to allocate expenditures with scarce financial resources and accumulated a massive debt. The LDP-centered tripartite coalition continued the fiscal expansion when Yoshiro Mori became prime minister in April 2000, and the cabinet headed by his successor, Junichiro Koizumi, has also followed the same path.

Somewhat unexpectedly, an opposition camp began criticizing the fiscal expansion of the tripartite coalition. As a result, party positions on the
issue of the accumulation of budget deficits have become muddled. For example, the Democratic Party includes members from moderate conservatives to leftists, and was expected to be no less lenient toward fiscal expansion than the LDP. But in campaigning for the general election in June 2000 the party criticized lavish spending on public works and even proposed lowering the level of minimum taxable income. Moreover, the Democratic Party leaders intentionally proposed measures for deficit solution and tried to convince the public that the party was more responsible on financial and economic management than the LDP. After a decade of struggle with recession and deficit finance, as the parties in power gradually came to favor fiscal stimulus financed by deficit bonds, the opposition parties metamorphosed from advocates of fiscal expansion to champions of fiscal consolidation. Consequently, the antipathy toward deficit financing is now more prevalent.

Increased antipathy toward deficit financing among opposition parties has three interesting characteristics. First, the opposition parties abandoned fiscal activism while the LDP accepted deficit finance during the recession. Second, criticism of deficit financing has become more pervasive as its original advocate, the MOF, has declined in influence, especially because of the administrative reforms of 1997 that aimed to increase the power of the political executive. Third, as a result, the party’s influence generally has increased in policy discourse in the context of looming budget deficits and accumulating government debt.

**Conclusion**

The combination of narrowing ideological distance among political parties and advancing globalization has been expected to cause policy convergence among industrial democracies. However, cross-national variation in social policies has significantly increased over the last three decades. In this article, we selected two diametrically different cases, Sweden and Japan. Sweden was able to overcome a severe economic and financial crisis that hit the country in 1992, and is today one of the OECD countries with the largest public sector while at the same time managing to create a budget surplus. The Social Democrats, who have been in power since 1994, have been able to combine fiscal conservatism with a continuation of comparatively high levels of taxation and public spending. Although favoring a considerably lower level of taxation, the conservative and centrist parties in Sweden have not been able to present a viable political alternative to the Social Democrats’ policy, which has a solid support base among voters. The situation in Japan is a mirror image of that in Sweden. First, since the austerity policy in the early 1980s, the accumulated public debt and budget deficits have become “common knowledge.” The governing LDP legitimately claimed itself as a defender of fiscal conservatism despite the accumulated budget deficits, and the opposition parties have since the 1980s been unable to advocate expan-
sion of public programs without deficit solutions. In the 1990s Japan’s response to a serious economic crisis was thus delayed, but facing the deepening recession, the LDP coalition government finally adopted an active fiscal orientation. To maintain high spending with institutionally weak revenue-raising power during an economic downturn resulted in the worst of both worlds—increasing budget deficits and continued spending that failed to inflate the economy. This sequence has unexpectedly fortified public antipathy toward deficit finance: the largest opposition party started to criticize the LDP coalition for “lax spending” and have even advocated revenue enhancement. In short, the institutional logic behind these two different cases is that a public policy, once implemented, changes the policy debate so that both support for the policy and opposition are defined in relation to the existing institutions.

This explanation is consistent with other recent studies that tend to regard Japan as a case of different political and economic adjustment from Sweden. In the study of the welfare state, the Japanese case has been characterized as a very different combination of a welfare state and capitalism from the Swedish approach of universalism combined with an active labor policy. In Japan, both the government and private enterprises have committed to developing a so-called “welfare mix” that provides company-based benefits (including old-age pension schemes) and high job security (i.e., working-lifelong employment) (Estevez-Abe 2002). In the “varieties of capitalism” literature (e.g., see Hall and Soskice 2001), both Sweden and Japan are typical cases of “coordinated market economies,” a model that contrasts with that of “liberal market economies.” However, how they have adjusted to politico-economic problems—such as the labor–management relationship—in different ways, resulted in a differently coordinated equilibrium (see Kume and Thelen, this volume).

While demonstrating differences between Sweden and Japan, a comparison of their financial policy orientations since the 1990s also illuminates an important parallel in the relationship of policy to partisan politics. Sweden and Japan are typical cases that characterize the opposing adjustments to government size that are consistent with the ideology of parties long in power. Influence can persist despite interruptions in rule because of the political dynamics that result from implementing a distinct policy that has fundamentally changed the scope of policy debates. The reasons for this consequence lie in the limitations of available policy options. The Japanese government has inherited only ineffective measures to inflate the economy. This point is clear if the situation is compared with that of Sweden, considering, for example, the level of female participation in the labor market. In Sweden, a high level of female participation in the labor markets goes hand in hand with a large public sector, both in employment and spending, because of the need to finance universally available high-quality day care and care for the elderly. The existence of institutionalized policies like these makes it possible to get public support for raising taxes. In contrast, the Japanese government’s small size and
lack of universal social programs has gone hand in hand with market income equality derived from stable job opportunities for the traditional system of male breadwinners (Kato 2003, 181–186, 201). Under this system, the scope for the government to boost demand is limited to a small number of options: pouring money into public works in the hope of decreasing unemployment, giving business opportunities and cutting taxes to encourage consumption.

This also illuminates the importance of an institutional logic to support the two distinct financial alternatives at the expense of the influence of partisan ideology. Big government is expected to have an affinity with Keynesian deficit finance, but the Swedish Social Democrats have chosen to avoid deficit finance to make large spending politically feasible. As a result, Social Democrats in Sweden are fiscally conservative by raising enough revenue for high spending, whereas the center-right coalition governments that ruled in 1976–1982 and 1991–1994 suffered from deficits and thus proved to be more Keynesian. In Japan, the same political logic has very different implications. Securing enough revenue to avoid deficits was considered as involving the risk of expanding the public sector, something that the conservative LDP, as well as the fiscal authority, the MOF, wanted to avoid. Restraining tax revenue during a high-growth period was embodied in the absence of the institutionalization of an effective revenue machine. However, after the high-growth period, a revenue structure with a low tax level resulted in large deficits. The limitation of ideological influence on policies is demonstrated by two unexpected cases: fiscal conservatism implemented by a notable example of a Keynesian welfare state (Sweden) and deficit finance instituted in a country long under the dominance of a conservative party (Japan).

Notes

1. In addition, a speculative boom in the real estate market ended in a sharp economic crisis that hit not only the real estate business but also the banking sector, thus causing instability in the whole credit system. The center-right government had no choice but to save the failing banks, which put heavy demands on public finances.
2. The center-right government’s main plan was that public services should be put out for competition and more private and nonprofit producers of services, such as day care and health care, should be stimulated. This is in itself an interesting question, but it has very little, if any, effect on the level of taxation of public spending because such private or semiprivate providers would be operating on public money (Blomqvist and Rothstein 2000).
3. In Swedish: “Den som står i skuld är inte fri.”
4. A postwar public finance law (in force since 1947) includes an article that severely restricts the conditions that allow the issuance of deficit bonds (the issuance of bonds requires the passage of special legislation in the Diet). This legal restraint is deeply rooted in the orientation of the MOF. It may be misleading or inaccurate to define it as fiscal conservatism. The imperative was to control budget making instead of the strict application of a balanced budget. The public finance law does not prohibit the issuance
of all bonds; there is no legal restriction on the issuance of “construction bonds,” which are defined as bonds to finance investments, such as the construction of a public transportation system, industrial development, and so on (see Kato 1994, 61–70). Deficit bonds are implicitly defined as bonds to finance already-scheduled expenditures during a revenue shortfall.

5. To cope with a restriction coming from the public finance law, the government enacted ad hoc special legislation to allow their issuance annually.

6. Temporary bonds (isunagi kokusai) added another unclear distinction in the kinds of bonds. This name implies that they were different from construction bonds, but also different from deficit bonds because they should not accumulate into chronic debt.

7. The general account is the total amount of government expenditures, except those in special accounts that the government establishes for specific purposes. The general expenditure excludes bond expenditures and local allocation taxes from the general account.

References


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The Political Frame for Negotiated Capitalism: Electoral Reform and the Politics of Crisis in Japan and Sweden

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This article examines the impact of political institutions on the strength of executive governments as well as the consequences of that strength for policymaking. It argues that both political changes and electoral reforms in Japan and Sweden have weakened the political frame for “negotiated” or “coordinated” decision making in these nations. In Sweden, however, the complete demolition of the old political frame has opened up opportunities and incentives for new modes of governance. In Japan, by contrast, reforms have buttressed rather than dismantled the old frame, impeding the transition to a new approach.

Much of the current debate on “globalization” is concerned with whether “negotiated” or “coordinated” market economies—whose main institutions were created in an era of relative autarky—can survive in a context of increasing liberalization of markets for goods, services, and capital (Berger and Dore 1996; Crouch and Streeck 1997; Hall and Soskice 2001; Streeck and Thelen 2005; Thelen 2004; Yamamura and Streeck 2003). At the heart of the notion of the coordinated market economy is the concept of a “high equilibrium trap”: some communities, industrial districts, or even nations have been able to simultaneously achieve high levels of employment and high levels of wages and job security, breaking with the predictions of neoclassical theory (Kitschelt and Streeck 2003). Although they represent opposite types of “embedded capitalism,” Japan and Sweden have long been considered to be outstanding examples of the benefits of a negotiated or consensual approach. Both achieved extremely high levels of employment and provided employees—at least in core sectors—with high levels of job and income security. The Swedish state—associated with the long political domination of the Social Democratic Party (SAP)—provided this security through a generous welfare state and expansive public sector. In Japan, where the Liberal Democratic Party (LDP) occupied this politically dominant position in the postwar period, the large corporation was the source of security, causing some commen-
tators to characterize the system as one of occupational welfare. In return for this security, unions in both nations practiced wage restraint, allowing a better trade-off between inflation and employment than that expected by economic theory—hence, the “trap.”

This article will not consider the question of whether such a trap is a local equilibrium whose economic viability rests on its relative isolation from alternative markets for various factors of production. Nor will it discuss which system—high-tax/high government expenditure in Sweden or low-tax/low government expenditure in Japan—was economically more efficient, and which one is socially more just. Instead our starting point is the observation that both systems have come under increasing pressure that has culminated in crisis. In contrast to many studies both of the emergence of negotiated economies in the postwar period, and of their viability in the face of increasing economic competition since the 1970s—both of which have focused on the social institutions that make such negotiations possible—this article will examine the role of the political framework within which social concertation takes place.

We seek to investigate the impact of recent electoral reforms on patterns of governance in Sweden and Japan. To this end, we proceed in four steps. First, we analyze the influence of political institutions on the strength, stability, and partisan identity of the executive government in both nations, both before and after the reforms. Second, we review the historical evidence regarding the link between the strength of the executive government and patterns of policymaking in the past. Third, we speculate on the implications of the changed political executive on contemporary models of governance in Japan and Sweden. Our argument is that the loss of one-party dominance has undermined the political framework for state-led negotiation in both nations. Consequently, political actors in both nations are renegotiating their strategies and structures for policy coordination: In each nation, alternatives are being sought to replace “strong-state” governance. At the same time, electoral reform has also changed the terms of political competition in each nation, such that the incentives for innovation seem to be higher in the Swedish than the Japanese political system. This helps to explain, we believe, the very different approaches to the management of crises in Sweden and Japan.

**The Impact of Electoral Reform on Executive Governments**

**One-Party Dominance**

In both Japan and Sweden, unions, employer associations, political parties, and bureaucratic agencies established a pattern of “coordinated” or “state-led” policy bargaining. By this we mean that representatives of interest groups and governments not only bargained over various policies—as is the case in any nation with pluralist interest group representation or the more concentrated neocorporatist types of interest intermediation—but
that complex package deals involving both trade-offs between various policy areas (such as economic, tax, regional, and/or social policy) and interest trade-offs over time (such as alternating benefits of occupational health and safety policies between capital and labor, or industrial investment policies between different sectors) could be made, and were upheld. Some authors have referred to these policy linkages as “tightly coupled” systems. Examples include the Swedish solidaristic wage policy—which entailed trade-offs between wage, social, employment, and monetary policies, as well as among firms with varying market positions—or Japan’s Ministry of International Trade and Industry (MITI)-led industrial growth strategy, which permitted the state to invest resources strategically, rather than according to the “watering can” principle.

Such “state-led” policy coordination, we assert, is possible only under the auspices of a “hegemon.” A hegemon is important for the establishment of a coordinated market economy or a state-led governance pattern, because a strong government of long tenure is a necessary political condition for establishing the trust amongst the social partners necessary for coordination. As Peter Gourevitch and James Shinn (2005) point out, the government must be able to make a credible commitment that promises will be kept, and this implies both that the executive government can get its policies through the legislature and that the same executive will be around for a sufficient period of time that trades can be enforced. And indeed, the coordinated policy regimes of Japan and Sweden did develop under conditions of hegemonic liberal democratic or social democratic rule (respectively) that T. J. Pempel (1990, 1998) has termed “One Party Domi-
nance.” In Japan, a member of the LDP held the position of prime minister uninterruptedly from 1955 to 1993. In Sweden, a member of the SAP held the post of prime minister uninterruptedly from 1936 to 1976; from 1946 to 1969, the same person, Tage Erlander, held this position. In both countries, executive governments were backed by large parliamentary majorities. Furthermore, peculiarities of the political institutions in these nations helped these executive governments extend their tenure well beyond a single electoral period.

According to the “veto points” model (Immergut 1990), this configuration of institutions and votes will produce executive dominance, as is shown in Figure 1. The executive government is backed by a stable parliamentary majority, and although there is a second chamber, its majority supports the government. In such a system, there are no veto points. Consequently, the most important stage of the policy process is the executive stage, and parliamentary discussions serve mainly as signaling games to constituents. In such a system, interest-group influence is virtually limited to the executive. Because groups dissatisfied with the outcome of executive-level negotiations do not have recourse to an alternate veto point, package deals become possible; a minority interest cannot threaten to torpedo a particular policy unless its particular demands are met. Government power can be used to persuade groups to stick to
complicated coordinated agreements; and because the executive can deliver on its promises, groups can trust that they will indeed be rewarded for sticking to their end of a particular policy bargain. As Fritz Scharpf (1997) argues, the “shadow of hierarchy” induces cooperation among social actors.

One important difference in the two systems that should be mentioned, however, is the somewhat lower level of party coherence in the Japanese political configuration. Whereas the extremely high level of party discipline in the Swedish SAP places cabinet power squarely in the hands of the prime minister, the Japanese factions should result in significant negotiations. These took place within the LDP’s policymaking organ, the Policy Affairs Research Council. With these splits within the political executive, the scope for administrative decision making is increased, as the veto players theory predicts (Tsebelis 2000; 2002, 36). Whereas in the Swedish executive, politicians dominated the bureaucrats; in Japan—

FIGURE 1
Veto Points and Executive Dominance

<table>
<thead>
<tr>
<th>Arenas</th>
<th>Moves</th>
<th>Results</th>
</tr>
</thead>
</table>
| Executive | 1. Does the executive government lack parliamentary majority?  
2. Is party discipline weak? | If yes, first chamber is a veto point | Political power concentrates in first chamber |
| First chamber | 1. Is the agreement of the second chamber necessary for passage of legislation?  
2. Does the majority in the second chamber differ from:  
   a) First chamber?  
   b) Government? | If yes, second chamber is a veto point | Political power concentrates in second chamber |
| Second chamber | 1. Does the majority in the second chamber differ from:  
   a) First chamber?  
   b) Government? | If yes, second chamber is not a veto point | Political power remains in first chamber or executive government |
| | | If no, second chamber is not a veto point | Political power remains in executive government  
*Japan 1955–1992  
*Sweden 1944–1969 |
although there are scholarly debates about the extent of bureaucratic dominance—the bureaucracy long enjoyed relative independence from the politicians (Christensen 2000, 22).

**Political Institutions and One-Party Dominance**

The Westminster model of government is also an example of executive dominance, as executive governments are backed by clear first-chamber (House of Commons) majorities, and the second chamber (House of Lords) can delay—but not veto—legislation. The British electoral system is an important part of this political configuration, as single-member districts (SMDs) tend to produce clear majorities. Indeed, as votes for small parties are “wasted,” SMD electoral systems are thought to encourage parties to fuse into a two-party system. As in Britain, Swedish and Japanese political institutions helped maintain the system of executive dominance. In contrast to Britain, however, executive dominance was based on one-party dominance within a multiparty system rather than on partisan alternation between government and opposition.

The strong position of these executive governments and the extremely long tenure in government of the respective dominant parties resulted from an interaction between electoral victories and political institutions in the two nations—although one must note from the outset that political strategies and political philosophy also played an important role in generating the postwar patterns of governance. The first of these institutional features was the electoral system, which united the dominant party and split the opposition. Each country based Lower House elections on medium-sized, multimember districts. In Japan, candidates ran individually (but under party labels) and were elected by single nontransferable votes (SNTV)—the least proportional of proportional representation methods, according to Arend Lijphart (1994). In Sweden, the d’Hondt method (also not extremely proportional) was used until the early 1950s, when the SAP bowed to opposition pressure, and agreed to switch to a more proportional formula (the modified St-Laguë method), as well as to slightly increase the average size of the electoral districts. Even after this change, however, the system provided an advantageous seats-to-votes ratio for the largest party, and hence, for the Social Democrats (von Sydow 1986).

Although it is simply a matter of historical luck that the SAP and LDP emerged early on as the largest parties in their respective party systems, once there, the medium-sized, multimember districts helped the parties maintain their dominant position, because the advantages of disproportional-ity for the largest party gave party adherents an incentive to remain within the party—thus counterbalancing the centrifugal effects, such as the incentive to form factions in the SNTV system—and quirks of disproportional-ity gave the opponents a disincentive for fusion. In many dis-
maintaining separate identities than if they had fused. Moreover, by maintaining separate profiles, they were able to attract a greater number of voters by covering a larger ideological space than would have been possible under a unified party label. Thus, despite these possibilities for the smaller parties to maximize their votes and seats—and in fact because of these possibilities—the dominant parties benefitted from a divided opposition. Finally, the disproportional representation of rural areas—which became more severe as these areas lost in population—happened to buttress the dominant party in each system, as Japanese rural areas voted LDP, while the Swedish North was overwhelmingly left wing.

Second, in addition to the electoral system, bicameralism in both nations aided the dominant party. Both systems were based on what Lijphart (1984, 1999) terms as “incongruent” bicameralism—that is, elections for the two chambers are held at different times and according to different formulas, such that incongruent majorities in the two chambers, and hence a veto point, is likely to arise. Nevertheless, in both systems, the second chamber served to secure the tenure of the dominant party. Because the dominant parties held relative or absolute majorities in both houses of parliament, opposition parties would need to rally two different antigovernment legislative majorities to block legislation. In order to unseat the government, as we will see, more than two electoral victories would be required.

In Sweden, the electoral method for the Upper House was extremely favorable for the SAP, and indeed, it was the absolute majority that the party enjoyed in the Upper House that made possible its 44-year tenure in government. Members of the Upper House were indirectly elected in staggered elections, with local politicians (those who had been elected to the county councils) serving as electors. This electoral method radically improved the seats-to-votes ratio (advantage ratio) of the party, simply because the slight disproportionalilty in the county council elections was then magnified as the popularly elected county councillors took part in the first chamber elections using the d’Hondt formula with extremely small numbers of voters. In addition, as only one-eighth of the chamber was elected each year, electoral swings were highly buffered. When the electoral popularity of the Social Democrats declined—as in the 1948 and 1958 elections, for example—Upper House majorities based on elections held as many as 12 years previously, helped keep the party in power. The reason for this was that although the Lower House majority traditionally served as the basis for government formation, the Upper House could veto all legislation, including yearly budgets. Thus, the Upper House—when filled with a majority for the dominant party—served as a kind of negative veto point. If the Lower House vetoed (Social Democratic) government legislation, the Upper House could veto the decision of the Lower House. Furthermore, the Upper House majority could be predicted into the future, as the electors for the Upper House were elected well in advance of the Upper House elections.
In Japan, on the other hand, the electoral method to the Upper House was less favorable to the dominant party than in Sweden, but the second chamber may have helped to stabilize LDP governments by allowing for protest votes. That is, knowing that the loss of an Upper House election will not unseat the government—especially if not all of the seats will be exchanged in any case—voters can punish their preferred government for specific policies without causing a change in government. This may reduce the pressure on governments and parliament to call for votes of confidence and early elections, for example, in the case of scandals. In any case, bicameralism meant that the LDP needed to suffer several electoral defeats in order to lose control of the government, and even then, its influence on legislation remained significant.

Electoral and Constitutional Reforms

Despite the many benefits afforded by each country’s political institutions to these dominant parties, both the SAP and the LDP agreed to change their political systems when faced with credible threats by the opposition. As was the case in the other policy areas examined in this special issue, the Swedish institutional reforms were more radical than the Japanese, and they have had more far-reaching consequences on patterns of governance. Ironically, Social Democrats agreed to these radical reforms from a position of nearly unprecedented parliamentary power, enjoying absolute majorities in both chambers of the Swedish parliament; while in Japan, it was an opposition reform coalition that passed reforms favorable to the LDP.

In Sweden, the SAP agreed in 1969 to make the electoral system extremely proportional, and to eliminate the Upper House of parliament—a long-standing demand of the Liberal Party. There seem to have been four main motivations for the party to agree to relinquish some of its institutional advantages. First, the opposition had been able to mount a credible threat to one-party dominance by forming a series of electoral alliances that improved the advantage ratios of the bourgeois parties during the 1960s. Second, the impression that the SAP was dragging its heels on constitutional reforms became—for the first time—a campaign issue in the 1966 election, such that Prime Minister Erlander pushed for a rapid conclusion of negotiations, even at the cost of making more concessions than perhaps necessary. Third, as the electoral standings of the Left and bourgeois blocs were becoming ever closer, not all members of the party elite were convinced that the electoral system and Upper House would continue to secure one-party dominance in the future. Fourth, some younger members of the party felt normative qualms about profiting from an institution as conservative and (in their eyes) undemocratic as the Upper House, and were nervous about the cost to them in votes of the Liberal constitutional reform initiative. Thus, the benefits of the old constitution seemed to be waning, there was pressure on the party not to
look like it was against reform, and it seemed prudent to enact reforms from a position of power, rather than letting the situation erode further. Nevertheless, while these considerations may seem “rational” in hindsight, there were also “irrationalities” in the constitutional process. Although the constitutional experts among the Social Democrats realized that letting go of the Upper House was against their interests, and that the combination of eliminating the Upper House and introducing an extremely proportional electoral system would weaken executive governments—which was against their constitutional principles—there was no way to express a defense of strong government in public discourse. The public became convinced of the Liberal Party’s claim that proportional representation was a fairer system, and from then on, remained staunchly convinced that proportional representation was morally superior to any electoral method that would encourage stronger parliamentary majorities and hence stronger executive governments. Confronted with these public beliefs, the SAP found no way to communicate effectively its philosophy of strong government (Immergut 2005).

In Japan, the same four factors as in Sweden were responsible for reform: a credible threat, voter interest, the waning advantages of the old system for the dominant party, and the normative qualms of the younger generation. In the Japanese case, reform proponents from within the LDP launched a credible threat by defecting from the party in 1993, and joining the opposition in forming a coalition government committed to electoral reform. Had these members of the LDP not left the party, there would not have been sufficient opposition votes for forming an opposition government or for passing the electoral reform. Second, for one of the few times in the postwar period, voters were very suddenly and very intensely interested in the issue of institutional reform, focusing in particular on the multimember electoral districts, which were blamed for a series of political scandals as well as the need for high-cost electoral campaigns. SMDs were viewed as a panacea that would clean up political campaigns, and reproduce the Westminster system with its two-party system and responsible alternation between government and opposition. Third, some LDP leaders had long been concerned about the factionalization of the LDP caused by the SNTV electoral system and were interested in converting to a plurality or SMD system. Their public arguments urged that SMDs would be needed to end “money politics” in Japan, but of course, it was apparent to all parties that as the party with most incumbents, the LDP would be best equipped to compete in SMDs. Finally, supporting the thesis of “overlapping generations,” many younger LDP politicians were concerned about the normative and political problem of remaining within what voters were increasingly coming to view as a corrupt system (Cox and Rosenbluth 1995; Kato 1998; Reed and Scheiner 2003; Soskice, Bates, and Epstein 1992).

As in Sweden, public beliefs set limits to what was politically possible. In the public discourse, reform of the electoral system became inextricably
intertwined with a party’s commitment to battle corruption. After LDP renegades made the introduction of SMDs a condition of their entry into the opposition coalition in 1993 (Sakamoto 1999), opposition reformers were squeezed between public opinion and the LDP. Thus, although the opposition’s preference for a more proportional system had blocked LDP proposals for SMDs in the past, now there was tremendous pressure to pass something quickly. Consequently, coalition leaders revived a previously rejected reform proposal, calling for a mixed system, comprised of 250 seats to be won in SMDs and 250 PR seats to be won in 11 districts (Christensen 2000; Curtis 1999; Kawato 2000; Pempel 1998; Reed 1999).

The Impact of Electoral and Constitutional Reform on One-Party Dominance

The pattern of one-party dominance changed abruptly at the same time that these electoral and constitutional reforms were introduced. Starting in 1970 in Sweden and 1993 in Japan, strong, stable, majority governments with exceedingly long tenure of one party in government were replaced with weaker, less stable, multiparty governments that oscillated in partisanship. In both cases, the hegemon was gone. To what extent did the electoral and constitutional reforms contribute to these changed political patterns? To what extent did the loss of one-party dominance lead to a crisis in governance?

As in most cases of institutional reform, changes in the context of political institutions make it difficult to evaluate the impact of institutional change. In particular, the significant loss of electoral popularity that occurred at the same time that these institutional changes were made makes it difficult to assess whether the loss of one-party dominance in these countries was a cause or a consequence of the institutional reforms. That is, starting in 1970, the SAP received on average 5% less of the vote than previously (42.8% from 1970 through 1998, compared to 47.5% from 1936 through 1968). Similarly, once the LDP defectors had left, the LDP never regained its former electoral results, averaging 36.6% of the combined Lower House vote from 1996 to 2003, compared to 49.1% from 1958 through 1990. Even in the landslide victory of 2005, the party achieved only 42.9% of the total vote.

One way to separate the effects of electoral system reform from changes in electoral popularity is to examine the advantage ratios for the various parties both before and after reform. This allows one to argue counterfactually, holding votes constant, and examine the impact of the electoral reforms alone. As Tables 1 and 2 indicate, electoral reform had a very different impact in Japan than in Sweden. In Japan, where only the electoral system was changed, the immediate impact was a decrease in the proportionality of the system, and hence an improvement in the advantage ratios of the LDP, from 1.15 to 1.36 (1.43 in 2005); for the single-member seats, the party’s advantage ratio was as high as 1.43.¹ Our calculations
## TABLE 1
Advantage Ratios in Japan before and after the Electoral Reform

<table>
<thead>
<tr>
<th>Party/Coalition</th>
<th>Lower House</th>
<th>Upper House</th>
<th>Both</th>
<th>Upper House PR</th>
<th>Upper House CS</th>
<th>Lower House</th>
<th>Upper House</th>
<th>Both</th>
<th>Upper House PR</th>
<th>Upper House CS</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>LDP</strong></td>
<td>1.15</td>
<td>1.236</td>
<td>1.02</td>
<td>1.38</td>
<td></td>
<td>1.36</td>
<td>1.10</td>
<td>1.43</td>
<td>1.304</td>
<td>1.08</td>
</tr>
<tr>
<td><strong>JCP</strong></td>
<td>.42</td>
<td>.539</td>
<td>1.08</td>
<td>.26</td>
<td></td>
<td>.32</td>
<td>.81</td>
<td>.01</td>
<td>.566</td>
<td>1.07</td>
</tr>
<tr>
<td><strong>JSP</strong></td>
<td>.70</td>
<td>1.003</td>
<td>1.09</td>
<td>.86</td>
<td></td>
<td>.51</td>
<td>.75</td>
<td>.33</td>
<td>.625</td>
<td>.95</td>
</tr>
<tr>
<td><strong>DSP</strong></td>
<td>.78</td>
<td>.708</td>
<td>1.06</td>
<td>.44</td>
<td></td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>Komei (to)</td>
<td>1.00</td>
<td>.974</td>
<td>1.2</td>
<td>.85</td>
<td></td>
<td>.87</td>
<td>.98</td>
<td>1.67</td>
<td>.928</td>
<td>1.07</td>
</tr>
<tr>
<td>Liberal League</td>
<td>2.536</td>
<td>—</td>
<td>—</td>
<td>2.13</td>
<td></td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>Sakigake</td>
<td>.95</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td></td>
<td>.34</td>
<td>.96</td>
<td>.52</td>
<td>.779</td>
<td>1.12</td>
</tr>
<tr>
<td><strong>JNP</strong></td>
<td>.84</td>
<td>.787</td>
<td>2.61</td>
<td>—</td>
<td></td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>Democratic Party</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td></td>
<td>.89</td>
<td>1.11</td>
<td>.73</td>
<td>1.145</td>
<td>1.06</td>
</tr>
<tr>
<td>New Frontier</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td></td>
<td>1.11</td>
<td>1.07</td>
<td>1.14</td>
<td>1.111</td>
<td>1.17</td>
</tr>
<tr>
<td>Liberal Party</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td></td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>1.05</td>
<td>—</td>
</tr>
<tr>
<td>Liberal Club</td>
<td>.63</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td></td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>New Liberal Club</td>
<td>—</td>
<td>.494</td>
<td>.52</td>
<td>.52</td>
<td></td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>Japan Renewal Party</td>
<td>1.07</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td></td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>NCP</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td></td>
<td>1.25</td>
<td>—</td>
<td>1.00</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>National New Party</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td></td>
<td>.70</td>
<td>.64</td>
<td>1.05</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>New Party Japan</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td></td>
<td>.16</td>
<td>.23</td>
<td>.00</td>
<td>—</td>
<td>—</td>
</tr>
</tbody>
</table>


LDP, Liberal Democratic Party; JCP, Japan Communist Party; JSP, Japan Socialist Party; DSP, Democratic Socialist Party; JNP, Japan New Party; NCP, New Conservative Party; PR, Proportional Representation; CS, Constituency System; SM, Single Member.

aFrom 1960 to 1993.

bSince 1967; not in the elections of 1996.

cFrom 1993 to 1996.

bIn the elections of 1993.

cSince the elections in 1996.

bOnly in the elections of 1996.

dFrom 1976 to 1986.

bIn the elections of 1993.

dIn the elections of 2003.

bIn the election of 2005.

dIn the elections of 2005.
show, for example, that the LDP’s Lower House electoral result of 1996, which netted the LDP 47.8% of the seats, would have resulted in approximately 41.1% of the seats under the old rules. For 2005, the difference is 61.7% (new rules) versus 49.4% (old rules). Thus, the new electoral system is responsible for the LDP’s absolute majority in 2005. In addition, if one compares the electoral results in the single-member districts to those in the PR districts, one sees evidence of a strategic effect of the electoral reform: on average, the LDP polled 41.2% of the votes in the single-member districts, but only 32% in the PR districts. For 2005, the difference is 47.8% versus 38%.

The Japanese electoral reform thus had mixed effects on Japan’s prospects for policy reform. The new electoral system, it had been hoped, was to move Japan toward a two-party system with high party discipline and eliminate the role of party factions—and hence dependence on campaign finance from special interests. And indeed, after several elections with a large number of parties running for office and some unstable coalition governments, the party system does seem to be moving in the direction of a two-party system. Further, Gary Cox, Frances Rosenbluth, and Michael Thies (1990) find that the factional membership has dramatically decreased after the reform.

On the other hand, however, the the SMD system benefits the LDP and has helped the party hold on to power. In addition, the SMDs and the large increase in the number of electoral districts (from 47 to 300), and hence, the large reduction in the territorial size of the constituencies increases the possibilities for strategic placement of candidates, as well as

### TABLE 2

**Advantage Ratios in Sweden before and after the Electoral Reform**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Lower House</td>
<td>Upper House</td>
</tr>
<tr>
<td>SAP</td>
<td>1.04</td>
<td>1.13</td>
</tr>
<tr>
<td>M</td>
<td>1.00</td>
<td>.98</td>
</tr>
<tr>
<td>C</td>
<td>1.06</td>
<td>1.17</td>
</tr>
<tr>
<td>F</td>
<td>1.01</td>
<td>.91</td>
</tr>
<tr>
<td>VPK</td>
<td>.55</td>
<td>.33</td>
</tr>
<tr>
<td>Greens</td>
<td></td>
<td>.31</td>
</tr>
<tr>
<td>KdS</td>
<td></td>
<td></td>
</tr>
<tr>
<td>NyD</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


SAP, Social Democratic; M, Conservative/Moderates; C, Agrarian/Center; F, Liberal/Folk; VPK, Communist/Left; KdS, Christian Democrats; NyD, New Democracy.
their responsiveness to local interests. In the 2005 campaign, these various tendencies came to a head: LDP renegades opposed to the postbank reform for reasons of local patronage were confronted by Prime Minister Junichiro Koizumi’s efforts to centralize LDP party leadership in order to follow a reform course. In the event, Koizumi was able to marshal high levels of voter support, but also used the weapon of strategic placement of “assassin” candidates (as they have been referred to in the media) in the electoral districts of recalcitrant LDP defectors. Although the SMDs made this latest strategy possible, their general tendency is not to promote party discipline (as we observe in the United States). To the extent that LDP centralization and party discipline in Japan have increased, this is owing to the actions and personal charisma of Prime Minister Koizumi, and not to the change in electoral system. It is thus an open question of how these trends will develop if Koizumi steps down in a year, as planned, or even if he can maintain the political pressure on legislators to vote with the government.

In sum, the Japanese electoral reform—by reducing the proportionality of the system, the incentives for party discipline, and the size of the electoral districts—did not eliminate the candidate centeredness of Japanese politics, and may even have increased ties between candidates and their local constituents. While it was hoped that the SMDs would reduce the dependence of politicians on campaign financing, SMDs are perfectly compatible with the personal vote or expensive campaigns. In fact, while SMDs are thought to favor two-party systems, it is the PR systems that should favor party discipline and programmatic politics, while SMDs create incentives for distributive politics and patronage (Persson and Tabellini 2003; Shefter 1977). And indeed, in Japan, it is the local and not the national branches of the LDP that are most involved in allocating candidates to the new districts, and these decisions are based on local popularity. Consequently, the need for expensive campaigns and koenkai (candidate support organizations) has not necessarily been reduced, and as a local constituency protects candidates against party discipline, party coherence need not increase. Thus, while the SMDs were associated in Japanese public discourse with clean government and the Westminster system, the final result may resemble the United States more than Britain. At the same time, these trends have been counterbalanced by the strong leadership and personal charisma of Prime Minister Koizumi.

The Swedish reform was more radical than the Japanese, as it eliminated the Upper House of parliament and made the electoral system nearly fully proportional. The immediate result of the new system was a large reduction in government majorities, and greater swings in parliamentary majorities. Increased proportionality made it harder for the largest party to obtain a majority of seats; the loss of the Upper House made it easier to effect a change in government. The overall advantage ratio of the SAP was reduced from 1.08 to 1.03; the loss of the Upper House entailed a loss from 1.13 to 1.03. As the Upper House seats were based on past electoral results, it is possible to calculate the Upper House distribu-
tion of seats with high reliability for the early 1970s. This calculation shows an absolute majority for the SAP in the Upper House through 1976 and beyond (Immergut 2002). Thus, under the old constitution, the SAP’s relatively poor electoral showing in 1976 would not have affected the party’s absolute majority in the Upper House—implying full control of all legislation and budgets. Under the new constitution, however, the SAP lost control of the government for the first time since 1936, and as in Japan, was replaced by a weak coalition government. Now, in contrast to the past, small shifts in electoral support for the parties were translated into immediate changes in government. As in Japan, government duration decreased significantly after the electoral reform, while partisan oscillation increased radically.

This counterfactual analysis has shown that the seismic shifts in the political framework for negotiated capitalism in Japan and Sweden have different sources. In Japan, the main shift has been a drastic drop in electoral popularity for the LDP caused by the defection of LDP politicians to new parties, which has been complicated by changes in the electoral system. Even though factionalism has decreased, SMDs continue to provide incentives for “pork barrel” politics, and thus provide a countervailing pressure to (urban) voter pressure for innovation and reform. In Sweden, on the other hand, a small fall in electoral popularity has been dramatically magnified by constitutional and electoral change. As the Upper House no longer exists and the seats allocated to the smaller parties such as the Left and Green parties have more than doubled, the potential for SAP dominance despite the lack of a Lower House majority has disappeared. It is no longer the inevitable party of government, and its ability to override Lower House vetoes by Upper House countervetoes has been eliminated. Moreover, intense electoral competition provides strong incentives for policy innovation. Thus, through different routes, in both Japan and Sweden, the LDP and the SAP have lost their position as the inevitable parties of government, and have declined to the largest of a group of competitive parties. But the structure of political incentives differs between the two cases, affecting the ability of party elites to manage their rank and file and their strategies to outcompete as well as to negotiate with the opposition parties.

As we will argue, these changes in the political frame affect patterns of policymaking and reactions to crisis. In both countries, executive governments are no longer supported by stable parliamentary majorities in the hands of a dominant party. The LDP and the SAP are still the largest parties, and have entered into government more frequently than their competitors, but as electoral and parliamentary majorities have narrowed, they have become reliant on the support of other parties for building governments and passing legislation. Consequently, the parliament in both nations is now a veto point, and we should expect a shift in political power from the executive government to the Lower House. In moving from executive dominance to a parliamentary veto point, the pattern
of interest-group influence should change from cooperative to more conflictual as it becomes more possible for groups to pressure individual members of parliament (MPs) or parliamentary groups. Furthermore, with the loss of the long time frame provided for by one-party dominance, governance strategies based on complex package deals should become much more difficult if not impossible. As in the case of institutional reform, however, the impact of a change in the political framework on patterns of governance is difficult to assess, as the problems that executive governments must address change over time. Therefore, to provide evidence for the impact of these changes in the political frame on patterns of government, we look to the past for clues regarding the role of “strong governments” in policymaking, and then speculate about the meaning of political and institutional change for current crises of governance.

Executive Dominance and the Postwar Settlement

The Logic of the “Golden Age” Swedish Model

Discussions of the rise and possible fall of the “Swedish model” have been made difficult by the fact that there are several different meanings of the term—although all are related. The concept has been alternatively applied to mean policy outcomes (a generous welfare state, a big public sector), a type of economy (Child’s much cited “middle way”), and a mode of policy decision making and implementation—that is, a mode of governance. Here, we focus on the latter. As Sven Jochem (2003) has pointed out elsewhere, “governance” in the Swedish case actually refers to four different types and levels of social and political negotiations. First, the term connotes the well-institutionalized system of interest-group consultation used to prepare political decisions (political corporatism), which includes the formal request to interest groups to comment on government proposals known as remiss, as well as the more informal and exclusive meetings of the top levels of the trade union confederation and the employers’ confederation with representatives of the executive, which were a tradition of the 1950s and 1960s. Second, the term refers to a system of public administration achieved by staffing public boards—such as the occupational health and safety administration, or the labor market board—with representatives of the trade union confederation and employers’ confederation, and in many cases delegating policy decisions to these boards (administrative corporatism). Third, the term Swedish model was applied more narrowly to the procedures and results of bipartite negotiations between trade unions and employers, ranging from the labor peace introduced by the pact at Saltsjöbaden in 1938 and culminating in the highly centralized wage negotiations of the solidaristic wage policy in place from 1956 to the 1980s (Elvander 1988), which was embedded in the overall framework of the so called Rehn-Meidner model (Erixon 2001). And fourth, at the heart of the Swedish model was a consensus approach...
to political decision making that combined strong governments with compromises between government and opposition.

Although a leitmotiv of these aspects of the Swedish governance pattern is compromise and conciliation, none of these practices came “naturally,” nor was Swedish political culture or Swedish society conflict free. Instead, from historical origins in the late nineteenth and early twentieth century, procedures and institutions for conciliation were constructed using state power. A major milestone in Sweden was the parliamentary collaboration between the SAP and the Agrarian Party in 1933, which converted the system of rule from “minority” to “majority parliamentarism,” as Olle Nyman (1944) put it, as the party system realigned and consolidated in the wake of this coalition into a stable five-party system. The five-party system lasted until the 1980s; the farmer–labor coalition until the end of the 1950s (Esping-Andersen 1985, 87). The Red–Green crisis policy in 1933 satisfied mutual interests for the Agrarian Party (subsidies to farmers), the trade union confederation (LO)—deficit-financed job creation programs, and the employers’ association (SAF)—depreciation of the Swedish currency (Notermans 1993). The direct impact of the crisis policy was rather marginal, as the upturn of the economy and the decline of open unemployment was more influenced by the increase of demand for Swedish coal and steel from Nazi Germany. Its main value, however, was symbolic, that is, to demonstrate that the government had the (Keynesian) instruments and the political will to counteract the economic crisis, as Junko Kato and Bo Rothstein argue in this special issue.

This political watershed affected not just political parties and governments, but interest groups as well. Particularly, in the area of industrial relations, the emergence of strong government with a commitment to intervention changed the outlook of both the trade union confederation and the employers’ association. Previously, widespread tensions, some very intensive conflicts, and even violence had characterized Swedish labor relations. As early as the “December Compromise” of 1906, the labor market partners had attempted to agree on the ground rules for labor relations, calling for a pragmatic approach and freedom from government interference. But SAF, in alliance with conservative governments, nevertheless tried to combat trade unions and reduce the wage level after this compromise. This conflict escalated in the great labor market strike and lockout of 1909. In the course of this event, both main federations were weakened, and the route to centralized agreements between the SAF and LO was blocked for the time being. During the 1920s, changing minority governments could not provide the stable political frame necessary to overcome labor market conflicts—a situation that was in part aggravated by the temporary split of the Liberal Party and the difficulties of the fragmented bourgeois parties to agree on common policy goals. It was only when the SAP established majority government by entering into an alliance with the Agrarian Party in the 1930s that there was sufficient
pressure on labor market partners to enforce cooperation. The powerful position of the SAP, its alliance with the Agrarian Party after 1933, and the open threat of the government to intervene in labor relations by law changed the costs and benefits of confrontation versus compromise. Now, bipartite negotiations without government intervention were seen as the “best” solution for Swedish employers, and the Saltsjöbad agreement of 1938 marked the beginning of a lasting labor peace (Kjellberg 2000, 172–175; Steinmo 1993, 85–89).

After the World War II, SAP cemented its dominant position in Swedish politics by implementing the labor movement’s postwar program “The Twenty-Seven Points,” which established the main pillars of the Swedish welfare state. As in the case of labor legislation, many of the policy ideas were not new. National health insurance legislation had been proposed in the 1920s, when the SAP enjoyed a relative majority in the Lower House, but Conservatives had used their majority in the Upper House to set limits on the welfare state. Similar conflicts over unemployment insurance had created a governmental crisis in 1923, when the first Branting government resigned in response to the veto of the Upper House. After the 1941 election, the SAP held an absolute majority in the Lower House, and previous social democratic electoral victories had finally worked their way into the Upper House, giving the SAP an absolute majority in that chamber that held unbroken until the implementation of the constitutional reform in 1970. Now the SAP government used its majorities in both chambers to pass national health and pension insurance, family and housing allowances, and worker safety legislation. Although the party had the parliamentary seats to pass these programs for social provision unilaterally, all of these laws were prepared by thorough expert committee investigations and debate in the parliamentary standing committees, in which the opposition was equally represented. Indeed, important compromises were made—for example, when the initial expert committee report for a salaried medical practice provoked vociferous resistance from the medical profession, it was laid on ice. Nevertheless, even when the opposition joined the SAP in passing these new social rights, there was a feeling that they had no choice but to agree. Nils Stjernquist (1966, 141) points out that the opposition parties were placed in a position of “permanent opposition,” which left them trying to fulfill two contradictory roles, by “trying to criticize the government in order to replace it and at the same time collaborate with it in order to participate in the decision-making process.”

Consequently, it was at this time that the Liberals began to promote constitutional reform, arguing that if the possibilities for popular referenda were increased, it would be easier to mobilize opposition to specific social democratic policies. When the SAP began to turn to more invasive economic planning, the opposition mounted an aggressive ideological campaign in the 1948 election. Business groups were very eager to see the bourgeois opposition topple the Red–Green coalition, and mobilized both
economic experts and groups such as the Taxpayers’ Alliance against SAP policies. Although this campaign allowed the Liberal Party to double its voter share, the reward in terms of seats was very sparse owing to the braking effect of the Upper House as well as the disproportionalities in the electoral rules. Consequently, the Liberals made constitutional reform a central plank in their program, and they worked for the next 20 years to make the electoral system more proportional and to eliminate the Upper House entirely. At the same time, as Social Democratic rule began to be seen as permanent, business groups—like the parliamentary opposition—took on a more conciliatory stance.

Disputes over the introduction of an earnings-related supplementary pension pillar (ATP) ended the cooperation between SAP and the Agrarian Party in 1959. Since the introduction of the universal pension scheme, an upgrade in pension provision was frequently debated in parliament. At the time, SAF and the bourgeois parties were against the introduction of a compulsory superannuated pension scheme. The Agrarian Party preferred an expansion of the universal pension scheme. This, however, was rejected by LO and SAP. The conflicts over the ATP reform illustrate the role of the Upper House in maintaining one-party dominance. Although the SAP did not hold a majority of the votes in the Lower House, through its Upper House majority—which would be maintained into the foreseeable future through the specific electoral method—the SAP had the power to veto any reforms put forward by the nonsocialist parties in the Lower House for years to come. Hence, after a referendum on the pension issue (that could not decide the issue) and new elections (that did not change significantly the power relations in the Lower House, and did not affect the Upper House in any way), a single member of the Liberal Party backed the reform proposal of the SAP in the Lower House, explicitly stating that he preferred a reform under the auspices of the SAP to no reform at all (Heclo 1974, 426; Jochem 2003).

This reform can be seen as the starting signal for the further expansion of the Swedish model. As the bourgeois parties had to recognize, the SAP had successfully changed its programmatic profile and transformed itself into a catch-all party that attracted even the white-collar electorate (Svensson 1994). Partly as a reaction to the bourgeois defeat on the ATP issue, the parties in the middle of the Swedish party system tried to enhance their social policy profile. The Center Party (the former Agrarian Party) and the Liberal Party accepted the Social Democratic dominance in social security issues and transformed themselves gradually to parties in favor of encompassing social security. Only the Conservative Party (Moderaterna) opposed the social democratic “image of society,” as Francis Castles (1978) calls it, which in turn led to its programmatic and political isolation in Swedish politics until the late 1970s.

Despite the historic compromise in Saltsjöbaden, the move toward centralized negotiations between labor and capital under the conditions of unchallenged social democratic hegemony was not self-evident. With
the abolition of the wartime regulations for wage bargaining, pay talks were conducted again on a sectoral level. Especially the wage round 1950–1951 resulted in significant wage increases and provided an inflationary stimulus. The government tried to convince both partners to contain wage increases and inflation, or otherwise the government would be forced “to take drastic action” (DeGeer 1992, 95). In response, the LO prepared its “Full Employment Program” of 1951, which opened up the way for the Rehn–Meidner model of economic policy, which combined wage moderation, active labor-market policy and the regulation of profits (Erixon 2001). But nevertheless, the SAF and the Social Democratic government had to push the trade unions toward centralized bargaining after 1956 (Swenson 1991). Crucial for this renewed centralized cooperation between labor and capital was the implicit accord between both wings of the labor movement—and the trust on both sides—that moderate wage bargaining patterns would be complemented by active labor-market policies, generous social policies, and the regulation of profits. Under the auspices of stable Social Democratic governments and the powerful (negative) veto point the SAP occupied in the Upper House, LO could trust in the long-term fulfillment of this implicit political exchange, while the SAF accepted the dominant position of the SAP in party politics as virtually inevitable.

During the 1960s, new challenges undermined centralized wage bargaining and the collaboration between the centralized organizations of labor and capital in Sweden. First, white-collar trade union associations (TCO, SACO) expanded and reduced the importance of the blue-collar trade union federation (LO). Second, with the expansion of social public sector services, the state as employer became more and more important, and the divide between private and public wage bargaining created new tensions. Nevertheless, until the end of the 1960s, when wild cat strikes began to signal the “end of the Swedish model,” wage bargaining was quite successful in moderating wage increases and containing inflation (Steinmo 2000).

The Logic of the “Golden Age” Japanese Model

From the perspective of the Swedish model, several similarities and differences to the Japanese “Golden Age” stand out. By introducing many policies that favored labor, the Swedish Social Democratic “hegemon” had forged a climate of cooperation. Employers were induced to cooperate, because under conditions of Social Democratic hegemony, high taxes and generous social policies were unavoidable, but compensated for by wage restraint and plentiful investment capital, as well as low corporate taxes. Unions, securing that pacta sunt servanda, reduced their strike rates, moderated wages in the highly profitable export sector, and agreed to high levels of managerial autonomy within firms, as well as various microconcessions at the firm level, such as agreeing to introduce “engi-
neered” solutions to occupational health and safety problems first when new machinery was purchased and to rely in the interim on protective equipment to be worn by workers (Kelman 1981). In addition, unions trusted that the high benefits of unemployment insurance and the active labor market policy would protect their members sufficiently in times of unemployment such that relatively liberal employment protections could be accepted. Thus, under the aegis of the Social Democratic “hegemon,” that is, in the “shadow of hierarchy” (Scharpf 1997), voluntary agreements produced many positive sum gains for business and labor—or more, accurately, for specific sectors of business and labor—in the “Golden Age.”

By contrast, the policies of the Liberal Democratic “vote-gathering wonder” (Pempel 1998, 65) were more favorable to business and agriculture than to labor, and indeed, the Japanese pattern of governance has been termed “corporatism without labor” (Pempel and Tsunekawa 1979)—although the term is not without its critics (Kume 1998). Taxes were kept low, and the welfare state slim. Nevertheless, as in Sweden, although the Japanese labor movement was strike prone and ideological, labor peace was eventually achieved, as conflict proved ineffective. Moreover, whereas the “social wage” was low, the “core” labor force was rewarded with employment security, seniority pay, wage bonuses, and “occupational welfare,” as well as the containment of open unemployment. Like the SAP, the LDP overcame the erosion of its traditional base through a catch-all strategy of promoting a doubling of the national income in the 10 years between 1960 and 1970. This “income doubling” was known as a “policy with no losers” (Kume 2000; Pempel 1998, 109). Thus, as in Sweden, hegemonic power was used to create a positive sum game.

Especially in the late 1960s and during the economic turmoil of the 1970s, the LDP installed some informal consultative forums to intensify cross-class negotiations, such as the Industry–Labor Roundtable (Sanrōkon) (Schwartz 1998, 35–40). These quasi-corporatist relations between the state and some selected interest groups in the policy process were supplemented by a concerted wage-bargaining strategy called shunto or “spring offensive.” Arranged in 1955 to overcome the weaknesses of enterprise unionism, the shunto places wage struggles across industries at one time in the year. In fact, this concertation strategy enabled the pattern-setting industry, mainly the steel and metal industry in the Golden Age, to set the frame for the whole economy. As a result, wage growth was comparatively low after the introduction of the shunto. Additionally, this moderate wage growth enabled the big firms in Japan to introduce seniority wages, or the principle of lifetime employment, in order to recruit highly educated labor under the framework of tight labor markets (Thelen and Kume 2003, 2006). The shunto cooperation as a way to control wage competition could also enable flexible wage adjustments in “hard times,” for example, in the case of the shunto round of 1975, in
which wage levels were rapidly adjusted downward. This flexible (downward) wage-adjustment pattern was in Japan even more pronounced than in the United States until the early 1990s (OECD 1996, 114).

Under the industrial policy of “embedded mercantilism,” the Japanese state injected capital and government research selectively to modernize specific sectors. At the same time, side payments—in the form of protectionism, agricultural subsidies, and regional policies—shared the wealth with the potential losers of modernization. The Japanese economy has been called a “mixture of pygmies and giants” (Pempel 1991, 419). The change from a rural economy into one of the most industrialized countries of the Organisation for Economic Co-operation and Development (OECD) took off in the 1960s when, in close cooperation with business, the government initiated an encompassing restructuring of the economy. Beginning with encouragement for firms in the shipbuilding, coal, and electric power industries to merge, the government further initiated far-reaching restructuring processes in the manufacturing and information technology (IT) industries. This “merger mania” (Pempel 1998, 54) was possible because of the close relationships between the LDP, the executive bureaucracy, and big business. Channeling scarce capital into preferred industries did accomplish the modernization of the economy, and at the same time it rested on and in fact reinforced the networks between LDP and big business, or “reciprocal consent,” as Richard J. Samuels (1987) argues.

Close relationships could be fostered given the stability of the partisan identity of successive executive governments, which gave the government—and especially the executive administration—the inside information to make such investments (as stressed in the “varieties of capitalism” literature). Periodic corruption scandals indicate that at times these business–government relationships became too close, but during the “Golden Age,” the “pygmies” profited through the closure of domestic markets against international competitors, while the “giants” entered international markets for goods and services with the help of specific subsidies provided by the government (Pempel 1998, 50). At the same time, the LDP protected its electoral base using policies aimed at the less productive domestic producers—small business and agriculture (Cox and Thies 1998, 2000; Ramseyer and Rosenbluth 1993; Schwartz 1998, 34).

The Politics of Crisis

The Crisis of the 1970s

Sweden. The new Swedish constitution had a dramatic impact on the rules of the game of Swedish politics. Government strength and stability were reduced to a very great extent. With the introduction of nearly full proportionality, the intensity of political competition increased and parliamentary majorities became precarious (Steinmo 1993, 121–122). With
the loss of the Upper House, the SAP lost its negative veto point, and thus its dominance over public policies and its hold on government. Consequently, power shifted from the executive to the parliament, and the government could no longer place the same pressure for cooperation on either the opposition or interest groups. At the same time that the tools for strong-state governance and policy coordination had been severely weakened, the Swedish political economy was hit by the external shocks of the first and second oil crises.

From 1970 to 1976, the SAP retained control of the government, but with smaller majorities than previously, no Upper House veto power or control of budgets through the united parliament, and with its previously “silent” partner, the Communist Party, having now doubled in size. From 1973 to 1976, each political bloc controlled exactly 50% of the votes, leading to talk of the “Balance-of-Power Parliament” and the “Lottery Parliament,” as some political decisions had to be settled by drawing a lot in parliament. Although the Social Democratic minority government of Sven–Olof Palme attempted to overcome the political stalemate through negotiations with the Liberal and Center parties, for example in the Haga talks of 1974–1975, the main reaction of all of the parties to the increased political competition was to radicalize and reinforce the basic Left-Right ideological cleavage in Swedish politics. The highly divisive SAP proposal for wage earner funds was part of a political strategy of outcompeting the opposition by taking a decisive next step toward economic equality. Whereas in earlier periods the SAP had placed the labor unions under pressure to compromise, now the party was driven to produce policies to the left of the unions.

Other social policy and equality policy expansions of this time were the introduction of partial pensions, and legislation for worker codetermination. Later, over the course of the 1970s and 1980s, the tremendous expansion of family policy and public sector employment for women can be viewed as the result of electoral outbidding amongst the parties to court women’s votes. In contrast to the waves of social policy expansion of the 1940s and 1960s, the initiatives of the 1970s lacked fiscal backing, and brought no positive trade-offs in terms of wage restraint. To the contrary, unions and employers association were less willing to work out package deals, and even when they did, they were undermined by wage drift (Jochem 2003). In comparison to the previous period, then, interest-group attitudes had switched from cooperative to militant.

The governance capacity of the executive declined even further when the leftward move of the SAP cost the party the 1976 election, and one-party governance was replaced with a series of nonsocialist coalition governments. The four bourgeois governments of the next six years were characterized by internal conflicts and the increased importance of the Conservative Party in Swedish politics. The issue of nuclear power plants as well as the issue of an adequate economic crisis policy to counteract the economic turmoil dominated this period. Under conditions of extreme
electoral competition, the bourgeois parties were afraid to cut social spending, instead trying to give the welfare state a bourgeois flavor through policies such as opening up private practice opportunities for doctors, thereby increasing health-care costs. They did, however, introduce a waiting day for sickness pay, which turned out to be a red flag for the unions. As Kato and Rothstein (2006) point out, the bourgeois government even intensified Keynesian deficit spending and the expansion of active labor-market measures. Subsidies to failing industries were increased substantially as well. Instead, the only significant modification of social democratic policy was the reduction of taxes. Consequently, public debt skyrocketed. Not surprisingly, government efforts to control escalating wage costs also failed miserably, and the peaceful moderation of the Saltsjöbaden accords came to an end in 1980 with the first general strike since the 1920s. As the Liberal and Center parties finally compromised with the SAP on a tax reform in 1981, the Conservative Party withdrew its support for cooperation in the bourgeois bloc.

With its victory in the election in 1982, the SAP returned to power, forming a minority government with the support of the Communist Party. It immediately reversed some bourgeois policies, such as the waiting days for sickness pay and private medical practice. However, as a result of the new electoral formula, the Communist Party now had twice as many seats as previously, and the SAP was in a much weaker position, lacking the Upper House and holding a more precarious relative majority in the Lower House. As the Communist Party tried to exploit its privileged position as the pivot for Social Democratic government, the tensions between both parties increased. Additionally, the SAP itself became more fragmented as the party was split between a traditional wing that sought to compromise with the LO and a reformist wing that was represented by the minister of finance, Kjell-Olof Feldt. Social Democratic policymaking now lost a great deal of coherence, with left-wing social policy expansions and “right-wing” promotion of tax cuts, banking deregulation, and other measures to liberalize the economy. In order to achieve the quiescence and cooperation of the LO in economic policymaking, the government implemented the highly contested wage-earner funds—despite intense criticism from within the SAP (Feldt 1991).

The emergence of partisan alternation of government changed the political costs and benefits to interest groups. Business could hope for a change in government as an alternative to compromise with Social Democratic policies, and with the radicalization of the Left, could no longer trust the Social Democrats to pursue consistent and stable pro-business policies. Labor, subject to increased interunion rivalries in any case, could not be sure that wage restraint and patience would be rewarded, given the shorter terms of governments and oscillations in partisanship. Consequently, not able to marshal the credible commitments to labor or the threatening posture to employers, the SAP turned to currency devaluation in place of its earlier, more ambitious package deals of wage restraint
coupled with social wage rewards. In the first years after the 16% devaluation of the Swedish krona in 1982, wage bargaining could indeed defend the comparative advantage of this devaluation strategy. But after the break-off of the trade unions and employers’ association in the export-oriented manufacturing industries from centralized wage bargaining in 1983, wage rivalries between different sectors spread again over the labor market and large wage increases fueled inflationary tendencies. In contrast to the contemporary bourgeois governments in the Netherlands and Denmark, the Social Democratic government in Sweden avoided open intervention into wage bargaining. The political common ground between the SAP and the Communist Party was too fragile, as was shown explicitly at the end of the 1980s. The economy was overheated (due in part to the liberalization of the domestic capital market) and, as the government tried to intervene in the highly inflationary wage-bargaining pattern with a crisis package (that contained a wage stop and even a limitation of the right to strike for trade unions), the Communist Party withdrew its support for the Social Democratic government, which in turn was forced to resign. Given the changed economic frame and the nonintervention of the government into wage bargaining, inflationary wage growth set the scene for the economic crisis of the early 1990s (Jochem 2000).

As early as 1989/1990, the Social Democratic government under Ingvar Carlsson broke with crucial pillars of the Swedish model. As national governance became ineffective, the government sought membership in the European Community and joined the Swedish currency to the ECU, as an external anchor (Notermans 1993) for the unbalanced Swedish economy. Political actors in the Swedish model thus adopted the economic goals of the institutionalized monetarism most prominently realized in the German model.

In sum, political instability and weak governments—induced by constitutional changes, the impact of intensified party competition, and precarious parliamentary majorities—made effective reforms of the Swedish model very difficult. The precarious and fragile power base of Swedish governments allowed only short-sighted and defensive reform measures in the 1970s and 1980s that actually intensified Sweden’s economic problems. In place of “hegemon-induced” conciliation and “state-led” policy coordination, one observes ideological party competition and interest-group conflict, and efforts to compensate for weak governments through ineffective devaluation policies which led, finally, to the coupling of the Swedish governance framework to the external anchor of the European Union.

Japan. In contrast to Sweden, Japan experienced the economic shocks of the 1970s while still under one-party dominance. Perhaps not surprisingly, government measures to combat the crisis of the 1970s displayed more coherence than in Sweden. The strong executive leadership neces-
sary for coordinated policymaking had not been lost, but in fact emerged from the crisis of the 1970s with new strength. In contrast to the unraveling of the solidaristic wage policy in Sweden, tripartite bargaining in Japan allowed unions to exchange wage restraint for job security and retraining programs on the part of employers. The LDP government contributed to both sides, providing financial support for training and restructuring, as well as giving firms tax breaks and imposing policies to check inflation. Pempel (1998, 186) states that

[T]his arrangement quickly stemmed wage-price inflation and enabled Japan to become the first industrial country to snap back from the economic shocks of the early 1970s with only a minor hiatus in its growth. Government resources, managerial concessions, and labor linkages to firms proved to be key ingredients in warding off what might have been a severe challenge to national and company export competitiveness.

Although the LDP faced a loss of electoral support during the 1970s as its rural basis continued to shrink to levels beyond what could be salvaged through gerrymandering, it was able to reach out to new voters by modernizing its program to take up issues of more concern to urban voters, such as better social security and environmental protection. As the unions moderated their ideological profiles, the rift between the LDP and the blue-collar voter narrowed, so that the LDP’s class basis broadened. As in Sweden, the narrower margin of electoral support for the dominant bloc resulted in fiscally loose policy expansion, and thus, rising deficits. However, as soon as the LDP majorities in both houses recovered in the 1980 double election, the government used its recovered executive dominance to return to austerity. LDP governments cut pension and health care programs; and introduced a controversial consumption tax (Kato and Rothstein 2006; Pempel 1998, 189–191). With continued one-party dominance, the LDP was thus more effective than the SAP or Sweden’s bourgeois nonsocialist coalition governments at steering the negotiated economy through a difficult period.

The Crisis of the 1990s

The great success of Japan executive governments in managing the crisis of the late 1970s and early 1980s turned to a disadvantage when the crisis of the 1990s broke. In both Japan and Sweden, the economic downturn of the 1970s and early 1980s was followed by economic boom and great inflation of real estate prices. These overheated economies covered up deficiencies in economic adjustments to increasing international and regional economic integration. High tax revenues allowed governments to put basic problems in the structure of public expenditures on the backburner. In Sweden, however, previous efforts to adjust to the changed international framework for economic competition and the changed constitutional framework for domestic political competition had introduced so many cracks in the Swedish model that, when the crisis of the 1990s
emerged, it was completely overhauled. In Japan, by contrast, the adjustment to the 1990s has been much more halting and ineffective.

Sweden. When the crisis of the 1990s hit Sweden, the tensions in the political and industrial relations systems had already culminated in a breakdown of the model. Shortly before the 1991 election, the Swedish Employers’ Confederation went on the offensive, announcing its “Farewell to Corporatism,” as one pamphlet termed it (Svenska Arbetsgi-vareföreningen [Swedish Employers’ Confederation], SAF 1991). Since the experiences of the general strike of 1980, the SAF had deliberated breaking with corporatist traditions in Sweden, as it viewed corporatist representation—the remiss system, administrative corporatism and centralized wage bargaining—as institutions that cemented the influence of labor in Swedish politics. With the decline of Social Democratic dominance, the SAF sought to destroy labor platforms in Swedish politics. It saw itself as a hostage in Swedish corporatism because, as it argued, even under bourgeois governments, trade unions could counteract the work of the government in corporatist agencies (Johansson 2000, 120). As a consequence, in the early 1990s (with the active encouragement of the bourgeois government elected in 1991), the SAF refused to act as a negotiation partner in wage bargaining and announced unilaterally the dissolution of administrative corporatist agencies.

In the political sphere, not only had the era of Social Democratic dominance ended, but the stable five-party system broke down as well. In 1988, the Green Party had entered the parliament with 20 seats, but with the “bombshell” election of 1991, the small parties entered Swedish politics as decisive actors in government formation and policy enactment. The Christian Democrats and New Democracy received 26 and 25 seats in the unicameral parliament, respectively, enough to shift the balance between the two blocs of the traditional parties, which were divided into 144 seats for the Moderates, Center, and Folk parties, and 154 for the Social Democrats and the Communists. Under the old constitution, neither the Christian Democrats nor the New Democracy would have held any seats whatsoever in the Upper House, and a mere 18 seats in the Lower House; that is, the Social Democrats would have maintained control of the Upper House, and the bourgeois parties would have controlled 101 seats to the Social Democrats’ and Communists’ 115 in the Lower House (Immergut 2002). As it was, the 1991 election—with the worst electoral result for the Social Democrats since 1928—shattered the party’s own confidence in the Social Democratic model of society and opened the way for radical revision.

The minority government of Carl Bildt took office in 1991 based on a four-party coalition between the “old” bourgeois parties—the Moderate, Folk, and Center Parties—as well as the Christian Democratic Party, which, despite a long history, had won its first parliamentary seat in 1985 through an electoral alliance with the Center Party. Consequently, despite
its avowed goal of breaking with the Swedish model to “turn Sweden around,” as a conservative economics report termed it (Lindbeck et al. 1994), the government had to negotiate reforms with the right-wing populist New Democracy or the SAP (cooperation with the Left Party, the former Communist Party, was not an option). Although pundits had predicted that such a heterogeneous government with insufficient parliamentary support would surely fall before the end of its mandate, the four-party government managed to hold on until the next election, and introduce some portions of its platform. The liberalization of public social services was one of the most important reforms. This not only changed the dominance of the public sector in the provision of social services, but opened the way for new political actors that entered the Swedish welfare market with their new and specific interests (Statens Offentliga Utredningar [Royal Commission Reports] (SOU) 2001, 79; Svensson 2002). Furthermore, the government was able to implement a significant reduction of transfer levels across most social security programs. And finally, the government “turned around” the unemployment scheme, as the previous Ghent system in which the unemployment funds were administrated by the trade unions was changed into an obligatory insurance under public auspices. This reform, however, was reversed immediately after the Social Democratic return to power in 1994 with the consent of the former Communists, who had changed their name to the Left Party.

The more significant reforms, however, came as a response to the economic crisis, and could be enacted only with the full cooperation of the Social Democrats. As Torsten Svensson, Masaru Mabuchi, and Ryonoshin Kamikawa (2006) have described, the bank crisis, which was so extreme as to cause a run on the currency, was dealt with quickly and decisively. As they point out, previous Social Democratic decisions to make the central bank independent of the government and allow private banks more autonomy, gave politicians scope to bail out the banks for bad loans without being blamed for political corruption. Moreover, the Social Democrats’ ambitions to use capital flows for industrial policy had already been abandoned, so that the hesitations that had stood in the way of economic liberalization and decentralization of capital markets in the late 1980s no longer impeded financial policy.

Cross-bloc cooperation was also used to enact a reform of the pension system, ranked by the World Bank as one of the most radical reforms in the world. A Social Democratic government had appointed a commission to study the long-term financing of public pensions as far back as 1984. Although pension experts agreed that reform was necessary to assure the financial health of the system and the quality of pension benefits, the Social Democrats were loath to touch their “jewel in the crown,” moving only very slowly to develop policy proposals. But with the psychological shock of being ousted from office, Social Democrats reassessed their social policy stance, and cooperated with the bourgeois government to pass a pension reform that entailed a symbolic “privatization” of pensions by
introducing an *individual accounts* portion of the public pension scheme that could be invested in private mutual funds. In addition, the pension formula became more stringent, basing benefits on all years of earnings, rather than the best 15 out of the last 30. The pension law was passed in two steps: the general law in 1994, just prior to the 1994 election; a completing law to regulate various details of implementation passed four years after the 1994 election, which had seen the Social Democrats return to power. Nevertheless, the Social Democrats did not succumb to the temptation of making electoral “hay” out of the pension reform, but in fact helped the bourgeois opposition achieve one of their (rather few) accomplishments in office, and withstood both significant trade union opposition (in particular from the white-collar unions) to the reform, and calls from the party base to retract the reform rather than completing it with further legislation in 1998 (Anderson 2001, 2004; Palme 2001; Schludi 2003). In its period of government from 1994 to 1998, the SAP continued to address the problems of Swedish social policy and high government deficits, through a combination of cutting benefits and raising taxes, thus achieving a remarkable turnaround of the deficit in a short period (Kato and Rothstein 2006) and becoming the most mobile party in Europe in terms of shifting its political profile rightward (Bergman 1995, 71–76). More recently, however, the party has shifted leftward, as has the Conservative Party, a mobility, we argue, which is related to the extreme proportionality of the electoral system.

**Japan.** Whereas Swedish political actors were pushed by the crisis of the early 1990s to complete changes in their mode of governance that had begun when the constitutional changes disrupted the older pattern, in Japan, the “political class” needed to adapt to electoral reform and economic crisis at the same time—as had been the case in Sweden in the 1970s. The LDP’s fall from government and the changed terms of political competition disrupted the predictability in policy made possible by long-term one-party dominance. Like the SAP, the LDP remains the largest party and has continued to spend more time in government than out of it. Yet the conditions of LDP government have become very different, with double majorities in the Upper and Lower Houses replaced by complex coalition agreements that have had to be sweetened by the sharing of offices (even the prize plum of prime minister) with much smaller parties.

The Japanese electoral reform aimed to clean up Japanese politics and thereby improve public policy by reducing the need for campaign spending and hence “pork barrel” politics. The result has been uncertainty regarding the direction of government policy through the elimination of one-party dominance, but significant motivation for “pork barrel” spending nonetheless. In the area of industrial policy, efforts to restructure the Japanese economy through radical deregulation have been accompanied by so many subsidies to traditional industries as to hamper an effective adaptation to the current international economy (Hiwatari 2001). The
relationship between the political executive, the executive bureaucracy (in this case the Ministry of Finance), large firms, and the banking industry has been disrupted by partisan oscillation and economic crisis, such that political and administrative leaders long failed to come to terms with the bank crisis (Svensson, Mabuchi, and Kamikawa 2006).

Political conflicts over measures to reduce the government deficit have prevented both fiscal discipline and economic stimulation. As Kato and Rothstein (2006) show, efforts to reduce the deficit through the expansion of the consumption tax have been stopped by the anti-LDP coalition, at the same time that efforts to stimulate the economy through spending have been channeled through traditional public works vehicles that do not bring the desired economic effect. Social services and family policy expansion—which might bring a larger bonus in terms of employment—have been neglected, while social policies aimed at core constituencies like pensions, have been only marginally cut and far from radically restructured. In the area of corporatist consultation of interest groups, old patterns have been disrupted without a readjustment to a newer mode of interest intermediation (Estévez-Abe 2002). Similarly, Kathleen Thelen and Ikuo Kume (2006) indicate that many features of the collective bargaining system and occupational welfare have been called into question, without a new equilibrium having emerged.

The end of one-party dominance has not caused these changes. That is, the political system has not made it less attractive for firms to offer lifetime benefits, for example. But the end of one-party dominance together with the new incentive structure of political competition has made it more difficult for executive governments to manage these changes. The hegemonic governments of the periods of rapid economic growth and industrial restructuring, as well as the economic crisis of the 1970s, could support adjustment to economic change with interventionist policies meant to encourage particular lines of development (such as mergers, various cartel arrangements, and measures to develop technological innovation) as well as “environmental” policies aimed at creating a favorable climate for economic growth (low deficits, low social expenditures, selective payoffs to nonproductive sectors). By contrast, the weak and unstable governments of the postreform era have been unable to follow a set of coherent policies for helping citizens and firms adjust to a more liberal world economy. The 2005 election may mark a turning point in these developments, but this remains to be seen.

Conclusions
In this article, we have argued that one-party dominance or hegemony goes a step beyond electoral popularity: Political-institutional configurations in Japan and Sweden allowed the largest party in each system to achieve a position of near inevitability. For a number of conjunctural and contingent reasons, it became almost impossible to dislodge these parties from
of office, and, consequently, these parties were able to play the role of “hegemon” in both interparty and interest-group bargaining. Such bargaining “in the shadow of the state” produced some positive sum gains, even for social groups that were not constituents of the dominant party. To be sure, these powerful executive governments may have taken credit for economic growth that may not have been entirely (or even mainly) caused by their policies. Yet even if the “strong state” or “state-led policy” may have been to an extent a public “myth” as Kato and Rothstein (2006) as well as Svensson, Mabuchi, and Kaikawa (2006) claim, it was a credible myth, because strong and stable governments of long tenure allowed for long-term policy commitments and complex reciprocity in dividing the costs and benefits of both government policies and economic developments.

This stable pattern was interrupted by political and institutional change in both countries. Although the popularity of these dominant parties had slowly eroded over time, one-party dominance ended with sudden death and not gradual decline. In Japan, LDP defectors broke up the party and then pushed for reforms that cemented the scission of the party, but also the constituency centeredness of Japanese politics. In Sweden, Social Democrats bowed to opposition demands, eliminating one of their most important political weapons, the Upper House. In both cases, policy visions did not adapt automatically to these changed political constellations. Instead, trial and error brought about (or are bringing about) a reequilibration of political and administrative strategies that better fit the new realities of executive power.

In Sweden, constitutional reform ended the conditions for hegemony in 1970, thus interfering with adjustments to the economic crisis. Political parties across the board continued to propose policies based on a vision of a strong state—or the strong society, “starka samhället”—even though the political basis for these policies no longer existed. Without cooperation among parties and interest groups, the result was simply budgetary expansion, ineffective policies, and an end to trust. In Japan, by contrast, the 1970s crisis was mastered under continued hegemony, and one observes effective coordinated policymaking—including the ability of the government to effect radical changes.

By the 1990s, however, Swedish political actors had adjusted to the new political parameters for policymaking. Both the loss of office and the newer, more competitive electoral system encouraged party leaders to abandon previously fixed policy stances. In Japan, by contrast, the economic crisis of the 1990s coincided with political adjustment after the electoral reform. As in Sweden, the reform undermined a condition of one-party hegemony—namely the centripetal effects of the old electoral system. But unlike Sweden, and counter to the hopes of Japanese reformers, the reform failed to eliminate incentives for distributive politics, and hence decreased rather than increased their personal motivation to pay for the costs of reform by cutting benefits to favored constituencies.
It is always tempting to look for monocausal explanations for political phenomena. But such attempts are doomed to failure in the world of politics because politics depends as much on the ways in which human beings interpret their world as on objective reality. In this article, we have tried to show how politicians’ reactions to economic crisis depend upon both their interpretations of crisis and the tools available to manage crisis. Constitutional frameworks affect the ability of executive governments to manage crisis by affecting the strength and longevity of executive government. Inducements to interest groups to cooperate and policies meant to improve the climate for business investments will be effective only to the extent that they are viewed as credible and stable. The particular sets of social, economic, and political institutions that made up the Swedish and Japanese variants of “negotiated capitalism” emerged from within stable political frameworks with strong majority governments of unusual stability and tenure. Today, citizens, politicians, and policymakers are grappling with international economic change at a time when this political framework too has undergone radical change. The rules for converting votes to seats and for setting the limits to executive power create incentives structures that affect the behavior of individual politicians. The impact of these rules is thus generally predictable. But the exact political patterns and policies that will emerge is just as much a matter of political strategy and human ingenuity as incentives, and thus properly a matter of future historical research.

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Notes

1. These results are supported also by Gallagher (1998).
2. This is merely a rough approximation based on average advantage ratios in the two periods. For a more detailed and exact statistical simulation, see Immergut (2002).
3. Some, and perhaps a significant portion, of this drop in electoral share may be caused by electoral redistricting, but this is beyond the scope of this analysis.
4. As a consequence, the number of seats was reduced in 1976 from 350 to 349.

References


Book Reviews

Review Essay

International Organizations and Institutional Change in Central and Eastern Europe


Since 1989, scholars have grappled with the challenges of analyzing institutional change in central and east Europe (CEE). They have offered important insights into the ways that different variables—socioeconomic conditions, strategic political calculations, societal mobilization, historical institutional legacies, cultural predispositions, and others—interact to preserve or transform domestic institutions. These insights have gone some way toward meeting the challenges of explaining continuity and change in a complex world region. But the terrain of CEE politics and the challenges of studying the region have become more complex as states in the region have moved toward membership in the European Union (EU) and the North Atlantic Treaty Organization (NATO). Since the mid-1990s, institutional changes in CEE have continued in tandem with the processes of international organization (IO) enlargement. Changes were particularly frequent and visible in the months and years preceding May 2004, when eight CEE states acceded to full EU membership. But how, exactly, have the processes of IO enlargement and domestic institutional change been related? How have Brussels-based inducements to change interacted with domestic pressures for stasis? Have national politicians brokered institutional compromises to negotiate between national and international pressures, or have they been forced to accept suboptimal outcomes by powerful international actors? Can these empirical questions be
answered by using concepts and models developed in other literatures? And do their answers portend a special analytical status for CEE or a pivotal place for this region in broader theories of institutional change?

Until quite recently, book-length considerations of these large and important questions have been rare. “Transitologists” have tended to focus on domestic-level variables. To them, the EU—with its postwar roots in western Europe and its 80,000-page *acquis communautaire* (the accumulated body of EU laws, decisions, and regulations)—has remained distant, daunting, and dull. Scholars in EU studies, for their part, have also failed to devote sustained theoretical attention to the domestic institutional implications of EU enlargement. They have concentrated mainly on the supply side of enlargement, trying to explain why actors in the EU-15 have been willing to endorse the enlargement project given enlargement’s limited short—and medium-term payoffs. The three books reviewed here are welcome exceptions to these trends. All three take EU domestic interactions seriously and offer major insights into the roles of international institutions in promoting domestic institutional change. They help overcome the shortfalls of existing treatments of institutional change and begin to bridge the surprisingly wide gap between the transitology and EU studies communities. While the authors do not always agree on the nature of the relationship between EU enlargement and national institutional change, they draw from and contribute to broader theories in international relations and comparative politics. Together, they provide an excellent conceptual vocabulary for understanding the nexus between international and national politics in the twenty-first century, and, while strongly rooted in the empirical details of CEE politics, speak to all scholars interested more broadly in the interfaces between international and national politics.

Frank Schimmelfennig, Ulrich Sedelmeier, and the contributors to *The Europeanization of Central and Eastern Europe* seek to explain EU influence on accession states by testing models and hypotheses adapted from international relations (IR) theory. The authors see EU enlargement as a process of “rule adoption,” in which CEE states accept institutions and policies that the EU either directly sanctions or indirectly favors. Since the mid-1990s, CEE states have become increasingly “Europeanized,” as they have adopted more and more EU-compatible rules. These rules span a wide gamut, from foundational structures like human rights protections, the rule of law, legally protected civil services, and functioning structures of subnational governance, to sector-specific structures intended to regulate the environment, occupational safety, state borders, etc. The authors are struck by the fact that in all candidate states and almost all policy sectors, the candidates have adopted (some sooner, some later; some more completely, some less completely) EU-compatible rules.

The volume’s guiding empirical question is why, exactly, the process of EU rule adoption has occurred. In their excellent first chapter, Schimmelfennig and Sedelmeier (S&S) develop three alternative models to
The first model, the external incentives model, derives from rationalist strands of IR theory. It proposes that “a government adopts EU rules if the benefits of EU rewards exceed the domestic adoption costs” (12). CEE countries adopt EU rules in order to gain preaccession assistance and (more importantly) EU membership. Rule adoption is more likely, according to the first model, when the EU attaches clear conditionality to institutional demands, when conditionality is credible (when domestic actors are convinced that the EU will deliver on promised threats and rewards), when the domestic political and economic costs of adoption are low, and when the number of domestic veto players is low. The two alternative models draw on constructivist theory. The social learning model suggests that “a government adopts EU rules if it is persuaded of the appropriateness of EU rules” (18). The persuasive power of the EU, in turn, is affected by the legitimacy of particular EU-sponsored institutions, the identification of national elites with the Union, and the domestic resonance of EU-sponsored rules. In the social learning model, elites adopt EU rules once they are persuaded by EU actors that rule adoption is the suitable thing for “a country like ours” to do. The third model, the lesson drawing model, sees rule adoption as a response by national-level actors to the perceived failures of existing domestic institutions. The lesson drawing model is not driven by elites’ craving for EU benefits or the persuasiveness of EU actors. Rather, it is driven by domestic institutional failure and a sense by national policy makers that EU-compatible institutions will promote more effective public-policy solutions: “a government adopts EU rules if it expects these rules to solve domestic policy problems” (22). The voluntary adoption of EU rules, according to this model, is more likely the greater the domestic dissatisfaction with particular institutions, the more institutionalized the relationships between national policy makers and international epistemic communities promoting EU rules, and the greater the “transferability” of EU rules.

In general, the volume hangs together well, and the contributors productively test the alternative models and their attendant hypotheses in particular national and policy contexts. Antoaneta Dimitrova, for example, tests the models across all candidate states in the case of civil service reform; Heather Grabbe does the same for free movement of workers and the rules governing the EU’s external borders. Chapters with more restricted country foci—i.e., Guido Schwellnus’s chapter on antidiscrimination and minority protection measures in Hungary, Poland, and Romania; Liliana Andonova’s chapter on environmental regulation in the Czech Republic and Poland; and Beate Sissenich’s chapter on social policy in Hungary and Poland—are both empirically rich and bear on the question of the models’ relative explanatory strength. The two chapters that fit least snugly in the volume are Adrienne Héritier’s essay on “Europeanization east” vs. “Europeanization west” (for more on this comparison, see below) and Rachel Epstein’s analysis of political contestation after rule
adoption in Poland. Both of the latter chapters are well constructed, clearly argued, and theoretically relevant. But Héritier’s chapter covers theoretical ground that might have been left to the editors in their opening and closing chapters, and Epstein’s dependent variable ( politicization/contestation of rule adoption) is slightly different (if no less interesting; again, see below) than the one examined by the other contributors.

Certain tensions exist between the empirical chapters. Yet, at the most general level, all chapters suggest that the EU has played a direct and central role in the process of CEE institutional change. In the editors’ words, “it is the main finding of th[e] volume that . . . the EU has had a tremendous impact on the Europeanization of CEE” (226). EU influence has worked predominantly, if not exclusively, through the mechanisms identified by the external incentives model. In certain countries and policy domains, external incentives, social learning, and lesson drawing have worked simultaneously or sequentially, at different historical moments. In general, CEE would be less Europeanized were it not for EU conditionality. Different elements of the external incentives model, according to the editors, prove particularly important in explaining different kinds of rule adoption. Regarding the establishment of basic democratic structures and the EU’s democratic conditionality (i.e., the stipulation that accession negotiations and membership are conditional on a country’s adoption of human rights, liberal democracy, the rule of law, and minority protection), the credibility of conditionality, and the size of adoption costs matter most. While the EU’s democratic conditionality is neither a necessary nor a sufficient cause of democratization in CEE, it has proven extremely effective in encouraging foundational institutional reforms in “reluctant democratizers” (i.e., Slovakia, Latvia, Turkey).

In the area of acquis conditionality (i.e., the EU’s stipulation that membership will not be extended until a candidate has accepted the entire acquis communautaire), the most important variable is the credibility of conditionality. If and when EU actors credibly suggest that the failure to adopt a certain rule will endanger a state’s membership prospects, then the state will adopt the rule. Domestic variables intervene to affect the timing of a state’s rule adoption, as overcoming determined domestic veto players could be difficult. But if a credible membership perspective exists and the EU convincingly suggests that the adoption of a given rule is a membership condition, domestic policy makers will eventually adopt the rule. In short, the authors suggest, social learning and lesson drawing may explain certain elements of EU rule adoption in CEE. But conditionality has been “the main driving force and the main condition of effective EU rule export in this region” (221).

Wade Jacoby, who also contributes a chapter to the S&S volume, develops an ambitious argument of his own in The Enlargement of the European Union and NATO: Ordering from the Menu in Central Europe. Jacoby’s focus—institutional “emulation”—is nearly identical to the “rule adoption” discussed in the S&S volume, even though his empirical scope is
broader. He analyzes the domestic impacts of both the EU and NATO, and he also gives sustained attention to sectors (e.g., healthcare) where emulation has occurred in the absence of IO pressures. Canvassing an impressive range of policy domains (healthcare, consumer protection, regional policy, agriculture, civilian control of the military, and military professionalization) and focusing on the Czech Republic and Hungary, Jacoby emphasizes that all institutional emulation is not the same. Emulation varies, he argues, on a number of dimensions. Elites sometimes emulate foreign institutions voluntarily; other times, they are coerced into doing so. At times, they faithfully approximate foreign institutions; at other times, they radically transform them. Occasionally, they emulate institutions in policy sectors where domestic interests are well established; at other points, they do so in sectors where interests are weak. Finally, they emulate institutions in areas where IO standards are both expansively and feebly articulated. Jacoby’s empirical task, as he presents it, is to explain the variation in the kinds of emulation in which CEE states engage and the political outcomes of the emulation process.

Jacoby insists that international and domestic factors are not alternative explanations of institutional change. Rather, they are complementary: domestic conditions help determine both the modes of emulation (e.g., the ways that CEE states emulate foreign institutions) and the outcomes of emulation (e.g., the political results of emulating foreign institutions). Discussing four different emulation modes, Jacoby shows that CEE elites have occasionally drawn from and tinkered with foreign institutions, independent of any IO compulsion. He sees this mode (dubbed “templates”) as being relatively common in the early 1990s but increasingly rare in the run-up to the IO enlargements. It operated particularly clearly in the case of healthcare policy, where lesson drawing and experimentation were common soon after the regime change. On the opposite side of the spectrum, CEE elites have faithfully adopted institutions that IOs have effectively forced upon them. This “patching” occurred, for example, in the case of consumer protection, where CEE states folded ready-made EU laws into domestic legislation in the months immediately preceding accession. The observation that emulation can happen in the presence or absence of IO pressure and with different degrees of faithfulness is welcome. Jacoby might have done more, however, to problematize the dimensions of variation. Which factors make policy makers more apt to borrow (un)faithfully? And why do IOs choose to pressure national elites in some policy areas and not in others?

Jacoby is on a more stable explanatory ground in his analysis of emulation outcomes. Emulation’s domestic political impact varies as a function of two factors: (1) IO rule density and (2) domestic actor density. Where rule and actor densities are both low (as in consumer protection policy), homesteading will occur; enterprising-but-weak domestic policy actors will try to push the policy area forward by drawing, among other resources, on the few international rules that exist. Where IO rule density
is low and actor density is high (as in healthcare), politically uncontroversial learning will occur. Where IO rule density is high and actor density is low (as in regional policy), scaffolding will occur; previously unorganized interests will coalesce around the new policy area. And where both IO rule and actor densities are high (as in agriculture), struggle will take place. Jacoby insists that variation in emulation modes and outcomes is most likely across policy sectors (rather than across countries), and that there is no direct causal relationship between modes and outcomes. The latter suggestion is questionable, though, both given the aforementioned analysis by Epstein (who effectively links a “template” to postemulation political consensus and a “patch” to postemulation political contestation) and Jacoby’s own realization that “patches” alone do not guarantee the effectuation of institutions or the internalization of foreign rules by domestic actors.

In tandem with his already-complex empirical argument, Jacoby strives to synthesize various theoretical traditions. While his research program overlaps in many ways with the S&S volume, he chooses to frame his analysis within institutionalist strands of comparative politics. According to Jacoby, the three major institutionalisms (rational choice, historical, and sociological) are faux enemies. Different elements of the three traditions can be combined to understand emulation and institutional change. Were one forced to pigeonhole Jacoby’s argument, the “rationalist” label would be most attractive. His focus on elite institutional choice and external (membership) and internal (electoral) incentives recall rational choice analysis. In fairness, though, this is the kind of facile theoretical reductionism against which Jacoby inveighs. Elite rationality, on his account, is never “pure.” Elites desire the approbation of voters and IOs, but these desires are always embedded “in the two contexts we clearly see operating in CEE: norms and history” (30). Jacoby’s careful policy-based comparisons largely substantiate such theoretical ecumenism. In the book’s penultimate chapter, he revisits case material displaying a mix of modes and outcomes, engages counterfactuals, and suggests that no single theory tradition, by itself, could predict the dynamics of emulation. In the end, many of Jacoby’s conclusions overlap with S&S’s. Both books see elite responses to IO conditionality as key motors behind CEE institutional changes. But Jacoby’s work across wider temporal and substantive domains suggests that social learning and IO persuasion are not peripheral or secondary. Rather, they are integral aspects of change that have mattered more at some moments (i.e., the early 1990s) than others (i.e., the early 2000s) and in some policy areas (i.e., health) than in others (i.e., agriculture).

In some ways, James Hughes, Gwendolyn Sasse, and Claire Gordon’s Europeanization and Regionalization is a more humble undertaking than the other two books. Instead of hopscotching policy areas and drawing systematically from established theory traditions, the authors devote sustained attention to one particular policy sector (regional policy), and then
search for broader theoretical implications of developments in this sector. They too make the case that IO demands are meaningless if they are isolated from the national contexts onto which they are projected. National legacies constrain domestic identities and strategies, and these identities and strategies affect the kinds of institutions that domestic policy makers craft in response to IO demands. More novel is the authors’ suggestion—impressively made by an analysis of EU documents and interviews with European Commission officials—that the IO side of the conditionality equation is often at least as rife with complexity and contestation as many domestic policy scenes.

They develop this argument while analyzing CEE regional reforms. In the years preceding accession, most CEE states embarked on some kind of regionalization. There was significant variation, though, in the “species” of regionalization each state chose. Poland, for example, devolved authority to newly created regional units whose borders coincided with those established for the purposes of EU regional funding. Hungary, though, gave representatives of the central state disproportionate representation in regional development bodies whose borders were drawn to include multiple, preexisting subnational units. The authors offer two explanations for this variation. The first is rooted in the domestic side of the equation. Issues of regionalization had been the subjects of debates since the earliest days of the regime transitions, and each state’s eventual institutional bargains reflected institutional legacies, constitutional provisions, and party political balances. The second explanation involves the IO side. Unlike Jacoby, who sees regional policy as an area of high rule density, Hughes, Sasse, and Gordon argue that the regional policy acquis is actually quite thin. This thinness, according to the authors, has not stopped the Commission from becoming involved in the politics of regional reform. In fact, it has facilitated its efforts to place soft pressure on CEE policy makers. At the same time, though, the vague accession criteria have made consistent benchmarking of CEE progress in preparing for EU regional policy impossible and have led to disagreements within the European Commission. In the preaccession period, different parts of the Commission sent mixed signals about what constituted sufficient progress on regional reform and adequate structures for managing regional funds. Intra-Commission politics prohibited the EU from insisting that candidates establish a particular kind of regional structure and reinforced domestically based pressures for cross-national variation.

One might be tempted to view this argument through the lens of S&S’s external incentives model: the ambiguous regional policy acquis and inconsistent signals from the Commission decreased the credibility of the EU’s conditionality and allowed more room for maneuver to domestic actors. Hughes, Sasse, and Gordon, though, take their theoretical argument in a rather different direction. Unlike S&S, who conclude that conditionality has been largely successful (226), Hughes, Sasse, and Gordon make rather the opposite conclusion. Conditionality, at least when under-
stood in an uncomplicated positivistic sense where IO demands yield uniform national institutional responses, is “mythical.” Institutional outcomes, at least in the case of CEE regionalization, “have been overwhelmingly driven by domestic factors arising out of their transitions from communism—not by EU conditionality pressures” (174). The book thus clearly suggests (1) that conditionality is a complex process rather than a discrete phenomenon and (2) that one must engage in close, cross-temporal analysis of particular policy sectors and countries to reach a robust appreciation of conditionality and its effects. Still, the boldness of the book’s subtitle and the wide range of areas in which IOs have applied conditionality raise broader questions about the effects of EU conditionality. Is conditionality more likely to be “mythical” in some policy domains or countries than in others? Might conditionality resemble the less complex, more positivist conception in policy areas where the _acquis_ is thicker than that of regional policy, where the benchmarks are clearer and the room for interpretation and maneuver are less expansive? The S&S contributors and Jacoby, for their part, suggest a resounding “yes” to the latter question. Even with regard to regionalization, one leaves this engaging book still gnawing on a major counterfactual: would the dynamics of regionalization have differed in the absence of EU conditionality? Even if the _shape_ of the institutions established had been similar, would the _timing_ of institutional adoption have remained the same? If not, is conditionality really a myth?

Together, the three books provide a strong conceptual foundation for future analyses of international pressures and national institutional responses. Concepts like rule adoption, emulation, and embedded rationality will help analysts understand pressures and responses in CEE and abroad, as will the general suggestion that conditionality is a complex, context-dependent process. At the same time, the occasional conceptual tensions between the books—manifest, for example, in Jacoby and Hughes, Sasse, and Gordon’s disagreement over whether regional policy constitutes a thick or thin _acquis_—suggest that work remains to be done in specifying the measurement of various indicators. Can we develop more finely tuned parameters to differentiate between thin and thick demands, voluntary and involuntary emulation, intense struggle and attenuated struggle, etc.?

All three books also speak to the ever-expanding literature on Europeanization. The authors seem to disagree about the relationship of their respective findings to work on Europeanization in the EU-15, but the disagreement is one more of emphasis than of substance. Héritier, Schimmelfennig and Sedelmeier, for example, tend to highlight differences between “Europeanization east” and “Europeanization west”: an invasive Commission vs. a passive Commission, weak societal veto players vs. strong societal veto players, acceptance of prefabricated EU rules vs. active involvement in the creation of EU rules, etc. Hughes, Sasse, and Gordon, on the other hand, stress a major similarity: in both CEE and the
EU-15, domestic structures mediate the effects of European integration. In fact, both similarities and differences clearly exist. In the years preceding enlargement, candidates find themselves in a qualitatively distinctive position vis-à-vis IOs, who possess more resources and leverage to push for institutional changes than they do vis-à-vis their own incumbent states. IOs' advantages, however, are never absolute, and they project demands into complex domestic political contexts that can, depending on the nature of the IO pressure and the precise balance of domestic forces, accept, obscure, obstruct, or improvise on IO demands.

A critical question for the future—and a question whose gravity all authors clearly realize—is what happens once states become full members and their relationships to IOs fall into line with those of “old” member states? What happens to the rules that have been adopted, the institutions that have been emulated, and the bargains and compromises that have been struck? S&S and their contributors suggest—in an excellent conceptual distinction that remains underdeveloped in their book—that there are different “degrees” of rule adoption. Some rules are adopted only rhetorically, some formally, and some behaviorally. The question that arises in today’s CEE, and in all countries where IOs are somehow involved in institutional change, is to what extent these institutions actually “bite,” to what extent they actually affect the identities, attitudes, and behaviors of domestic actors. This question should be asked repeatedly in the years to come.

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In Policy Learning and British Governance in the 1960s, Hugh Pemberton presents an analysis of the primary economic and industrial planning reforms embarked on by the Conservative and Labour governments of the 1960s. Pemberton draws the reader back to events of the late 1950s and early 1960s. His intention is to establish the mind-set of British policy makers facing what many considered to be a national economic crisis following the growth years of the 1950s, when a relatively unregulated laissez-faire microeconomic policy had dominated. The book argues that because of poor economic performance and a corresponding decline in Britain’s international position during the latter part of the 1950s, the thinking behind the country’s economic paradigm underwent radical change, beginning under the Conservative government of Macmillan and continuing into Wilson’s subsequent Labour government. This rethinking led policy makers away from laissez-faire microeconomics and toward a belief in the need for active microeconomic and macroeconomic planning.
The core of Pemberton’s empirical analysis can be found in Chapters 4–6. In these chapters, he develops and applies a reconstituted policy network model (itself based on a recombination of Stuart Hall’s social learning model and R.A.W. Rhodes’ policy network model) to Britain’s decisions to adopt explicit growth targets across a range of economic-related factors (abandoned by 1968). Chapter 4 begins this discussion with an analysis of the efforts of the Macmillan government to develop an explicit industrial training policy. Pemberton depicts this as a third-order change (adopted from Hall’s idea that learning occurs on three separate planes, leading policy makers to engage in three types of orders of change in the real world), despite the fact that to varying degrees similar policies had been practiced throughout the postwar period by the Macmillan government. For Pemberton, the key to understanding why the government altered its thinking is found in alterations in the composition and thinking of the actors associated with the policy network governing British industrial training. However, presenting one of the key themes of the text, Pemberton goes on to argue that while the underlying thinking underwent third-order change, this was not translated into third-order change in the operation of industrial training. This was because of the active opposition of key individuals and groups controlling the provision and implementation of Britain’s training programs.

Chapter 5 picks up where Chapter 4 left off, discussing the Conservative government’s 1962 decision (carried forward until 1966 by Wilson’s Labour government) to implement an explicit incomes policy. As with the decision to follow a training policy, Pemberton presents this as constituting a third-order change in the thinking of treasury officials. As with the decision to intervene in industrial training, Pemberton presents the actuation of incomes policies as a failure arising from the failure of both Conservative and Labour governments to “build strong institutions able to overcome the resistance of organised networks of vested interests operating in the British labour market, or to co-opt or isolate these opponents” (14).

Chapter 6 completes Pemberton’s discussion of the failure to bring about third-order change, even in the presence of third-order change in the internal thinking of policy makers. Specifically, he argues that governments of both the Left and Right attempted to use taxation policy between 1961 and 1966 to promote growth through structural changes in investment patterns, and that this constituted third-order change in the thinking of key policy makers. However, just as with changes in industrial training and incomes policies, although considered by both Labour and Conservative governments, these ideas were never fully implemented because of the power of opposition interests operating within relevant policy networks.

The core to Pemberton’s analysis is found in Chapter 2, where he reviews Hall’s social learning model and Rhodes’ policy network model, arguing that alone, neither is capable of explaining why policy makers
altered their thinking in relation to economic and training policies, nor why they failed fundamentally to alter the course of British policy as a result of this thinking. According to Pemberton, to make up for the failures inherent in Hall’s social learning model and Rhodes’ policy network model, both should be fused into a new model, amalgamating the best elements of each. In doing so, Pemberton argues that his reconstituted policy network model is capable of demonstrating how and why “policy learning can both bring into being policy networks and affect the configuration of existing networks,” and how “these networks subsequently play an important role . . . in the translation of lessons learnt into effective policies” (9).

*Policy Learning and British Governance in the 1960s* presents a good historical analysis of events associated with British industrial and economic policy during the 1960s, and is well grounded in the work of both Hall and Rhodes. Unfortunately for Pemberton’s overall analysis, his work is not well grounded in network and social learning theory more generally. Either of these could have helped his analysis better establish cause-and-effect relationships governing the reforms of the 1960s. For instance, there is a well-established literature on social learning beyond Hall’s work, including works examining Bayesian knowledge updating; the impacts of partisan bias on the learning process; international herding and cascades; learning and new institutionalism; the isomorphic processes governing the learning processes and subsequent use of lessons within governing situations; and an advanced literature associated with international governance and the European Union. Any of these bodies of literature, particularly sociological institutionalism, would have strengthened Pemberton’s analysis, which reads as little more than a good historical analysis.

A related issue is Pemberton’s conception and use of the policy network literature. As presented in the text, Pemberton appears to argue that there were different networks associated with each of his case studies. While this is clearly true, what might have helped better explain the disjuncture between the development of third-order idea change and the lack of third-order change on the ground was not so much internal network issues, but the activities of different networks dominating the policy development and implementation processes. If different, though possibly overlapping, networks were responsible for different aspects of the policies under consideration, much of the difficulty Pemberton finds in trying to discuss what exactly was learned by the network might be overcome.

A similar problem emerges out of the use of governance (or the hollowed-out state) within Pemberton’s analysis. Pemberton uses the concept of the hollowed-out state to establish the need to use both network analysis and learning theory to elucidate the actions of these networks. While logically important for his analysis of the domestic forces and institutional structures responsible for the alteration of economic thinking
during the 1960s, a second and possibly more important explanation for the failure of domestic actors to implement the new thinking emerges from the governance literature associated with the role of the international arena. It is clear that global forces and trends occurring during the 1960s had a significant impact on European nations, particularly as the economic boom related to the rebuilding of Europe and the ending of the Marshall plan began to take effect. As such, it is likely that the international actors played a greater role in the transformations, or lack of them, than presented in Pemberton’s analysis.

Even in light of the aforementioned shortcomings, Pemberton’s analysis and scholarship has much to recommend. He has identified a new way to advance the scholarship associated with network analysis and in doing so, will hopefully initiate a new and more advanced use of the network analysis approach. As such, this book should appeal to a broad readership interested in the history of the British governing processes operating during the 1960s.

DAVID P. DOLOWITZ, University of Liverpool


The conventional wisdom in the China field is that the reforms carried out under China’s “Third Generation” leadership headed by Jiang Zemin merely consolidated Deng Xiaoping’s political and economic achievements. However, as Dali Yang’s Remaking the Chinese Leviathan reveals, Jiang Zemin, Li Peng, and Zhu Rongji did much more than consolidate Deng’s reform legacy. Indeed, had Deng-era traits such as economic decentralization, crony business empires, and uncontrolled investment persisted into the late 1990s, China would have become another Indonesia or Brazil, plagued by both rampant corruption and hyperinflation. Fortunately for China, a coterie of central government officials—helped by declining profitability in the state-owned enterprise sector, a real sense of crisis, and the Chinese Communist Party’s (CCP) continual monopoly in bureaucratic appointments—undertook the task of remaking the Chinese state for a market economy.

Yang’s volume provides the most detailed and comprehensive account of the Chinese state’s transition from an incoherent mix of rival corrupt agencies held loosely together by the CCP to an increasingly integrated central state apparatus. Remaking the Chinese Leviathan moves the China field forward by engaging in a multidimensional analysis of China’s state-building efforts over the past decade, including discussions on the state-owned enterprise reform, the fiscal system, anticorruption measures, government downsizing, market regulation, and state oversight.
Yang’s broad approach in this book makes the overall argument, that the Chinese state is better geared for market regulation (as opposed to rent seeking) today than 10 years ago, difficult to refute. Still, Yang does not take full advantage of the full array of materials he has to work with. The multidimensionality of his cases generates both cross-dimensional and overtime variations in terms of China’s move toward the ideal regulatory state.

For instance, while fiscal centralization took place as early as 1994, the main antismuggling efforts and initiatives in government downsizing did not take place until 1998. Furthermore, the divestiture of military businesses and efforts to improve oversight of senior government officials dragged on for years after 1998. What explains the variation in the speed and timing of change in the different policy areas? Professor Yang does hint at the role of the military in succession politics (115–118), but what exact role did it play? And why Deng did not crack down on military businesses after the fall of the Yang Shangkun clan in the early 1990s? In my mind, an overarching theory about elite politics in China would have clarified Yang’s cases.

Remaking the Leviathan raises both perennial and new research questions in the fields of comparative politics in general and Chinese politics in particular. In the field of comparative politics, Yang’s work once again raises questions about China’s relative economic success, despite the presence of a politicized bureaucracy and considerable corruption in the armed forces and in the police apparatus. Yang’s answer seems to be rooted in the CCP’s continual manipulation over the appointment of officials. While this argument is accepted by many, it still begets the question of why the Chinese regime has been able to retain this authority when so many other communist countries were forced to cede this power. A fuller treatment of how socialist regimes retain or lose nomenclature power would undoubtedly make a significant contribution to the larger study of comparative communist states.

Within the China field, Yang’s work raises several issues that will surely motivate forthcoming dissertations and monographs. For example, Yang hints that Premier Zhu Rongji’s effort to scale back central state ministries made it easier for him to push forward China’s entrance into the World Trade Organization as fewer industrial ministries were capable of opposing Zhu (58). Is the manipulation of administrative structure for policy or political ends a common phenomenon in Chinese politics? Harry Harding long ago observed that the Chinese state went through cycles of administrative reform whereby drastic reductions in the administration tended to be followed by a gradual buildup of the bureaucracy (Harding 1981). Why do these cycles persist in China? Again, Yang’s book only provides a partial answer; a fuller treatment of the political logic of administrative change would greatly improve our understanding of contemporary elite politics in China.
Another issue raised by the book is the link between state-owned enterprise profitability and the state’s willingness to carry out enterprise restructuring. To be sure, the argument presented by Yang is very compelling and is probably the primary explanation of enterprise restructuring in many sectors in China. However, his explanation is incomplete. For example, if profitability was the main concern among civilian and military bureaucracies, why did they pursue a policy of “grabbing the big and letting go of the small”? Some of these “big” firms were indeed big money losers, yet we find tremendous efforts on the part of the state to save these entities. The official explanations for saving these large state-owned enterprises are often rooted in arguments about economies of scale and unemployment. In my mind, cash flow concerns seem to be only one of the many factors which drove Chinese industrial policies over the past decade; the massive layoffs since the mid-1990s further reveal that the leadership was not afraid of causing massive unemployment. The full story of enterprise restructuring during the 1990s, structured by a convincing political logic, has yet to be told.

In summary, Yang’s volume is both informative and challenging. In addition to making convincing observations of the secular trend toward institutionalization within the state apparatus, Yang’s *Leviathan* also challenges us to think more about why China seems to be so successful, especially when compared with many postcommunist regimes, and why some areas of administrative and economic reform took place so much more rapidly than in others.

VICTOR SHIH, Northwestern University

**Reference**

Charles A. Levine was an outstanding scholar in the fields of public policy and administration. He played a major role in the creation and early life of both this journal and its owner, the Structure and Organization of Government Research Committee of the International Political Science Association (SOG). After his untimely death in 1988, the Editorial Board of Governance and the Executive Committee of SOG established an annual book prize in his memory.

The book selected should meet the following criteria:

1. It makes a contribution of considerable theoretical or practical significance in the field of public policy and administration.
2. It takes an explicitly comparative perspective or produces findings the implications of which are highly significant for comparative research.
3. It is written in an accessible style and form so that it is of value both to scholars and practitioners.

The Levine Prize will be awarded to the book published in 2005 that best meets these criteria. Nominations should be made by March 31, 2006, and sent to the chair of the committee. Please send a copy of the book to all three members of the committee:

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Note: Please ensure that books being nominated will reach all three members of the committee BY MARCH 31, 2006.