2007

# Greater flexibility, greater growth: A comparative study of labor and capitalist models in Japan, Germany, and the United States

Jay Arthur Thompson
*University of South Florida*

# Greater Flexibility, Greater Growth: A Comparative Study Of Labor And Capitalist Models In Japan, Germany And The United States

by

Jay Arthur Thompson

A thesis submitted in partial fulfillment
of the requirements for the degree of
Master of Arts
Department of Government and International Affairs
College of Arts and Sciences
University of South Florida

Major Professor: Dajin Peng, Ph.D.
Susan Northcutt, Ph.D.
Earl Conteh-Morgan Ph.D.

Date of Approval:
November 2, 2007

Keywords: free market, government control, unions, reunification, post world war ii economic policy, globalization, liberalism, neo-liberalism, capitalism, non-liberal

## Dedication

This thesis is dedicated to my dear wife Michelle who has shown more support, patience and love than one should have any right to ask for during this process.

## Acknowledgments

This thesis would never have been possible without the knowledge, support, patience and contributions of my advisor Dr. Dajin Peng. I also gratefully acknowledge the support and contributions of the other members of my thesis committee, Dr. Susan Northcutt and Dr. Earl Conteh-Morgan. I would like to thank Ms. Lois Henton of Pasco-Hernando Community College for her assistance in the proof reading and grammar corrections. I also thank the Department of Government and International Affairs of USF personnel for all of their work in support of the thesis, especially Ms. Doris Kearny. Finally, I thank my family and friends for the innumerable acts of assistance during this process.

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ABSTRACT

After the end of the Second World War, three major economic powers emerged. Japan in Asia, Germany in Europe, and the United States in North America, quickly became the economic engines of their respective regions. Japan, with its “catch-up” and producer centered economy, grew so fast and so large, that there were worries in America that the Japanese would end up winning the economic war. West Germany, supported by the capitalist world, became a miracle economy, and the economic power of the European Union.

In the past fifteen years however, these two economies have faltered and stagnated. In Japan, the nineteen nineties are referred to as the “lost decade”. In Germany, unemployment continued to grow throughout the decade, and in the former East Germany remained at near catastrophic levels. Much has been written about the reasons for this, referring to the quick and somewhat chaotic reunification of Germany, and the focus of the Japanese on “catching up” to the West. Yet these are not adequate explanations. The problems lie deep in the systemic level of both economies, particularly in the area of labor policies, both in formal written laws and policies prevalent in

Germany, and the informal cultural guarantees that are seen in the Japanese systems. The area of the non-liberal capitalist model, particularly the banks and capital investment also contributes to the continued economic stagnation of these two states. Comparing these to the liberal economic policies in the United States, this thesis will show that greater flexibility in both the capitalist and labor models allow for greater success in the globalized economy.

# Chapter 1

## Introduction

After the end of the Second World War and the beginning of the new global economy, three economies began to grow and then ultimately dominate the world economic system. The United States, Germany, and Japan were considered to be the economic engines of this system, with production levels to back up such claims.

Japan and Germany were devastated at the end of the Second World War, economically, politically and militarily. Yet the way they bounced back and dominated their spheres, they took on the title of "economic miracles," models of marvel for the world to emulate. Indeed the Japanese model became the base of the East Asian model and the German model became the economic engine for the European Union.

Beginning in the nineteen nineties, however, both Japan and Germany began to face serious economic challenges. Both systems encountered stagnant growth, high unemployment, large and bloated industries not adaptable to the fast-paced global economy, and labor practices that made change difficult.

What happened to the two economic miracles since the nineteen nineties? Indeed, this has been a matter of much discussion and analysis recently. Scholars in general and German scholars in particular often lay the blame on the reunification of Germany. While the quick reunification that was completed under the leadership of Helmut Kohl was a shock to the West German economy, it does not adequately explain the continued stagnation of the German economy.

The economic system of the United States, however, has continued to flourish and grow. While there have been downturns, such as the deep recession in the early nineteen nineties, the United States economy recovered and grew at a high rate, including the longest period of expansion since the end of the Second World War, during the same time that Japan and Germany were struggling with sustained economic decline in the 1990s.

Both Japan and Germany's economic systems were designed to be "catch-up" economies. This required an emphasis on labor and on mass production, at the expense of innovation and creative education. Solid ties were required between the government and labor, giving much power to the unions. Such guarantees as lifetime employment, paid sick leave, paid vacation time, assured employment, generous pensions and unspoken assurances against unemployment were, in the eyes of the governments, necessary to build their economies.

In addition to the emphasis on labor and on mass production, the capitalist system itself developed in a similar fashion in the two states. "Catching up" required a non-liberal style of capitalism, something that seems on the surface to be a contradiction. Featuring heavy investment from banks which, especially in Japan, are influenced or directly controlled by the federal government, these "non-liberal" capitalist models were for over forty years an attractive alternative for developing economies that were not entirely convinced by the *laissez-faire* economic model of the United States but did not wish to adopt a command and control economic system similar to the Soviet Union. For a time it seemed as though these “catch-up” economies were in fact going to surpass the United States. Then they caught up.

*Research Problem*

The research problem addressed in this paper is the non-liberal economic model and its limitations as an alternative to the United States *laissez faire* economic model. This subject is important as the world watches the rise of non-liberal capitalist economies such as China and Singapore and developing countries look to a system that will allow them to develop and succeed yet not necessarily bow to the liberal democratic altar of the United States and the United Kingdom. Azar Gat speaks of this at length in his article from the July/August 2007 *Foreign Affairs* entitled “The Return of Authoritarian Great Powers.” Gat sees the rise of economically successful non-democratic states as the formation of a new second world, and that this new second world would be regarded as an “attractive alternative to liberal democracy.”[1] Considering the failure of the United States’ attempt to forcefully install a liberal democracy in Iraq, this is definitely within the realm of possibility.

The non-liberal subjects of this study, Japan and Germany, cannot be considered authoritarian powers by any means. Both feature well-developed democratic institutions- though not based on the United States democratic model as both are closer to a parliamentary system. However, their economic systems are somewhat closer to an authoritarian model, funded by large banks that are often in the control or influence of the federal government, and inexorably tied in with a highly educated and well trained labor force.

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[1] Gat 2007 p. 67

In fact, looking at Japan and Germany's economic models there are perhaps two defining features that separate it from a U.S.-type model: the symbiotic ties to labor, and a capitalist system that is based on credit and bank investment.

*Thesis and Methodology*

It is the hypothesis of this work that the capitalist system and inflexible labor policies that are prevalent in Japan and Germany are major underlying factors to the economic stagnation of their systems. These policies, important and necessary in a catch-up economic system, include strong ties between the government and labor, a high level of governmental control of the direction of the economy, formal, codified guarantees to labor, such as the right of arbitration, paid sick leave, extended paid vacation, a high level of authority given to the unions, and informal guarantees that are part of the society and culture. Using the United States as the preeminent example of a liberal *laissez-faire* economy, comparisons will be made using a variety of economic performance measures from 1970 to 2000, including GDP, growth in GDP, unemployment, change in unemployment, inflation levels, among other factors. This thirty-year period gives ample time to show economic upswings, downturns, and recoveries, as well as the explosive growth exhibited by Japan and Germany before the nineties.

The methodology will be comparative and qualitative in nature. The economic performance of the three states for the time period of 1970 to 2000 will be examined. There will then be an examination of the genesis of the German and Japanese systems, followed by separate chapters examining each of the three systems in regards to their labor policies and capitalist models. There is then an overall analysis, as well as a final chapter listing conclusions. This project should show that the inflexibility inherent in the non-liberal systems is a catalyst for stagnation and that greater flexibility leads to greater growth.

*Conceptualization*

In this paper, the following terms are utilized:

*Neo-Liberal*- This is the economic model that is globally based, with little or no trade barriers such as tariffs and quotas. It shares many features with the liberal capitalist model.

*Liberal Capitalism*- this is the economic model used in the United States. A *laissez-faire* system, liberalism is a flexible system with little or no control from the government, consumer driven, and is funded primarily by capital investment.

*Non-Liberal Capitalism*- the economic model found in Germany and Japan. The non-liberal economic model is a top-down economic model, funded primarily by banks and is a producer driven model. The system differs from a command and control system in that it is still a capitalist system with both personal and corporate private ownership.

*Globalization*- Globalization is defined in this paper as the global export of the neo-liberal economic model.

*Literature Review*

The topics of the failure of the Japanese and German systems over the last fifteen years has been a subject that has been discussed widely and frequently, with many explanations, predictions, and "fixes" postulated and discussed. With solutions ranging from maintaining the status quo to outright economic revolution, the research studied runs the gamut across all ideologies and theoretical frameworks.

Certainly the role of labor in both the success and failings of these economic systems has been examined. The role of labor in the era of globalization is a matter of much debate. Germany and Japan have two of the most symbiotic relationships between government and labor in the world. It was labor that was a primary cause for the economic resurgence of Germany and Japan, and the governments that developed policies that were beneficial for labor. It can be expected then that the labor would fight what they would see as threats to the guarantees they have come to expect.

What would be the impact of the lowering of labor standards? This is a specter of globalization: that in an effort to remain competitive, states would end up engaging in a "race to the bottom," described by Alan Tonelson in *The Race to the Bottom: Why a Worldwide Worker Surplus and Uncontrolled Free Trade are Sinking American Living Standards* as "…countries with the weakest workplace safety laws, the lowest taxes, and the toughest unionization laws win investment from American and European countries…"[2] While it is unlikely that we will see labor standards in Germany and Japan fall to third world standards, the idea of losing their generous benefits worries labor organizations in those states. This view however, may not be necessarily true.

In their 2004 article for *The Cambridge Journal of Economics* Vicente Navarro, John Schmidt, and Javier Astudillo make a case that under the current system of globalization the state welfare systems that exist in such countries such as Denmark and Sweden the social safety nets are not only maintaining their current levels, but actually

[2] Tonelson, 2000. *The Race to the Bottom*

increasing.[3] This is contrary to the current wisdom that in order to remain competitive, the "cradle to grave" system seen in Scandinavia must be cut.

The race to the bottom is not necessarily inevitable. Several works, in addition to the article mentioned above, take a more optimistic view of the current trends in labor issues in this age of globalization. *Can Labor Standards Improve Under Globalization* takes a qualitative look into the state of labor and the roles of international organizations in enforcing global labor standards, especially the International Labor Organization or ILO. The central argument in this book is that these organizations are necessary and that it makes economic sense to enforce global standards, such as freedom from forced labor, nondiscrimination, abolition of forced labor, and freedom to unionize.[4] In other words, the book makes a case that not only can standards improve, but these improvements will in fact benefit a state's economy. This case is further backed up by a study by Thomas Palley published in the January *Cambridge Journal of Economics* titled "The Economic Case for Labor Standards" that shows the economic benefits of instituting the core labor standards that are listed in the Elliott book. In this study he shows that such standards could promote economic stability, using the case study of South Korea and Indonesia in the aftermath of the Asian financial crisis of the late 1990s. South Korea thrived while Indonesia experienced a "total economic breakdown."[5]

If then the research shows that higher labor standards are beneficial to a state's economy, how may it be hypothesized, as it is in this thesis, that high labor standards are crippling the Japanese and German economies? It may lie in the inflexibility of the

[3] Navarro. 2004
[4] Elliott & Freeman 2003 p.8
[5] Palley. 2004 p. 31

system. United States labor also enjoys very high standards and the economy remains flexible and able to adapt. Wolfgang Streeck and Kozo Yamamura edited two volumes for the Cornell Studies in Political Economy series, both an invaluable resource for this project. These two volumes, *The End of Diversity? Prospects for German and Japanese Capitalism* and *The Origins of Non-Liberal Capitalism: Japan and Germany in Comparison* provide an excellent background for the study.

*The Origins of Non-Liberal Capitalism* is a look into the systems of Germany and Japan, both of which are capitalist, yet "place relatively little trust in laissez faire".[6] In Japan and Germany, according to these editors, there exists government controlled capitalism, managed by "various forms of hierarchical and organizational coordination that sometimes require heavy interjections of public authority with vertical control or horizontal collective bargaining often overriding contractual exchanges as entered into by private agents on their own volition, discretion and calculation."[7] In other words: governmental control over nearly all aspects of a free market economy. Seemingly contradictory, the system was remarkably successful for many decades. The selections in the book examine such topics as the beginnings of the system in Germany, how the German model impacted Japan- going back even further than the end of the second world war- and the trading regimes the two states were a part of.

The other volume, *The End of Diversity?: Prospects for German and Japanese Capitalism* is also an edited volume, examining the two economies in a more contemporary setting. One selection, written by Peter Katzenstein, looks at Japan and

[6] Streek. 2001 p.6
[7] Ibid.

Germany's roles in their respective trading areas, Europe and East Asia. It looks at the different systems of integration, from the formality of the EU to the informal networks of East Asia.[8] Looking at these two methods of integration is interesting especially, as with regards to labor standards: formality in the west and informality in the East. In other words, German guarantees to its workers are formal, codified, and written. In Japan, they are understood more so than written, part of a cultural system in place for hundreds of years. Not only does this make it notoriously difficult to research, but makes the solution even more difficult, as it requires deep systemic changes that will not only be difficult for the people to accept, but may also cause short-term damage, making the benefits of such reform difficult to see and in democratic systems, where the government is ultimately responsible to the people, difficult to maintain.

The edited volume *The Future of the German Economy: An End to the Miracle?* looks at this in some detail. It was the continuing economic stagnation that caused the Christian Democrats under the control of Helmut Kohl to lose control of the Bundestag for the first time in decades in 1998. Despite electoral hardships, Chancellor Gerhardt Schroeder's red-green coalition maintained control in the 2002 election[9], allowing them to continue their reforms.

The book takes a slightly different path than most works regarding the future of the German economic model. It is optimistic; bringing up positive indicators such as low

[8] Katzenstein. 2003

[9] This was likely caused by Schroeder's solid opposition to the Iraq war, a stand very popular with the German public

inflation and large exports- it is the third largest exporter in the world.[10] Despite its optimistic tone, however, the editors admit to serious flaws in the model.

Many of these flaws also exist in the Japanese model. It is interesting how similar these two economies are in their makeup, their strengths, their weaknesses, even their history. Sheldon Garon looks at the history of Japanese labor and its impact with the state in his book *The State and Labor in Modern Japan.* This book is an overview of the labor movements in Japan in the period from 1868-1945. Primarily historical in nature, the work shows that many of the features of the Japanese economy and labor existed long before the end of the Second World War. "As early as 1902, a former prime minister, Okuma Shigenobu, declared his nation's modern social policies to be firmly grounded in the Confucian ruling ideology of Japan's pre-industrial past …'from ancient times, our statesman have espoused ideas of state socialism'".[11] This supports the hypothesis that the flaws in the system are deep and systemic, and change will be difficult.

Looking at some of these difficulties, Ikuo Kume writes *Disparaged Success-Labor Politics in Postwar Japan*, again from the Cornell Studies in Political Economy. This work takes a look at the Japanese state and labor after the Second World War, directing attention to the role of unions and their strength in shaping the post-WWII economic system. Kume feels that labor in Japan has not gotten its fair due of credit in the success Japan experienced. He states: "Most scholars, however, have characterized Japanese labor as docile and powerless, and have neglected its achievements"[12] This is an assessment that is merited. Labor in Japan and Germany has been possibly the most

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[10] Harding & Paterson 2000. p. 127
[11] Garon. 1987 p. 11
[12] Kume. 1998. p. 3

instrumental factor in the amazing success that the two states experienced, coming out of devastation. As will be shown in later chapters, though labor does not extend its influence in Japan in the same manner as in the west, it is a force that is not taken lightly by the Japanese government. In Germany, labor and the unions are a central part of the economic system, and are often pandered to by the government.

What is seen in the research examined above is excellent background for the purpose of this study. There has also been several works produced for a more popular audience, including Thomas Friedman's *The Lexus and the Olive Tree*.[13] These works give a good overview of the non-liberal capitalist models for a more general audience. It is important and interesting that the idea of different capitalist models is gaining more and more attention, especially as authoritarian powers such as China become more powerful and influential in the global economy. However, the weaknesses and failures of the non-liberal economic models, particularly in the area of labor and labor policy, make a convincing argument that these non-liberal models are not conducive to long-term sustained economic growth.

[13] Friedman, 1999.

## Chapter 2

## Economic Performance

The economic performances of Japan and Germany have faced downturns in the past decade and a half. Can this be explained as merely a normal though long-lasting downturn? To answer that, economic performance will be examined for thirty years, 1970 to 2000, for Germany, Japan, and the United States. This period may show any economic downturns and recoveries within the three states central to this study. The factors examined will be the following: Gross Domestic Product and changes in GDP, unemployment rates and changes in unemployment, and the changes in inflation rates. These three factors will give an overview of the performance of the respective economies over a significant period of time.

### *GDP*

The gold standard of economic indicators, GDP is perhaps the most often used indicator for economic performance, as well as that rates annual change. We will first look at the performance of the United States. The following data comes from the Econwatch website.[14]

[14] *EconStats*

**Table 1- US GDP, 1970-2000**

| Year | GDP - real (2000$) | Change from Previous Year in $ | Change from Previous Year |
|---|---|---|---|
| 2000 | 9817 | 346.7 | 0.04 |
| 1999 | 9470.3 | 403.4 | 0.04 |
| 1998 | 9066.9 | 363.4 | 0.04 |
| 1997 | 8703.5 | 374.6 | 0.04 |
| 1996 | 8328.9 | 297.2 | 0.04 |
| 1995 | 8031.7 | 196.2 | 0.02 |
| 1994 | 7835.5 | 302.8 | 0.04 |
| 1993 | 7532.7 | 196.1 | 0.03 |
| 1992 | 7336.6 | 236.1 | 0.03 |
| 1991 | 7100.5 | -12 | 0.00 |
| 1990 | 7112.5 | 131.1 | 0.02 |
| 1989 | 6981.4 | 238.7 | 0.03 |
| 1988 | 6742.7 | 267.6 | 0.04 |
| 1987 | 6475.1 | 211.5 | 0.03 |
| 1986 | 6263.6 | 209.9 | 0.03 |
| 1985 | 6053.7 | 240.1 | 0.04 |
| 1984 | 5813.6 | 389.8 | 0.07 |
| 1983 | 5423.8 | 234.5 | 0.04 |
| 1982 | 5189.3 | -102.4 | -0.02 |
| 1981 | 5291.7 | 130 | 0.02 |
| 1980 | 5161.7 | -11.7 | 0.00 |
| 1979 | 5173.4 | 158.4 | 0.03 |
| 1978 | 5015 | 264.5 | 0.05 |
| 1977 | 4750.5 | 209.6 | 0.04 |
| 1976 | 4540.9 | 229.7 | 0.05 |
| 1975 | 4311.2 | -8.4 | 0.00 |
| 1974 | 4319.6 | -21.9 | -0.01 |
| 1973 | 4341.5 | 236.5 | 0.05 |
| 1972 | 4105 | 206.4 | 0.05 |
| 1971 | 3898.6 | 126.7 | 0.03 |
| 1970 | 3771.9 | 3771.9 | X |

**Units : Billions of 1996 dollars.**

In Table 1 there are only two years of negative GDP growth, 1974 and 1982, both years of deep recessions. By this figure, it is seen that even during downturns, the US economy was active and growing at a sustainable rate.

Table 2 looks at the German GDP data.

**Table 2- German GDP, 1970-2000**

| Year | Gross domestic product in $ | GDP Change from Previous Year in $ | GDP Change from Previous Year |
|---|---|---|---|
| 2000 | 1877.513 | -234.979 | -0.13 |
| 1999 | 2112.492 | -36.927 | -0.02 |
| 1998 | 2149.419 | 35.966 | 0.02 |
| 1997 | 2113.453 | -274.206 | -0.13 |
| 1996 | 2387.659 | -75.561 | -0.03 |
| 1995 | 2463.220 | 364.286 | 0.15 |
| 1994 | 2098.934 | 139.898 | 0.07 |
| 1993 | 1959.036 | -63.986 | -0.03 |
| 1992 | 2023.022 | 244.301 | 0.12 |
| 1991 | 1778.721 | 273.24 | 0.15 |
| 1990 | 1505.481 | 322.614 | 0.21 |
| 1989 | 1182.867 | -11.662 | -0.01 |
| 1988 | 1194.529 | 85.933 | 0.07 |
| 1987 | 1108.596 | 217.358 | 0.20 |
| 1986 | 891.238 | 266.536 | 0.30 |
| 1985 | 624.702 | 6.751 | 0.01 |
| 1984 | 617.951 | -36.851 | -0.06 |
| 1983 | 654.802 | -0.317 | 0.00 |
| 1982 | 655.119 | -26.316 | -0.04 |
| 1981 | 681.435 | -130.029 | -0.19 |
| 1980 | 811.464 | 52.692 | 0.06 |
| 1979 | 758.772 | 118.597 | 0.16 |
| 1978 | 640.175 | 125.477 | 0.20 |
| 1977 | 514.698 | 68.74 | 0.13 |
| 1976 | 445.958 | 27.088 | 0.06 |
| 1975 | 418.870 | 37.887 | 0.09 |
| 1974 | 380.983 | 34.494 | 0.09 |
| 1973 | 346.489 | 88.532 | 0.26 |
| 1972 | 257.957 | 44.168 | 0.17 |
| 1971 | 213.789 | 29.491 | 0.14 |

Units in Billions of U.S. Dollars

Table 2 tells a different story compared to the United States. The German GDP rate was in a word phenomenal during the 1970s. For example, in 1973 Germany had a growth rate of 26 percent. Such growth, however, was not sustainable. From 1990 to 2000, Germany had five years of negative growth, some of it quite significant (2000 and 1997). Later growth rates have not been encouraging.

Table 3 looks at Japan.

**Table 3- Japan GDP, 1970-2000**

| Year | GDP$ | Change in Dollars | Change from Previous Year |
|---|---|---|---|
| 2000 | 4763.239 | 262.845 | 0.06 |
| 1999 | 4500.394 | 559.241 | 0.12 |
| 1998 | 3941.153 | -369.509 | -0.09 |
| 1997 | 4310.662 | -388.813 | -0.09 |
| 1996 | 4699.475 | -585.245 | -0.12 |
| 1995 | 5284.720 | 479.818 | 0.09 |
| 1994 | 4804.902 | 436.518 | 0.09 |
| 1993 | 4368.384 | 567.822 | 0.13 |
| 1992 | 3800.562 | 316.881 | 0.08 |
| 1991 | 3483.681 | 434.604 | 0.12 |
| 1990 | 3049.077 | 89.028 | 0.03 |
| 1989 | 2960.049 | -18.305 | -0.01 |
| 1988 | 2978.354 | 520.692 | 0.17 |
| 1987 | 2457.662 | 434.943 | 0.18 |
| 1986 | 2022.719 | 658.562 | 0.33 |
| 1985 | 1364.157 | 81.062 | 0.06 |
| 1984 | 1283.095 | 80.001 | 0.06 |
| 1983 | 1203.094 | 102.028 | 0.08 |
| 1982 | 1101.066 | -83.104 | -0.08 |
| 1981 | 1184.170 | 113.709 | 0.10 |
| 1980 | 1070.461 | 59.39 | 0.06 |
| 1979 | 1011.071 | 40.215 | 0.04 |
| 1978 | 970.856 | 279.38 | 0.29 |
| 1977 | 691.476 | 129.956 | 0.19 |
| 1976 | 561.520 | 61.143 | 0.11 |
| 1975 | 500.377 | 41.465 | 0.08 |
| 1974 | 458.912 | 44.236 | 0.10 |
| 1973 | 414.676 | 109.811 | 0.26 |
| 1972 | 304.865 | 74.839 | 0.25 |
| 1971 | 230.026 | 26.305 | 0.11 |
| 1970 | 203.721 | 203.721 | |

Units in Billions of U.S. Dollars

Like Germany, Japan experienced remarkable growth in the 1970s and even into the nineteen eighties. However, in the 1990s the poisoned fruits of the “lost decade” begin to be seen. Like Germany, Japan experienced five years of negative growth, and later growth rates have not been strong.  Again we see unsustainable growth as compared to the United States.

*Inflation*

The term that brings a collective shudder to both Germans and Americans, inflation which is based on consumer price index or CPI, is the increase or decrease in the cost of living.  Low inflation is an indicator of stability, high inflation the reverse.  It was the high inflation levels of the nineteen thirties that paved the way for the fascist government to take hold of power in Germany and the "stagflation" of the nineteen seventies that helped to elect Reagan in the United States.   The specter of inflation has been somewhat muted in the last few years in the United States, however, as the following table shows.  The following figures come from EconStats.[15]

[15] Ibid.

**Table 4- United States Growth in Inflation Rates, 1970-2000**

| Inflation Rates | |
|---|---|
| **Year** | **Change from Previous Year** |
| 2000 | 1.19 |
| 1999 | 0.64 |
| 1998 | -0.79 |
| 1997 | -0.59 |
| 1996 | 0.12 |
| 1995 | 0.2 |
| 1994 | -0.34 |
| 1993 | -0.08 |
| 1992 | -1.2 |
| 1991 | -1.17 |
| 1990 | 0.57 |
| 1989 | 0.75 |
| 1988 | 0.42 |
| 1987 | 1.76 |
| 1986 | -1.65 |
| 1985 | -0.75 |
| 1984 | 1.09 |
| 1983 | -2.92 |
| 1982 | -4.2 |
| 1981 | -3.22 |
| 1980 | 2.3 |
| 1979 | 3.62 |
| 1978 | 1.13 |
| 1977 | 0.76 |
| 1976 | -3.74 |
| 1975 | -1.91 |
| 1974 | 4.87 |
| 1973 | 2.97 |
| 1972 | -1.02 |
| 1971 | -1.55 |

As seen from the above chart, inflation rates for the decade of 1990-2000 have been what most economists would consider insignificant. This is an important indicator of the continuing strength of the US economy.

Table 5 looks at inflation rates for Germany.

**Table 5- German Growth in Inflation Rates, 1970-2000**

| Year | Percent Chg per Year |
|---|---|
| 2000 | 2.10 |
| 1999 | 0.70 |
| 1998 | 0.60 |
| 1997 | 1.50 |
| 1996 | 1.20 |
| 1995 | 1.70 |
| 1994 | 2.70 |
| 1993 | 4.50 |
| 1992 | 5.00 |
| 1991 | 3.70 |
| 1990 | 2.70 |
| 1989 | 2.70 |
| 1988 | 1.30 |
| 1987 | 0.30 |
| 1986 | -0.10 |
| 1985 | 2.10 |
| 1984 | 2.40 |
| 1983 | 3.30 |
| 1982 | 5.10 |
| 1981 | 6.40 |
| 1980 | 5.60 |
| 1979 | 3.90 |
| 1978 | 2.70 |
| 1977 | 3.70 |
| 1976 | 4.30 |
| 1975 | 5.90 |
| 1974 | 7.00 |
| 1973 | 7.00 |
| 1972 | 5.50 |
| 1971 | 5.20 |
| 1970 | 3.40 |

Germany's inflation rate, while not catastrophic, still is high when compared to the United States. Between the years 1993 to 1995, Germany saw an inflation rate of nearly ten percent. This is not an indicator of stable growth.

Table 6 looks at Japan.

**Table 6- Japanese Growth in Inflation Rates 1970-2000**

| Year | Percent Chg per Year |
|---|---|
| 2000 | -0.80 |
| 1999 | -0.30 |
| 1998 | 0.60 |
| 1997 | 1.70 |
| 1996 | 0.00 |
| 1995 | -0.10 |
| 1994 | 0.70 |
| 1993 | 1.20 |
| 1992 | 1.70 |
| 1991 | 3.30 |
| 1990 | 3.10 |
| 1989 | 2.30 |
| 1988 | 0.70 |
| 1987 | 0.10 |
| 1986 | 0.60 |
| 1985 | 2.00 |
| 1984 | 2.30 |
| 1983 | 1.90 |
| 1982 | 2.80 |
| 1981 | 4.90 |
| 1980 | 7.80 |
| 1979 | 4.00 |
| 1978 | 4.20 |
| 1977 | 8.20 |
| 1976 | 9.40 |
| 1975 | 11.70 |
| 1974 | 23.10 |
| 1973 | 11.70 |
| 1972 | 4.80 |
| 1971 | 6.40 |
| 1970 | 7.60 |

Japan has not experienced such fluctuation in inflation rates as Germany. Indeed, it can be said that Japan has had more success with containing inflation rates. It must be remembered, however, that this may be attributed to Japan's low interest rates.

*Unemployment*

The final economic indicator examined, unemployment, is the most politically charged as it is the indicator that most directly affects the voters that determine the government in democracies. Many US presidents have discovered to their chagrin the results of high unemployment, particularly during an election year. Bumps in the unemployment rate can be expected as part of the business cycle, yet continuing and long-lasting unemployment and growth in these indicators is indicative of larger problems.

**Table 7- US Unemployment Rates, 1970 to 1999**

| Year | United States | Change from previous year |
|---|---|---|
| 1999 | 4.2% | -0.3 |
| 1998 | 4.5% | -0.4 |
| 1997 | 4.9% | -0.5 |
| 1996 | 5.4% | -0.2 |
| 1995 | 5.6% | -0.5 |
| 1994 | 6.1% | -0.8 |
| 1993 | 6.9% | -0.6 |
| 1992 | 7.5% | 0.7 |
| 1991 | 6.8% | 1.2 |
| 1990 | 5.6% | 0.3 |
| 1989 | 5.3% | -0.2 |
| 1988 | 5.5% | -0.7 |
| 1987 | 6.2% | -0.8 |
| 1986 | 7.0% | -0.2 |
| 1985 | 7.2% | -0.3 |
| 1984 | 7.5% | -2.1 |
| 1983 | 9.6% | -0.1 |
| 1982 | 9.7% | 2.1 |
| 1981 | 7.6% | 0.5 |
| 1980 | 7.1% | 1.3 |
| 1979 | 5.8% | -0.3 |
| 1978 | 6.1% | -1.0 |
| 1977 | 7.1% | -0.6 |
| 1976 | 7.7% | -0.8 |
| 1975 | 8.5% | 2.9 |
| 1974 | 5.6% | 0.7 |
| 1973 | 4.9% | -0.7 |
| 1972 | 5.6% | -0.3 |
| 1971 | 5.9% | 1.0 |
| 1970 | 4.9% | X |

In twenty of the thirty years analyzed, rates were negative, meaning that unemployment dropped.  The longest period of positive growth of unemployment was three years.  The unemployment rate of 4.2 percent in 1999 meant that for most purposes, unemployment was nearly nonexistent.

Germany has not experienced similar results.

**Table 8- German Unemployment Rates, 1970-1999**

| Year | Germany | Change from previous year |
|---|---|---|
| 1999 | 9.0% | -0.4 |
| 1998 | 9.4% | -0.5 |
| 1997 | 9.9% | 1.0 |
| 1996 | 8.9% | 0.7 |
| 1995 | 8.2% | -0.3 |
| 1994 | 8.5% | 0.6 |
| 1993 | 7.9% | 1.2 |
| 1992 | 6.7% | 1.1 |
| 1991 | 5.6% | 0.6 |
| 1990 | 5.0% | -0.7 |
| 1989 | 5.7% | -0.6 |
| 1988 | 6.3% | 0 |
| 1987 | 6.3% | -0.3 |
| 1986 | 6.6% | -0.6 |
| 1985 | 7.2% | 0.1 |
| 1984 | 7.1% | 0.2 |
| 1983 | 6.9% | 1.3 |
| 1982 | 5.6% | 1.6 |
| 1981 | 4.0% | 1.2 |
| 1980 | 2.8% | -0.1 |
| 1979 | 2.9% | -0.4 |
| 1978 | 3.3% | -0.1 |
| 1977 | 3.4% | 0 |
| 1976 | 3.4% | 0 |
| 1975 | 3.4% | 2.8 |
| 1974 | 1.6% | 0.9 |
| 1973 | 0.7% | 0 |
| 1972 | 0.7% | 0.1 |
| 1971 | 0.6% | 0.1 |
| 1970 | 0.5% | X |

Germany's unemployment has grown steadily since 1990, reaching a peak of nearly ten percent in 1997. This rate is high for any economic system. Since 1990 the unemployment rate has increased by over five percent. It is the unemployment rate that was a major factor in the downfall of the Christian Democratic Party's coalition after eighteen years.

Table 9 examines Japan.

**Table 9- Japanese Unemployment Rates 1970 to 1999**

| Year | Japan | Change from previous year |
|---|---|---|
| 1999 | 4.7% | 0.6 |
| 1998 | 4.1% | 0.7 |
| 1997 | 3.4% | 0 |
| 1996 | 3.4% | 0.2 |
| 1995 | 3.2% | 0.3 |
| 1994 | 2.9% | 0.4 |
| 1993 | 2.5% | 0.3 |
| 1992 | 2.2% | 0.1 |
| 1991 | 2.1% | 0 |
| 1990 | 2.1% | -0.2 |
| 1989 | 2.3% | -0.2 |
| 1988 | 2.5% | -0.4 |
| 1987 | 2.9% | 0.1 |
| 1986 | 2.8% | 0.2 |
| 1985 | 2.6% | -0.2 |
| 1984 | 2.8% | 0.1 |
| 1983 | 2.7% | 0.3 |
| 1982 | 2.4% | 0.2 |
| 1981 | 2.2% | 0.2 |
| 1980 | 2.0% | -0.1 |
| 1979 | 2.1% | -0.2 |
| 1978 | 2.3% | 0.3 |
| 1977 | 2.0% | 0 |
| 1976 | 2.0% | 0.1 |
| 1975 | 1.9% | 0.5 |
| 1974 | 1.4% | 0.1 |
| 1973 | 1.3% | -0.1 |
| 1972 | 1.4% | 0.1 |
| 1971 | 1.3% | 0.1 |
| 1970 | 1.2% | X |

Japan’s unemployment in the last decade has more than doubled, and in the following years has continued to grow. Japan has experienced more than a decade of unemployment that has remained constant or in most cases has increased. The nearly five percent unemployment is catastrophic for a state that never had an unemployment rate over 2.9 percent in twenty-five years.

*Conclusions*

In the preceding sections it is shown that Japan and Germany are experiencing stagnation that is continuing and unrelenting. By comparing them to the United States, the standard of success, one can see that there are definitely severe and deep problems in the economic systems used by the two states.

## Chapter 3

## Genesis of the German and Japanese Economic Systems

Now that it has been shown that these states are experiencing slowdowns, the question is why.  There are many reasons.  However, looking at why and how the economic systems of Germany and Japan developed is a necessary starting point.

The major countries of the European Union and Asia maintain a strong control over labor policies in their respective countries.[16] Germany and Japan are no exception to this standard.  This is a hallmark of a non-liberal capitalist system.  The Schroeder and Koizumi governments attempted several reforms, but met with only limited success. There are several reasons for this, which will be examined in more detail.  These include the influence of labor unions on political parties, particularly those parties that are considered left-leaning, and the “political will” of the citizens of a state to accept changes that may cause some problems in the short-term, such as higher unemployment and the loss of certain guarantees considered almost sacred by the members of that state.

To understand the reason for the development of non-liberal capitalist and labor models, it is necessary to go back to the beginning of the modern era, the end of the Second World War.  According to estimates, the Germans lost a staggering 3.5 million

[16] An excellent example of this is the 2006 French labor reform which was eventually defeated by popular revolt.

soldiers (not including the millions that were injured and incapacitated for the rest of their lives). Japan's numbers are estimated at close to two million killed.[17] Given the makeup of martial forces in the mid part of the twentieth century, it can be stated that the major portion of these casualties were young men, the core of any working force. Near the end of the war, as the Axis was forced to use young boys, they lost a portion of its next generation of workers. The end of the war found the two countries in shambles, their governments killed, arrested, or in hiding, their infrastructures destroyed, their economies in ruins, and a large part of their labor forces in graves or in pieces. Labor was at a premium and a near blank slate had been created for a new economic system. Those who had survived the terror of the most destructive conflict in humankind's history were now in control of the direction that the state would take in its future economic course. Adding to this "perfect storm" was the need for an entirely new government as the fascist systems had collapsed under the boot of the Red Army or the mushroom cloud of Hiroshima.

This brings up an important point. The Soviet Union lost nearly three times as many soldiers during the war[18] yet did not see the kind of change that occurred in both Japan and Germany. This is largely due to the fact that the totalitarian systems in the defeated states had fallen (though the Japanese emperor had been allowed to stay on the throne, with symbolic power only) while Stalin remained secure in the Kremlin (even more so than before the war, as he was now seen as the savior of the Motherland). With a near blank slate to work with in Germany and Japan, a new age might come to pass.

[17] City University of New York.
[18] Ibid.

This blank slate is not without historical precedent. Seen here is a similar situation to the end of feudalism after the rampage of the bubonic or “black” plague. The feudal systems that existed in Europe relied on one major factor: the abundance of labor. Basic economics tells us that as supply for a product or service is high, the price is low. The serfs were plentiful in number, so the owners of the land did not have to pay much for their services. When the plague hit, no one was spared; but as the serfs made up the lion’s share of the population of medieval society, they made up the lion’s share of losses from the plague. Exact figures have never been tabulated, but it is estimated that over a quarter of the population of Europe may have died from the pandemic. This mass loss of labor in such a short time (1347-1348 in the first outbreak) caused labor to no longer be abundant, but rather at a premium. Harvests had to be gathered. Human labor was needed to gather the harvests. The serfs who survived were now able to sell their one commodity, themselves, for a much higher price.

The pandemic did not just strike the serfs. No one was safe from its ravages and the upper classes fell victim as well. What developed at that point was a “perfect storm” of three factors:

1) The loss of a large portion of the workforce
2) The removal of the governing class
3) The elimination of the accepted status quo

Compare this to the aftermath of the Second World War in Japan and Germany. These three factors that had existed after the rampage of the plague were now in place in the two defeated states. Germany and Japan lost a sizeable portion of their primary workforce, giving those who survived the ability to sell their labor at a premium.[19] Not enough, the workers also demanded the ability to chart their own course. To put it another way, the unions were now in charge. This upheaval of the status quo was made possible due to the removal by the victorious powers of Adolf Hitler and the military government of Japan. Our third test case, the United States, a victorious party, did not suffer these effects described above. Its economic model would develop much differently.

This paper is not an account of the creation of the West German and Japanese economic systems. But some points are brought up to illustrate the historical roots of a political/economic system where labor and government are so intrinsically tied together that separating them is impossible. Added to this, however, was the unique global situation that immediately followed the end of the Second World War. The USSR, another victorious party in the Second World War- admittedly a victory earned at an incredibly high cost- had brought nearly every European state east of Germany- and part of that state- under its sphere of influence and command-and-control style economic system. A similar situation would likely have occurred in Japan and the Pacific had the atomic attacks on Hiroshima and Nagasaki not taken place.[20] The United States, the major occupying power of both West Germany and Japan, was now embroiled in yet another global conflict- albeit not a shooting conflict- and determined to demonstrate the

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[19] Note that the workforce at the time was defined as young males. There is no question of the impact of female workers, on both sides of the conflict, and nearly universally accepted that this conflict began the large scale entrance of women into the workplace. However, in the late 1940s, it was still held that the women would return home when the men did.

[20] It is felt by some scholars that this was the primary reason the United States used the atomic bombs.

benefits of a liberal economy. However, the situation was made complicated by the fact that its two show states- West Germany and Japan- were rubble. The workforce was devastated. The government was dead or in Allied prisons. And the physical infrastructure- the status quo- was gone. All of these were casualties of the worst conflict in humankind's history, and the result were two states that could not be less prepared to build, support, and maintain an economic system that required innovation and a large consumer base. Those two states would have to go a different direction than the one the United States perhaps would have preferred to have laid out. They would first need to "catch-up." The modern capitalist systems of Japan and Germany cannot be described as a copy of the United States model, despite the guidance of the United States in developing those economic systems after the end of the Second World War.

This "catching-up" would require a new way, a new method of capitalism. As described earlier, the situation that existed in Japan and Germany at the end of the Second World War was unprecedented. As the new governments developed, so did the economic systems. What resulted was a system that, while certainly not command and control, relied on government control and guidance- most importantly in the form of capital and credit from large banks that were often either part of the federal government or heavily influenced by the federal government. Another important aspect that has developed in this system has been an emphasis on the producer side of the economy. In other words, Germany and Japan are producer-driven economies, as opposed to the United States' consumer-driven economy. This is perhaps the defining feature of the non-liberal capitalist model. To put it another way, the two economies touted by the United States during the Cold War as the success stories of capitalism were neither liberal nor consumer-driven; they were in fact a new capitalism that shared some features with command-and-control economies.

The development of these economic systems has been extensively documented and analyzed, and will not be covered in this paper.[21] It is important, however, to understand the beginnings of the systems, to understand why the capitalist and labor models that developed were so important to the "catching-up" phases in Japan and Germany. Indeed, it can be said that the systems in those two states developed the only way they could if they were to attain the successes that were sought. With Japan and Germany in a state of such devastation, a liberal economy was not an option, at least not in the short term. And with the massive numbers of victorious U.S. troops still in the streets of Tokyo and Germany, a move toward a Soviet Marxist-type economic system was not a viable option either. The systems and models that emerged became a third way, a way that seemed for many years to be a viable long-lasting alternative. The features of these models, difficult to change and adapt once instituted, even if the models had failed, became thoroughly entrenched as Japan and Germany became economic miracles. After the downturn of the nineteen-nineties, the question of whether a non-liberal capitalist model- in particular the models of Japan and Germany- could sustain economic development began to arise. The following chapters examine the results of the development of those models, and what those models have done for sustained economic development.

[21] I recommend Wolfgang Streek's *The Origins of Non-Liberal Capitalism* for the development of Japanese and Germany's systems.

## Chapter 4

## Negotiations at the System-Wide Level: The German Model

Germany is called the economic engine of the European Union, and not without cause. The economic miracle that followed the Second World War and the resulting partition of the state was incredible by any standards, and this miracle was powered by an economic model that was unique in the West. Relying on a well educated, well trained and loyal labor force, coupled with major investment from central banks and state laws sympathetic to workers, Germany recovered from its destruction in a remarkably short period of time, only to face difficult challenges when its catch-up economy caught up. Examining the features of Germany's economic model, this chapter will examine the flaws found in a system that requires such strong ties between the state and labor, and the difficulties encountered when large banks are the primary source of capital, coupled with an indirectly controlled producer-driven economy.

The focus of the German capitalist system is a producer-driven economy, meaning that it is companies, not consumers, that dictate the direction of the economy. In a state such as Germany where the large producers, the banks, and the government share such close relations, it is an indicator of an economy that has strong, though indirect, direction from the central government. Given that a similar situation exists in Japan, study of this phenomenon will take place in a later chapter.

The central government also exerts some indirect control over economic direction in the manner that the labor system evolved. Germany's labor system development after the end of the Second World War was built around a nucleus of powerful, multi-industry-wide collective bargaining organizations.[22] These coordinated unions were supported at the plant-level by work councils which, while not bargaining for wages, had authority over "a range of shop-floor issues relating to personnel and employment policies"[23] such as hiring procedures.

In 2000 there were twelve multi-industrial unions which bargain for workers in the most important sectors of the German economy, such as the Metal Workers union. Though these twelve organizations bargain separately, they tend to follow the pattern set by the Metal Workers Union.[24]

It goes without saying that this system affords the German worker with very strong protections. Even more interesting is that these protections are enshrined into law, including the Works Constitution Act.[25]

There is in Europe a certain penchant for written agreements and laws, often enshrined in the constitution. This penchant certainly makes its presence known when examining the capitalist model in Germany. Wolfgang Streek states that in Germany "…the institutions that embed its economy and shapes its performance are politically negotiated and typically legally constitutionalized…"[26] To put it another way, the German capitalist and labor models are formal systems, with guarantees and co-

[22] Thelen & Kume. 1999 p. 479
[23] *Ibid.*
[24] *Ibid.*
[25] Thelen and Kume: 1999 p. 482
[26] Streek 1995 p. 8

operations that are in writing and often even in law. This is a unique feature of the German capitalist model, as seen later in the examination of Japan, and a feature that causes unique difficulties, especially in the age of globalization.

Union strength and viability has been called into question in the research of the last decade. Indeed, the push toward the popular view of globalization seems to almost require the adoption of neo-liberal norms giving employers much more power than they once held even in states and systems such as Germany. However, others point to the victories of German unions in the late nineteen nineties as evidence that neo-liberalism is not becoming the norm.[27] This is, according to one researcher, due to the German employers need for peaceful employee relations or run the risk in this age of hyper-global competitiveness of having their market disappear.[28] These agreements, however, can actually be detrimental to the unions, due to this reliance of labor peace over wage moderation. Thelen and Wijnbergen state that the employers are using the threat of the collapse of employer associations rather than the traditional lockout. As more employers drop out of these associations or ignore collective bargaining agreements, it is not the unions that are losing their strength, but the employer associations. [29] In the German system, however, both are necessary and complement each other. What ends up developing is a negative feedback loop, to use Thelen's terminology.

The question remains as to whether or not such a system is indeed a major factor in the end of the German miracle. As mentioned before, the *Ossies* are often the factor at the end of the pointed figure. The idea is not without merit. At the time of unification,

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[27] Thelen & Wijnbergen 2003 p. 862
[28] Thelen &Wijnbergen 2003 p. 863
[29] Thelen & Wijnbergen 2003 p. 870

West German productivity was *ten times* that of East Germany, the jewel of communist dominated Eastern Europe. However, time and statistics have not borne this out. If the depressed communist economy is the major factor of Germany's continued difficulty, then how does one explain the success of the Czech Republic and Poland since the fall of the old regimes. Both countries, it could be convincingly argued, were even more enshrined in the Soviet system and neither had the advantage of a benefactor such as West Germany. Both, however, were objects of the so called "shock therapy" system that led to disastrous consequences in post-communist Russia, yet the sudden liberalization contributed to consistent economic growth for those two states.

Even more telling is the fact that it is the former East Germany that continues to have the most difficulties. Unemployment in the former East Germany, as of 2000, remained steady at 16.5 percent[30] (compared to 9% overall for Germany). While at first glance this may indicate that it was the quick unification at work, examine this more closely. Poland and the Czech Republic have both been successful, yet neither had the economic productivity of East Germany prior to the fall of communism. East Germany, all things being equal, should have excelled at liberalization. It could be argued, then, that is it in fact the West German system, superior in the catch-up so desperately needed after the destruction of the Second World War, that caused the malaise of the East German system, and as a direct result, put and end to the miracle. How this occurred will be covered in subsequent chapters.

The flaws that made the integration of the East German economy so difficult are also some of the defining features of the German economic model. In the German non-

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[30] Selinger. 2007.

liberal capitalist economy, perhaps the institutions with the most influence on the German system are the banks. As the primary source of capital, the banks in Germany also have a large amount of control in several other areas. "Bankers hold nearly 10 percent of the seats on the supervisory boards of the one hundred largest industrial corporations in Germany."[31] In addition, the ratio of bank loans to corporate financial liabilities remained constant in Germany at 60 to 70 percent, indicating an obvious reliance on banks.[32] In terms of publicly held shares, banks hold nearly 10 percent in Germany.[33] Indicating further bank control of the German capitalist system is the German proxy voting system, which according to Pauly and Reich often leaves banks with control of 50% of the voting shares of many German MNCs. In addition, "In the largest German corporations…the lead bank also provides the board chairman."[34]

This does bring up the question as to who controls the banks, or to put it another way, are the banks under the control of the government. This is an important point as it is a strong indicator of how much control (albeit somewhat indirect) the central government has over the economic system, particularly in systems where the major source of capital is bank loans. In the case of Germany, the *Bundesbank* is independent of the Ministry of Finance, yet one wonders how much informal influence the government has over the federal bank which has built its credibility on price stability.[35] This goal is an interesting one for a capitalist system; the central bank's primary interest is not keeping the market

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[31] Pauly and Reich 1997 p. 11
[32] Pauly and Reich 1997 p. 9
[33] Pauly and Reich 1997 p. 8
[34] 1997 p. 12
[35] Boyer 2003 p. 160

as open as possible, but keeping prices from going too high, sometimes in spite of the market forces. It is quite a difference from a liberal capitalist system.

Another difference from the liberal capitalist system represented by the United States is this idea of system-wide negotiation. The development of negotiation at the system-wide level can be understood by going back to May 1945. The benefits of collective bargaining are extensively documented: higher pay, generous leave and sick time, worker's grievance procedures, etc. Taking a look at how badly (West) Germany needed what was left of its workforce after the end of the conflict, it is not surprising that concessions were given. However, one can also guess that these men, young and old, understood their position, that their work was now a premium; again, looking at the historical precedent of the black plague and the end of feudalism, and also taking into account that it was not just the societal structure and human structure that was decimated, it was also the actual physical structures of the state and nation. For some, their families were dead or gone. For many others, their family was all that remained from what they remembered before they left for the steppes of the Baltic. There was little, if anything, keeping them in the country that had failed them so miserably the prior six years. The state was in no position to bargain with those who remained, and they formed together- one can guess military indoctrination from early childhood had much to do with this- to get themselves and their comrades the best "deal". This is a major reason for the system-wide model that is seen in Germany, as well as a European sensibility for legal frameworks. Establishing a legal framework would take a national government, again something destroyed by allied bombs and guns. This national government would be forced to develop a system that guaranteed labor rights and benefits.

Germany set the standard with guarantees to labor in Europe, up to and including clauses in the federal constitution that guarantee the right for collective bargaining.[36] The effects of collective bargaining will be detailed in a later chapter, but deserves some examination in this context. Collective bargaining, especially at a quasi-governmental level like what is seen in Germany, removes wage determination from a market-based model. In other words, it is an artificial level of pay, which has several consequences, both positive and negative. This is an important point for the German model as it is a system-wide collective bargaining in the case of the largest industries, which leads to the conclusion that the government, in an indirect yet strong way, determines the wages for labor. Returning to the starting point of this system, the end of World War II, one can make the reasonable assumption that these wages would be unnaturally high. This is particularly true in the lower-wage earning brackets. Statistically speaking, lower wage jobs tend to have greater elasticity in the amount of compensation. However, in states such as Germany, these jobs have less elasticity, which may have effects that would not be immediately apparent, which will be discussed in a later chapter.[37] In addition, especially considering the chaos that many of these men experienced, guarantees of continued employment would be at the top of the list.

Horst Siebert of the University of Kiel discusses the idea of employment security at some length. “Hiring a worker becomes a somewhat irreversible decision,” he states in a 1997 article from *The Journal of Economic Perspectives*, speaking of the protections

[36] Siebert. 1997. p. 39
[37] Siebert 1997 p. 45

that European governments mandate for workers.[38] He further states that in some cases, hiring a worker can be a longer-term investment than even a capital investment such as new machinery.[39] Again, the effects of this will be discussed in a later chapter, but one can begin to imagine the consequences of such policies, both positive and negative.

We also must take a look at the required workers councils and the mandated worker representation on supervisory boards. The 1976 codetermination law requires that half the members of the supervisory boards of major firms must be worker representatives.[40] In addition, the plant-level contains protections and representations for workers in the form of work councils. From the very top of the economic control levels, the very constitution of the republic, to the industry-wide collective bargaining, to workers councils at the plant-level, we see a system that acquiesced to the demands of labor. Indeed, the symbiotic relationship between labor and government was by and large a major cause, if not the primary cause, of the "economic miracle" Germany enjoyed for over forty years after the defeat and destruction of World War II. This relationship was a model for economies attempting to "catch up."[41] Unfortunately, as time and later statistics have suggested, a catch up economy runs into massive difficulties once they have actually caught up. This will be further borne out in the examination of Japan.

Another consequence of catching up and the movement toward a globalized neo-liberal economy has been the drop in German FDI. "… (in) 1996, foreign companies

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[38] 1997 p. 49
[39] *Ibid.*
[40] Siebert 1997 p. 41
[41] Siebert actually maintains that Germany caught up in the 1970s, and that the end of the miracle came to fruition in the 1980s.

repatriated all their German profits, pulling a net $2.6 billion out of Germany. That's the first outflow in years."[42] Globalization, or the new global economy, relies not only on foreign investment, but also the ease at which foreign investment occurs. Evidence seems to indicate that the German non-liberal capitalist model has made it "less and less attractive as a destination for capital investment."[43] It is another unique challenge of the German model.

*Conclusions*

Examining and comparing the labor and capitalist systems in Germany yields interesting results. One can see how the two systems are complementary and even symbiotic.

A formal system does have some advantages. In a state governed by the rule of law, these agreements are easy to track and easy to examine if any changes are to be made. When changes are deemed to be necessary, however, it is this rule of law that may make those changes difficult to institute, especially if the state is governed by a democratically elected leadership. As will be examined in a later chapter, making changes that are beneficial in the long run but cause short term pain- higher unemployment, higher inflation- are detrimental to the goal of keeping power. More so in rule-of-law states is that the companies, the government, the people are subject to the rule of law. These agreements, these constitutional guarantees, must be adhered to or negative consequences will result. What this results in, especially in regards to constitutional guarantees, is a system that is not easily changed and a system that makes

[42] Parnell 1999 p. 33
[43] Parnell 1999 p. 39

changes on an informal basis, i.e., the company level, very difficult if not impossible to accomplish.

Take for instance, the formal ties between government and labor. Labor guarantees are enshrined into the constitution. Major unions bargain for wages on the system-wide level with the government. These ties between labor and government end up with the net effect of making change very difficult, as workers are the large majority of the electorate in a West European liberal democracy. Making things more difficult, however, is the capitalist model that requires such influence from banks. Banks are interested in long term credit; in other words, they are not as adaptable as a stock or investor based capital system. In short, banks are patient. Investors are not. The effects of this will be examined in more detail in later chapters.

With a non-liberal capitalist system such as in Germany, it is not surprising that what has developed is a producer driven economy. Given the “catch-up” needed after the Second World War, the non-liberal capitalist system, with the strong and formal labor ties, was the strongest system to achieve the goals of both Germany and the United States. However, in the examination of this chapter, deep flaws have been found that could lead to a continued malaise that cannot be solved easily. The question remains as to whether or not the non-liberal system of Germany can remain mostly intact and still compete with the United States, integrate into the globalized economy, and counter the challenges of developing economic powers such as China and India.

# Chapter 5

## Informal Guarantees Carved into Stone: The Japanese Model

The economic engine of the Asian-Pacific, Japan's economic malaise since the early nineteen-nineties has been caused by a combination of a changing world economy, labor policy, and a non-liberal capitalist model that cannot adapt quickly to changing factors. Like Germany, Japan's economic model is a new way, neither command/control nor liberal, with strong influence by banks and producers. Also like Germany, Japan's economic model features strong ties between government and labor. What makes the Japanese model unique, however, is the informal nature of these ties. The informality of the ties makes the Japanese model difficult to research and even more difficult to change.

Despite the difficulties of the "lost decade" as the 1990s are known in Japan, the model has been successfully exported throughout the Asian-Pacific region. The economies of East Asia are often referred to as the East Asian Tigers, ferocious, powerful, and fast-moving. Building on the model created in Japan, East Asia has become an economic powerhouse that is a marvel to the developing world, a model exported from Japan. What remains to be seen is if these states face the same challenges as Japan. Those challenges are examined in this chapter. Looking at labor and the non-liberal capitalist model in Japan, the causes of a slowdown that shattered the illusion of a Japanese economy poised to conquer the world will be shown.

I remember as a child my father, who at the time was taking economics classes as part of his baccalaureate program, telling me about an editorial cartoon showing the United States on the deck of a battleship signing economic surrender papers to the Japanese delegates. Indeed, in those heady days of the late seventies to the end of the nineteen eighties it did seem that perhaps the monster that we had helped create after the mushroom clouds of Hiroshima and Nagasaki would overtake and defeat us. After all, who, by the mid nineteen eighties, did not have a VCR or television stamped with "Made in Japan" or more distressing, drove a Honda or a Toyota instead of one of the good old fashioned Big Three vehicles?

The Japanese "catch-up model" with guarantees "such as 'lifetime' employment guarantees, internal promotion ladders, and flexible job design became export items in themselves."[44] The Japanese non-liberal capitalist model shares quite a bit in common with the economic model of Germany, not surprising considering that the two states were forced to rebuild their economies at the same time with the same goals in mind, overseen by the same power. As explained earlier, Japan and Germany were in a unique position after the end of the Second World War with infrastructures in shambles, a major portion of the workforce killed or injured, and governments in prison. What makes Japan unique is "commanding compliance as a matter of informal obligation…"[45] In other words, there are few laws that shape the economic system. One must be careful with this, however. There are some laws or formal associations that do not exist in Germany. For an example of this, one needs look no further than the Bank of Japan which, according to

[44] Thelen &Kume 1999 p. 477
[45] Streek 1995 p. 8

Robert Boyer "has long been subject to the influence of the Ministry of Finance and seems…that growth, credit, and the stability of the financial system appear to be the objectives of monetary policy."[46]

This is an important distinction from Germany, for like Germany, Japan's major source of capital and corporate governance comes from banks.[47] What this means is that in Japan, even more than in Germany, the government controls the direction of the economy, albeit in an indirect way. The Japanese government's primary monetary policy is to keep the system stable. The method of accomplishing this task is through the Bank of Japan. The Japanese model was utilized to great effect by the East Asian tigers, each attempting to out-japan Japan. However, just as with Germany, the Japanese catch-up model began to run into problems when it finally caught up.

As opposed to the German model, the Japanese model that developed after the end of the Second World War was much less centralized and much less formal. Rather than industry-wide mega-unions that developed policy from the top down, the Japanese guarantees to their labor developed from the firm level.

This is an interesting dichotomy, and speaks to the East Asian model of informal agreements. Dajin Peng addressed this in his paper "Invisible Linkages". Analyzing the informal networks of Asian expatriates, Peng concluded that these networks contributed in a major way to the continued development of the East Asian Tigers[48]. Such networks were not necessarily common to all expatriate groups; Russian expatriates, for example, send little "home" as opposed to their Chinese counterparts. This difference can

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[46] Boyer 2003 p. 160
[47] Pasca 2004 p.18
[48] Peng. 2002. p.430

reasonably be assumed to be part of the culture of those groups. This cultural phenomenon of East Asia does carry into Japan, as the guarantees given to Japanese workers are as much cultural as legal. Consider, for instance, the idea of "lifetime employment."

Somewhat misnamed, the lifetime employment system, however, is a powerful guarantee to the Japanese workforce. The term "lifetime employment" is a shorthand term referring to the strong protections that Japanese workers have against dismissal, which come from two major sources: labor law and the labor movement.[49] Looking at labor law first, it is shown that outright dismissal for reasons other than malfeasance is quite difficult, requiring firms to show that they have an excess number of employees, that the firm has attempted to avoid redundancies, and that they have a proper procedure in place for selecting those to be dismissed. Large firms have usually found their dismissals to be invalidated by the courts due to these strict conditions.[50]

The labor movement, on the other hand, has produced some interesting results. As stated before, the majority of labor protection in Japan is informal in the sense that it is centered around the plant or firm-level rather than at a governmental-level. These plant-level firms, covered in more detail later, will actually accept nearly stagnant wage growth as opposed to the loss of jobs. In the nineteen nineties, the infamous "lost decade" wage growth increased by only two percent over the course of the decade.[51] Compare this to an inflation increase of close to twelve percent over the same period. In other words, real wages, or the purchasing power of the *yen* that was brought home,

[49] Genda & Rebick. 2000. p.90
[50] Ibid.
[51] Genda & Reibeck. 2000 p. 88

decreased by approximately ten percent. This is a significant trade off by the unions at large for not letting workers go. It is the Asian-group dynamic that plays a major part here, the informal, invisible linkages.

Even these guarantees are not enough to stop the decline in employment, in particular the manufacturing sector. Industrial productivity in the since 1990 rose only slightly, and over one million manufacturing jobs disappeared between 1992 and 1996.[52] To be sure, manufacturing is the economic sector that has taken the hardest hit in nearly all developed countries in the age of globalization, but it is interesting that in a state and system with such strong protections to labor that the losses in both jobs and productivity would be so severe. Overall in face, during 1992 to 1998, the growth in employment on average for Japan was 0.3 percent. Compare this to a growth rate of 1.6 percent in the United States during the same time period.[53]

The Japanese tradition and culture causes some unique challenges of its own in the new globalized economy. Globalization is not necessarily seen in Japan as a benefit; many in fact blame the globalization movement for the economic bubble that caused the late nineties Asian financial crisis in Japan.[54] Globalization also puts an emphasis on economic efficiency, and according to Gao is the main priority of industrialized countries in the new age.[55] Efficiency has not been achieved in Japan, at least in terms of labor costs, which are now twice as high as labor costs in the United States.[56]

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[52] Cowling & Tomlinson 2000 p.359
[53] Cowling & Tomlinson 2000 p. 361
[54] Gao 2000 p. 437
[55] Gao 2000 p. 447
[56] Gao 2000 p. 448

Some economists feel that this efficiency has been sacrificed for the benefit of equal outcomes. Indeed, economist Nakatani Iwao has stated that "to protect equality…Japan has enacted too many regulations that have seriously restrained competition."[57]

Looking at this system, one might be begin to question how the capitalist model in Japan can actually be called capitalist. Chalmers Johnson answers this question by stating that "the government imbeds incentives and disincentives within the market to achieve its goals; market players, enjoying private ownership of property, respond as they see fit in order to secure their personal advantage."[58] In other words, private property owners including businesses, consumers and producers are under no legal obligation to do as the government asks. To put that another way, the ties that bind are informal.

As stated when examining labor, this phenomenon can be partially explained by the culture and traditions in Asia. This point has to be understood, as this is what provides the reason why an informal system as in Japan does not break down. It is a somewhat safe assertion that what you see in Japan could not happen in the United States or in Europe (and indeed has not in the case of Russia). That culture does not exist. Also like Germany, Japan has built its economy around producers rather than consumers. Corporations are seen as national assets in Japan, and as such it is not surprising that they are looked at by the government and by the society as resources to be used for the benefit of the state, much like oil or natural gas. In a culture and society such as Japan where the informal linkages are perhaps the strongest, business owners see themselves and their

[57] Ibid.
[58] 2001 pp. 57-58

companies as part of the state, and as such feel an obligation to the state. This plays out with the labor policy described above and a willingness for the central bank and the bureaucracy to dictate economic policy. It is –much more so than in Germany- command and control without being command and control. This fascinating aspect of the Japanese economy is the foundation on which the entire economic model is built. It is also what makes change in the system so difficult.

Taking a look at another defining feature of the Japanese labor model, the (again misnamed) seniority wage system, this idea of informal guarantees plays out again. More accurately described as a skill-based system (meaning that the increase in wages is commensurate to the learned skills and training achieved by the worker over the course of his/her employment), [59] this system, not enshrined by any law, guarantees workers higher pay the longer they are with the firm (under certain conditions). This informal guarantee, considered a bedrock of Japanese labor policy to the extent that Japanese workers are willing to take a de-facto cut in pay to preserve it, ties in directly with lifetime employment as powerful incentives to stay with the firm. This is a direct consequence of needing to keep workers in a devastated Japanese homeland.

To keep workers in a devastated Japan, to institute these guarantees, there had to be some organization to the labor that had survived. Unlike the German model, however, which coalesced around industry-wide unions, Japanese unions are more fully based around "plant based labor markets".[60] It is these unions, while only representing twenty

[59] Thelen & Kume 1999 p. 483
[60] Ibid.

two percent of workers in Japan that set the standard for the other unorganized firms. [61] It is also these unions that have accepted the real wage drop as described above. Also a question that remains is what the advantage of such an informal system would be. In the chapter examining Germany, the advantages of a formal system were looked at. The informal system of the Japanese, however, hold many advantages, not the least of which is using the culture of the Japanese, and indeed of Asia, in building up an economic model that is an attractive alternative to the model of the United States and even as an alternative to the non-liberal model of Germany. In other words, the success of the Japanese model up until the 1990s showed that massive changes not only to the economic system, but also to a country's culture and way of life was not only unnecessary, but possibly even harmful to the state. The Japanese economic model was a true third way, a "plan-rational economy, neither socialist nor Anglo-American capitalist in orientation or operation."[62] Little wonder that states such as South Korea and Taiwan decided to duplicate it rather than a U.S. style model. In many ways, it can be said that the Japanese non-liberal capitalism is a perfect fit for Asia and Asian culture.

Furthermore, it is these informal guarantees that make the Japanese model so difficult to adapt and reform. These guarantees have their genesis in the very culture of Japan, which itself is not easy to change. Governments can pass laws and courts can set mandates, and in the West, such as Germany, the culture is centered on the rule of law. This is not the case in East Asia. It is far easier to change and adapt a written law than

[61] Genda & Reibeck. 2000 pg. 95
[62] Johnson. 2001 p.57

one that exists merely in the core of a culture, making reform of the Japanese labor system a difficult task.

Another way these ties are apparent is in the system of shareholding. Examined in some detail in following chapters, the shareholding system is a good indicator of the direction of the economic system. In Japan, banks and non-financial firms both hold 25 percent of the publicly available stock. The banks owned a quarter of the publicly listed countries, to look at it another way.[63] Moreover, the banks in Japan –as in Germany- hold loans that constitute the lion's share of corporate financial liabilities, from 60 to 70 percent of those liabilities. It is not surprising then that these banks have a steering function, as in Germany.[64]

Like Germany, a producer-driven economy was an excellent match for the goals that Japan wished to achieve when rebuilding the state during the American Occupation. Also like Germany, the population was not in a position to support a consumer-driven economy. While there is little surprise that such an economy developed, the question as to whether or not it is sustainable in the age of a globalized economy remains.

*Conclusions*

The Japanese capitalist model is perhaps one of the more interesting studies. Built on culture and tradition rather than rule-of-law, perhaps one of the most interesting aspects, especially to those who have a Eurocentric mindset is the fact that such a system could even succeed, even in the "short" term. The success of the Japanese model, especially in terms of "catching up" cannot be debated, however. What can be debated is

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[63] Pauley and Reich. 1997 pp. 8-9
[64] Ibid.

whether an informal system based on culture and tradition, in unwritten guarantees and promises can be competitive in the new world. The very nature of this system makes change very difficult, for the state and the people are being asked not just to change laws, but to change the very essence of a society that they hold dear to their hearts. In many ways, this can be seen as a far more difficult task than changing policy in a state such as Germany.

One can ask though whether it is necessary to change the culture, or if it is possible to adapt the new global economy to the culture. This culture has much that is not compatible with the new global economy, making change even more difficult. Obviously, change has occurred before, or the economic miracle of Japan would not even be spoken of, much less exported to the Pacific Rim. Further study of how those other states -South Korea, Taiwan, and of course China- might give some insight into how to adapt the strengths of Japan's capitalist model to the new world economic order. Economic growth breeds political liberalism, an effect that should be of much interest as China becomes a stronger player on the world stage.

## Chapter 6

## Spoils of Victory:  The United States Model

The gold standard of a consumer driven, innovative, market based liberal capitalist model, the United States has experienced constant growth since the end of the Second World War, without the prolonged periods of stagnation experienced by Japan and Germany.  This chapter examines the liberal model embraced by the United States, and how the flexibility granted by a model that is not intrinsically tied with labor and is funded by a market based system allows for the ability to adapt quickly to changing international economic norms.

The liberal economic model in the United States developed over the course of two hundred years and did not have to be rebuilt in the same manner after the end of the war as Japan and Germany did.  The war was actually an economic boon to the United States, which up until 1941 was still struggling with the effects of the Great Depression.  Being a victorious party of the Second World War, along with being the only major Allied power that did not suffer any physical damage to the home country put the U.S. in a unique position at the end of the conflict.  The casualty level of over half a million men, though significant, paled in comparison to the losses sustained by Japan and Germany, or by some of the U.S. allies.[65] Just as important was that the United States suffered no damage to its infrastructure. Unlike their defeated German and Japanese counterparts, U.S. veterans did not return to rubble but rather to a bustling economy and a country eager to reward their heroes. As a result of post war economic development followed a highly different track, one that gave the United States the ability to adapt far more quickly when the economic model changed so drastically following the end of the Cold War. The liberal capitalist system in the United States, much like the labor system, differs from the systems in Germany and Japan in several key aspects. Perhaps the most interesting aspect of these differences is that all skew towards allowing more and quicker flexibility in the economic system. Three key aspects that differentiate the U.S. capitalist system from Germany and Japan are the stock market, the role of banks, and the focus of the liberal economy, namely the consumers.

The United States was not in the same situation as Japan and Germany, a primary reason that a very different system developed. Labor, while still important- especially in a manufacturing-based economy that was running at a fever-pitch- did not have the same footing to call the shots as did the survivors of the defeated Axis powers. Another way that the United States system developed differently was the capital financing system. Unlike Japan and Germany which are not only steered but also financed largely by the central banks, corporations in the United States are financed by investors, often through the well developed stock market (public ownership). This type of system results in corporate governance that does not share the patience that is a defining feature of the non-liberal systems. With close to 90 percent of the voting shares in publicly listed

[65] City University of New York. 2007

corporations owned by pension funds, mutual funds, and individual households,[66] it can be expected that year after year of continual corporate losses will not be tolerated, especially by those looking at their retirement portfolios and those who make their livings on stock market trading. These shareholders are also going to be interested in continual innovation. Attempting to put this another way, shareholders, whether large organizations or small day traders, understand that in the American economic system, those who rest on their laurels will quickly be passed by. These shareholders or rather the shareholders who hold voting stock in a corporation are the ultimate authority. Just like politicians those in power, i.e. CEOs, wish to stay in power. Upsetting the majority of voting shareholders, even if the corporation is doing well, is not the best way to keep one's position.

Going further with this case, innovation or research and development is not just encouraged in this type of system, it is required. The United States economic system is oriented toward innovation, and it can be argued based around innovation.[67] This emphasis on innovation carries over to both the role of the banks and the consumer basis of the United States economic system.

In other words, the United States had no need to "catch-up" but rather a need to innovate. This innovation-based economy required a large amount of flexibility for both labor and the employers. This plays itself out in a number of ways in the labor system, such as the low levels of unionization, the mobility of the American worker, the average

[66] Pauly and Reich 1997 p.8
[67] Pauly and Reich 1997 p. 23

tenure of a worker, and the unique system of reeducation available for the United States worker.

Unionization in the United States has a long and interesting history. There is no doubt, however, that unionization has been in decline since the end of the Second World War with coverage of only fifteen percent by the mid nineteen-nineties.[68] While this does vary from industry to industry and from region to region, the cumulative effect is that the United States has one of the lowest levels of unionization in the developed world. The reasons for this are varied, such as governmental interference, management resistance, free-shop regulations, and a general indifference on the part of U.S. workers, especially those who were not reared in areas with a strong union presence. Opinion of labor unions in the United States is actually mixed, with many seeing unions as a hindrance to economic growth rather than a benefit.[69]

There is not a cultural attachment to unions in the United States as in Japan and Germany. Unions fail, according to some literature, due to a lack of their own will and must share a part of the blame for the decline of the union movement since the end of the Second World War.[70] Accepting the thesis that the genesis of the labor movements in Japan and Germany came from an entirely different situation than existed in the United States, one can see the reason for this apathy. There was no emergency situation that required the labor to coalesce and demand greater control. Indeed, what ended up happening in the United States, according to Clawson and Clawson, was that unions and management developed an unofficial accord where "business accepted unions and unions

[68] Nickell. 1997. p.63
[69] Rasmussen Reports, 2006.
[70] Clawson & Clawson. 1999. p.98

became the de facto allies of management, helping to regulate and co-opt worker discontent"[71]

Even this accord was not enough to maintain what little true power the unions had, as management resistance became more and more pronounced. With the rise of globalization and neo-liberal economic theory, unions became more and more a roadblock to what the corporations thought was progress. As such, management began to resist both existing and new union movements, using a variety of methods to discourage unionization. These methods included passive interference such as delay tactics, to compulsory company meetings where anti-union presentations were made- without any equal time provision- all the way to the forced quitting or outright firing of those who engaged in union activity.[72]

This resistance was aided by laws and political developments that further eroded the influence of unions. United States labor has the right to organize, yet at the same time employers are allowed by law to "influence and intervene in the process,"[73] a situation unique among all industrial democracies.[74] Even if a union exists or is formed, the most powerful weapon -organized work stoppage or striking- is curtailed by law. Many unions are prohibited by law from striking, usually for reasons of public safety or order, and in cases where organized work stoppages are allowed, the employers maintain

[71] 1999. 96
[72] Clawson & Clawson. 1999 pp. 102
[73] Clawson & Clawson. 1999 pp. 100
[74] Ibid.

the right to continue production and bring in permanent replacement workers.[75] Striking workers would then be reassigned, often into undesirable positions.

In addition to the continued weakening of the power of unions, the political clout of the unions continues to weaken as well. The rise in power and six-year near absolute control the anti-union Republican Party enjoyed from 2000-2006 severely curtailed the influence of labor organizations and the rise of the "moderate" wing of the Democratic Party has curtailed this influence even further. This is a bitter pill for unions as the Democratic Party has been the traditional ally of organized labor.[76]

As with unions, banks in the United States share little of the clout of their counterparts in Japan and Germany. Banks in the United States fill much different roles than the banks of Germany and Japan. Not centralized or under the control of the government save for regulatory functions, such as the FDIC and key interest rates, banks in the United States do not have a steering function in U.S. corporations. In terms of bank loans to corporate liabilities, a factor examined with both Germany and Japan, the ratio is only 25 percent, as opposed to 60-70 percent in Japan.[77] Therefore, it can safely be said that banks are not the major source of capital in the Unites States. They do fulfill important functions including secondary financing, cash management, selective advisory work and other finance related services.[78] However, the trend is for corporations to rely on retained earnings or capital markets to fund investments.[79]

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[75] Ibid.
[76] Clawson & Clawson. 1999 pp. 97
[77] Pauly and Reich 1997 p. 9
[78] Ibid.
[79] Ibid.

This is an important distinction that again shows an economic system that relies on flexibility.  The process of attaining bank loans is a cumbersome process, and for small or even medium businesses can be difficult to gain access to bank loans.  The ease and speed of using one's own funds goes without saying, and the process of raising capital via the market does not require collateral or a lengthy application process.  The trade-off for this is that some control of the corporation is ceded to the shareholders who are looking for quick results in many cases.  It is a rare shareholder who is willing to invest in an innovation that will not return profits in a reasonable amount of time.  In terms of bank ownership of publicly available stock, the rate in the United States is less than one percent, as opposed to 10 percent in Germany and 25 percent in Japan.[80]  It is a reasonable conclusion then, looking at that figure and the ratio of bank loans to corporate liability that the U.S. banks are not in the business of capital allocation and as a result not a large player in steering economic direction.

The United States labor model, like the capitalist model, has several unique features.  In addition to the influence or outright control of organized labor, another feature of the United States labor system that is unique is the comprehensive system of reeducation available to experienced workers.  This system has its roots as well in the period following the Second World War.

With thousands of veterans returning, there was a need to prevent the situation that had existed immediately after the end of the First World War when soldiers returned to high unemployment.  There was also a desire to reward the victorious soldiers, and some of this reward came in the form of the GI Bill, part of which included a payment

[80] Pauly and Reich p.8

voucher for college tuition.[81] With the large number of returning soldiers spread out across the country, the existing system of a small number of large four-year universities made higher education, even with tuition vouchers, inaccessible for many veterans. The two-year or community college system, already in place, began to expand in great numbers, doubling in enrollment between 1944 and 1947. Enrollment further increased after the end of the Korean War, and quadrupled in the nineteen sixties, as the baby boomers came of age and the Pell grant system came into place. [82]

However, it should be noted that the evolving community college system is more important for U.S. labor. Originally instituted for the expressed purpose of awarding Associates of Arts degrees, or degrees that allow for the transfer into a university system, the community college has expanded into vocational training, workforce development, and continuing or non-degree-seeking programs.[83] While the crown jewel is the Associates of Arts, it is these Associate of Science and Vocational Certificate programs that pay the bills for many of the country's community colleges. These colleges often gear themselves toward serving the so-called "non-traditional student," defined as any student who does not fill the standard definition of a student who has just finished high school, usually in age from 17-19 and supported by their parents. This definition of the "traditional student" has become less and less "traditional," in 1997 close to thirty percent of students enrolled in higher education are over the age of 30.[84] Community colleges achieve this through a number of methods, including lower tuition, gearing class

[81] Kane & Rouse. 1999. p.64
[82] Ibid.
[83] Ibid.
[84] Seftnor & Turner. 2002. p.338

schedules for working students, such as weekend and evening courses, and reaching out to part-time students.

For American workers that have been laid off or are in an industry that is in decline, the availability of re-training is a unique “safety- net” available to them, as is the ability to change careers. Financial aid programs make education at the community college- with an average annual tuition of $1,283 for full time students[85]- affordable for most working adults, particularly those attending part-time. Current research does indicate that a large number of non-traditional students are taking advantage of the Federal Pell grant system, to the point that “the median recipient is not a teenager, but a student in her twenties.”[86]

A laid off worker, or a worker deciding to “get while the getting is good” would likely have the following profile: They are over the age of 30, attending school part-time while holding down a job to pay the bills, pursing a program with the major purpose of being trained for a specific occupation once the program is completed- in other words, a nursing degree rather than a political science degree- and is utilizing the financial aid programs available to them. In some cases, this is their first time in higher education, and therefore is in need of remedial classes, another specialization of the community colleges. Other times, they have already secured employment, and their education is being paid by their new company, with the understanding of a work contract to last several years.

This system is important as it is an indicator of the course that the United States took with their labor system after the end of the Second World War. The fact that such a

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[85] Kane and Rouse 1999. p. 64
[86] Seftnor and Tuner. 2002. p. 337

system is in place, along with the financial aid programs, gives employers the moral cover they need when they announce downsizing or realignment. It is also an indicator of greater flexibility in the liberal system.

Despite these peculiarities in the liberal capitalist system of the United States, the biggest and most important difference is the main player in steering United States economic policy: the consumer. The United States liberal economic model is a consumer-based system. What this means is that the consumers, not the producers, decide what is produced. This is a direct result of the innovation based economy.

In other words, the economic direction of the United States is directed by where the dollars go. Personal technology is perhaps the greatest example. From VCRs to cellular phones to MP3 players, items that are at first considered to be novelty quickly become household mainstays. This is not due to Apple deciding that MP3 players need to be in the American consumer's hands, it was due to consumer demand for a better portable music system. Another interesting aspect of this is that it is consumers, not producers, who decide on which model, which design, or which format will be the industry standard. Take for example the so-called "format war" during the early age of home video recorders. Two competing and incompatible systems, the VHS and Beta, were introduced to the market at roughly the same time. Beta was widely considered to be the superior system in terms of quality, but VHS had the advantage of a longer recording time. VHS also allowed the licensing of the system, allowing other companies to market clones of the system, as opposed to Sony, who kept the Beta system proprietary. The resulting reduction in price and growth in availability of the VHS system allowed for the inferior product to gain the larger market share, and by the mid to late nineteen-eighties, VHS was the industry standard.[87] It was the consumers who had decided this.

Walkmans were replaced by portable CD players, which in turn were replaced by portable MP3 players. VHS was replaced by DVD, and even now a new format war rages to replace the DVD. Consumers demand innovations, those who do not innovate are left to the dust pile of history. To innovate, there must be flexibility, room to grow and adapt. This is the defining feature of the liberal capitalist system.

*Conclusions*

The United States has a very different system. The reasons for this are varied and it can be expected that it should be different from Japan and Germany given the differential outcomes of the Second World War. However, it is these differences that make the United States economy much more versatile and able to withstand the shocks and changes in the worldwide economy. There are some unfortunate side effects to this liberalism, including corporations' flexibility to let go of workers, to move overseas, to institute programs in other states with very little oversight by the national government. It can be argued that there is too much flexibility in the United States system, that the continual need to innovate in order to please the consumers that feed and direct the economy causes massive abuses in the system, and that these abuses are morally covered by lower prices for the consumer or by the comprehensive retraining programs offered in the United States. These too are difficulties and challenges that are not easily remedied. However, in an objective analysis of the global economic system, it is sure that the

[87] A near exact situation occurred with the IBM PC and Apple Macintosh systems. Apple kept their systems proprietary, IBM allowed for the PC to be cloned, leading to near complete dominance of the home computer market by PCs.

United States system has been the most successful, especially of the three systems examined in this paper. In the following chapter, the differences of those three systems will be compared and contrasted, along with the effects of these differences.

## Chapter 7

## Catching Up and Slowing Down: Comparisons and Contrasts of the United States, Germany and Japan.

Exactly what is the best model, or more appropriately, what are the advantages the United States model has and are they actually advantages? In the brief overview of the three systems, differences have emerged in both labor and the capitalist systems. Major differences in labor systems include: The influence of labor on government, the influence of government on labor, the formal guarantees that are given to labor by company management and the government, the informal guarantees granted to workers, and the ability to retrain or change careers in the middle of employment lifetime. In terms of the capitalist systems, the differences examined include the role of banks, the major sources of capital and the central force of the economy. These differences all restrict or enhance the flexibilities that seem to stimulate economic growth. The major differences addressed in this paper: Influence of labor on government and the influence of government on labor, formal and informal guarantees to labor, banks and the capital markets, producer driven economies vs. consumer driven economies, and finally the challenges of globalization are each examined with overall conclusions at the end of the chapter.

*Influence of Labor on Government and the Influence of Government on Labor*

Germany and Japan both operate under a simple truth: Those who ignore labor do so at their own peril. Attempting to reform the economy is always a dangerous game, especially in democratic regimes that must eventually answer to the people who were affected by the reforms.

Let's look at it another way, from the view of the government. It is an axiom that those in power wish to stay in power. In democratic regimes, such as the three we are looking at, staying in power means keeping the populace you must eventually answer to happy. Ancient Rome utilized to great effect the concept of Bread and Circuses, or in lay terms: keep the people fed and entertained. This powerful concept is still in place today, and even the democratic governments utilize it to some degree. While the bread and circuses are not provided by the state, the means by which the populace buy bread and attend circuses are very much dependent on what the state can provide: an economy that will self-generate jobs, but more importantly, jobs that will provide enough compensation that workers can not only provide for their necessities on a long term basis but also advance in their careers.

In Japan and Germany, the catch-up models, these goals are achieved by a state that has instituted a symbiotic relationship with labor. The governments, in other words, need labor to shore up their power, and vice versa. In contrast, the United States, particularly since 1994, has adopted what could be described as an adversarial relationship to labor. What are the effects of this on the flexibility of the economy and its growth?

Going back to the idea of ignoring labor at the peril of power, it's easily seen how this can cause the governments of Japan and Germany to be cautious about reform. Economic reform, especially when changing to a more liberal model, can often be painful for workers as layoffs, closures, pay cuts often can be the result. However short-term these effects may be, unless the government in power is remarkably fortunate, an election cycle is likely to occur during the negative effects of these changes. The result of this goes without saying: the government responsible for those changes, beneficial or not, will be at the business end of the voter's wrath. Not only that, but the new incoming government will have learned from its predecessor's "mistakes" and quickly move to not only roll back the so-called reforms but also to strengthen the old system. In societies such as Germany and Japan, where organized labor is a powerful part of the populace, attempting such reforms without the support of organized labor can be most dangerous.

Contrasting this with the case of the United States, which, especially since the 1994 Republican takeover of Congress has developed a near adversarial relationship with organized labor-not unexpected, as unions have always been one of the mainstays of the Democratic Party's base- we see an unexpected result: greater freedom to pursue reforms that may cause some harm to established labor. Take, for example, the recent attention that has been paid to the struggling manufacturing sector of the United States economy. Once a stronghold of union power, the manufacturing sector has weakened with the rise of globalization and neo-liberal political economy.[88] With the dropping of trade barriers, both formal and informal, companies have been freer to pursue different business models, including a heavy reliance on foreign factories and the lower-wage foreign workers. The

[88] Clawson and Clawson 1999 p. 101

results of this model are greater profits for the business, supposed lower prices for the American consumer and the loss of jobs in the manufacturing sector. However, the growth in GDP does indicate that this model increases national GDP. The growth in GDP for the United States in 1981-1990 averaged 1.9% per year. From 1991 to 2000, commonly considered to be the advent of globalization, American GDP increased to an average growth of 3.2%. This growth in GDP is tempered by the loss of jobs in the American manufacturing sector, evidenced by the growth of the infamous Northeast and Middle West “rust belt”.

This change in direction, however, would have been difficult for the United States to pursue had there been more effective resistance by the labor movements. In fact, the opening up of trade barriers began in earnest by a Democrat, President Bill Clinton. By instituting the North American Free Trade Agreement (NAFTA) and spearheading the growth in influence of the Global Agreement on Tariffs and Trade. (later renamed the WTO, or World Trade Organization), this member of the traditionally-labor-union friendly Democratic Party took a leading role in the further weakening of the unions’ political influence. While there has been a backlash that has grown in strength in recent years against globalization and the neo-liberal movement, the dropping of trade barriers is continuing at a fast pace for the United States, evidenced by the passing of the Central America Free Trade Agreement (CAFTA) in 2006, fiercely opposed by organized labor.

*Formal Guarantees and Informal Guarantees: What do they actually guarantee?*

We see above that there is strong evidence that the flexibility enjoyed by the United States due to the waning influence of organized labor has benefited it, at the very least in terms of economic growth. Turning now to the unions themselves, the question must be asked as to whether or not the guarantees that organized labor gives to its members (and non-members, as organized labor does seem to set the tone for all other worker guarantees) help or impede economic growth.

This is a difficult and multi-layered question. It can be argued that any guarantee given to workers will impede economic growth. Take, for example, the minimum wage. The argument against this is quite simple: There is a natural limit for which people will not work for. As companies would be required to pay less, they could hire more employees willing to work at that price. Theoretically then, unemployment would cease to exist. While compelling, the hypothesis ignores a number of concerns, including that there is no guarantee that companies would take those savings and invest in more human capital, that if workers are earning below subsistence wages, there is no discretionary funds to go towards the company's bottom-line in a consumer-driven economy, and that at a certain point it is more profitable to just go on welfare and be a ward of the state. This is brought up because it should be pointed out that guarantees to workers are not necessarily an impediment to growth, and in fact, could be a benefit. The question, complex as it is, is at what point the guarantees start to impede growth, and which ones impede growth faster or more severely, to the point that the costs outweigh the benefits of these guarantees.

The major guarantees given to Japanese and German employees include lifetime employment, strong protections in terms of both wages and workplace protection, and protections against layoff or firing (excepting termination due to negligence or malfeasance.) Workers in the United States, at least on a system-wide level, do not enjoy these benefits.  How do these benefits restrict economic flexibility and does this greater flexibility translate into greater growth?

All these guarantees boil down simply to once you have a job, you will keep that job.  This was a powerful motivator to keep a short supply of labor in place after the end of the Second World War.  This paper has gone back often, because it is important to understand what it must have been like for those who had survived the war both on the battlefront and the home front.  Everything they had known was destroyed, and worse, they were the losing party.  Nothing was guaranteed.  But Japan and Germany needed them to rebuild, and the economic system that developed had the double advantage of both catching up and keeping the workforce in place.   Now that they have caught up, the cost is becoming clear.  These guarantees do limit the flexibility for companies to adapt to the changing global economy.

In business, the greatest expense is human capital, particularly in the developed world.  Protections and taxes are a weight on businesses.  With each technological innovation, there is a cost for labor, as these innovations cut down on the need for labor. As a result, these innovations meet with strong resistance from labor- the infamous case of the Dutch workers throwing their wooden shoes into the mechanical looms- and innovation does not necessarily have to come in the form of technology.  A contemporary example, the movement from on-site storage to the Just In Time (JIT) model (ironically developed by the Japanese) cut down on the need for warehousing and those jobs.  The movement of manufacturing to semi-peripheral nations has had a decimating effect on the manufacturing sector of developed nations.  However, we have shown already the advantages of these innovations.  These innovations come at a high cost to workers however, and in the case of Japan and Germany, it makes it difficult at best to institute these changes. Pressure from the rank-and-file of the unions becomes pressure on the leadership of the unions, which in turn becomes pressure on elected leaders. This symbiotic relationship in fact becomes a brake on the ability to adapt economically.

This ability is shown in an interesting and unique way in the United States. In the preceding chapter, the system of the community colleges was examined in some detail. How this shows the flexibility of the United States system is an interesting subject. It is an example that shows an often overlooked aspect of the American economic system. Workers have the ability to adapt to the changing economy, even at later stages of their career. This flexibility has two major benefits. First, it gives American workers the chance to improve their own footing, and second, it gives American companies the moral cover necessary to engage in activities such as shutting down factories or workshops that are the economic lifeblood of a community. It can be argued that American companies take advantage of this moral cover at far too great a rate, regardless; it is still an indicator of the greater flexibility of the liberal system. It is also, just as the German labor economic system reflects the German culture and the Japanese labor economic system reflects the Japanese culture, this unique flexibility reflects the American ideal of taking control of one's destiny, and research shows it does have a positive effect, both in the education level of American workers as well as their own economic performance.

*Banks and the Capital Markets*

The banking systems in Japan and Germany have two defining features: They perform a steering function in the economic system itself, and they are the primary source of capital in those systems. This allows for two things. First, the producers in these economies have the benefit of a system that by its very nature is patient and more mindful of the long-term implications of capital allocation. They are not subject to the whims of an investor wanting immediate return or a consumer wanting the newest and greatest innovation. Given the structured nature of loan payback- over a long period of time with the money generating interest- immediate return on investment is not a concern.

Second, given the nature of the banks in Germany and Japan, the central government has some formal and informal control over the direction of the state economy. To put it simply, the governments perform a steering function over the banks, and the banks perform a steering function over the economy. This type of system could not exist in an economy where the capital market is the primary source of capital. When that happens, economic control devolves to shareholders, and in true liberal capitalist countries, the banks hold very few shares of public companies.

In the United States, the case study of liberal capitalism, the primary capital allocation institution is the capital, or stock market. What this means is that public corporations trade off a portion of their controlling interest for capital. The effect of this is a system that demands a much faster return time. Individual investors and mutual funds are not willing to wait twenty years for a return on their investment. In many ways, this is liberal democracy in an economic form. (After a fashion. Corporate voting is certainly not one shareholder/one vote.) In order to meet a faster return time and satisfy capital market demands a free market is required and is the result. Government has little influence over the allocation of market funds, and has even less influence on the consumers that drive the economy. To put the point clearly, in the liberal-capitalist model, the central government has little direct or indirect control or steering ability of the market.

*Producer Driven vs. Consumer Driven*

The distinction of a consumer driven economy versus a producer driven economy is perhaps the defining feature of the two systems. Germany and Japan are producer driven economies, the United States consumer driven. This difference, more than any other, directs the economic direction of the three states, and clearly shows why more flexibility is necessary in a consumer driven economy.

In order to please the constantly changing, constantly improving, constantly adapting consumer, innovation has to be quick, affordable, convenient and accessible to the everyday user. Easier said than done, but as companies such as Commodore and Atari discovered those who are unwilling to continually innovate will be left behind, and there is little if any chance of catching up. A consumer driven economy is by definition a free market, subject to the whims not of a government or central bank, but to the consumers who feed it and the shareholders who fund it. To put it another way, a consumer driven economy cannot exist in Germany or Japan today. However, it must be noted that it would have been impossible to build a functioning and sustainable consumer driven economy in Japan and Germany after the end of the Second World War. Such an economy requires a consumer base that is able to afford the goods and services that such an economy would produce, and after the shock of that conflict, those factors did not exist in those two states. A producer driven economy was the result.

Still capitalist in nature, with private ownership and decision making a feature, the producer driven economy is as has so often been stated in this work a third way that shuns socialist control yet is not a *laissez-faire* Anglo-American economy. This economic model relies on capital from banks rather than a capital market, and on a government that is steering, though not controlling, economic and monetary policy. Producers must take direction from somewhere- either from the bottom up as in a consumer driven economy, or in the top down as in a producer driven economy. While governments in non-liberal capitalist countries do not own or control the means of production, they do, through institutions such as the banks, control the direction that the economy takes. Producers are seen, as stated before, as national assets, much like oil or natural gas. They are resources for the state to use for the benefit of their international standing, their economic strength, their wealth and power. This fits in so well with both Germany and Japan's political culture that it would be amazing if such a system had not developed in those two states.

One can see then the inherent loss of economic flexibility in a producer driven economy. Producers yield not to the people, or the consumers, but to the steering power of the state. This can make quick adaptation difficult, especially in states where the government derives their power from the electorate.

*Challenges of Globalization*

There is no doubt that for over forty years the non-liberal economic systems of Japan and Germany were incredibly successful, and showed little or no signs of slowing down. They were doing so well that in the 1970s and 1980s there was legitimate concern that the non-liberal capitalist model might well overtake the liberal capitalist model and this did not go unnoticed by developing states. However, in the nineteen-nineties there came two shocks to both systems that began to truly show their weaknesses and brought an end to both miracles.

First was the actual catching up of both economies. Both systems were built and developed with one goal: To rapidly rebuild their industrial base and become a global player on par with the largest economies. This they achieved remarkably well. However, once caught up, the non-liberal economies were not well suited for innovation or for the rapid adjustments necessary in an economy that is leading rather than following. This effect may not have been so hard felt had it not been for the second shock of globalization.

In the case of Germany, there was also in the nineteen nineties a large movement towards economic integration in the European Community. This integration began soon after the Second World War and by the late nineteen nineties had progressed to integration of several of the major economic currencies in Europe, including the German mark and French franc. While this economic integration certainly had an impact on the German economy; those effects are outside the scope of this paper, which focuses on the non-liberal economic model of Germany and the challenges of that model in the age of globalization.

When speaking of globalization, it is important to make the distinction that the globalized economy tends to take on a neo-liberal model. In other words, it is the United States model taken beyond borders. With the fall of the Soviet Union the major roadblock to the exporting of the United States system worldwide was dismantled. Coupled with the “shock therapy” that several of the former Soviet client states undertook, and the First World’s dominance of the world economic organizations, the long simmering conflicts of non-liberal and liberal capitalism finally came to a head, with the non-liberal economies on the losing end.  In such a global system that requires lower costs, faster innovation, and greater overall economic efficiency, the non-liberal systems are at a distinct disadvantage.

*Conclusions*

In the comparison and contrasts for this chapter, one can easily see where the liberal capitalist economic and labor models grant more flexibility for the consumers and the producers.  Taken with the long term economic performance already described in earlier chapters, it is a reasonable conclusion that greater economic flexibility yields greater economic growth, particularly in the age of the neo-liberal globalization.  One must be most careful however.  Abrupt changes to economic models rarely lead to positive results, and there are massive flaws in the liberal capitalist model that cannot and should not be ignored, particularly in regard to labor and the lessening of the spending power of consumers.

# Chapter 8

## Greater Flexibility, Greater Growth: An Accurate Assumption?

While it does seem from the evidence presented in these case studies that greater economic flexibility leads to greater economic growth, one must be careful not to go too far with the conclusions that this paper has drawn. At first glance, this paper may seem to be an attack on labor unions, labor guarantees and governmental influence of economies. Such is not the purpose of this paper. The case studies do seem to indicate that the less influence and fewer guarantees labor and producers have from the central government, the greater the ability for the economic system to adapt to changing conditions, leading to better economic performance. However, this paper also highlights how such influence and guarantees were not only necessary, but natural considering the massive shock that Japan and Germany had endured at the end of the Second World War.

The United States system, however, also endured some shocks after the end of that conflict. The community college system truly began to come into its own with the massive number of returning veterans who had been promised an education once they were mustered out of service. It must be understood how important the community college system, coupled with the federal student aid system, is to the thesis of this paper. Greater flexibility must be available at all levels, from the systemic level to the individual, and there must be both an accessible higher education system and a financial aid system available to students at any age and any level for the individual system to be viable. While it should not be sugar-coated the difficulty in changing careers at mid-age: the returning student is often saddled with a mortgage, a young family, miscellaneous debts, along with the difficulty in returning to, or possibly even attending for the first time, the rigorous demands of the post-secondary system, even attending part time. Yet it is a unique feature of a uniquely liberal American labor system.

There does remain a question as to whether or not the extended downturn in Japan and Germany are the result of faults in the non-liberal economic system or the result of normal, long-term cyclical changes in the global economic system. Is it possible that, all things being equal, Germany and Japan will start to experience a natural turnaround while the Unite States starts to falter? Indeed, as of 2007 there is some evidence of this, particularly with the continuing weakening of the dollar vs. the Euro and the Japanese Yen. However, it must also be noted that empirical evidence does not show that the economies of Japan and Germany are improving, despite the economic power of a rising Asia and a confederated Europe. Germany and Japan since the 1990s on have experienced continual malaise after over forty years of phenomenal growth. While it is possible that Germany and Japan are experiencing an economic "correction" cyclical downturn, this cycle would be far longer than the time examined in this paper.

What developed in Japan and Germany in the time covered in this paper was a marvel not only because of the impressive results for almost forty years, but also because of how perfectly the system came together in those two states. It is little surprise that this third way of producer driven economies became such an attractive model to other developing countries and economies. The situation that existed in Germany and Japan in

1945, however, was so unique that true duplication is impossible without the complete destruction of another world conflict, a conflict that most in the world are quite keen on avoiding. It may well be impossible to truly export the German and Japanese producer driven models, as the infrastructure and even the political systems developed in tandem with those economies. It is this fact that makes the flaws in those systems all the more difficult to rectify. At any time that guarantees are given, or agreed upon, it must be understood that an opportunity cost of such an agreement is the limiting of the ability to adapt. Agreements often become archaic and a burden to at least one of the sides very soon after they are signed. In Japan and Germany, however, there are unique challenges that have to be met if the continued malaise is to be broken. What is difficult, indeed, what makes it such a challenge, is that these guarantees are so intertwined with the Japanese and German political cultures, that changes to these systems is difficult are the traditional sense that such changes would almost certainly cause short term (a relative terminology, to be sure) hardship for the very group they are trying to help. It is also difficult in that a politician is asking their people, their culture, to go against the values and traditions that have existed in some case for centuries. To make an impossible sell even more impossible, these politicians and leaders are asking their people to adopt a system from a state that is viewed by some in pure contempt.

However, such changes are necessary. The purpose of this paper was to examine the unique aspects of each of these capitalist economies, and determine whether the continued growth of the United States had at least a major "root" in the economic systems differences. We have seen the differences and how they could restrict the ability for economies to adapt and grow. While the actual, specific changes that should be made are outside the scope of this work, further research is warranted.

Balance is necessary in all things. Greater flexibility does lead to greater growth. What must be guarded against, however, is the temptation to free the economy too quickly. Greater flexibility, done too quickly, will not lead to greater growth, but rather to the dreaded “race to the bottom”. That has been the lesson for the United States in the last decade.

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