The dilemmas of sectoral embeddedness and the limits of Japanese business mobilisation

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Recent research has provided significant insights into the impact which policy networks, or institutionalised patterns of state-society relations have on the policy process. One branch of this literature highlights how achieving a high degree of sectoral embeddedness can enhance the state's capacity to achieve industrial transformation and bolster economic competitiveness (Evans 1995, Weiss 1998). This paper builds on this research by assessing the impact of dense sectoral policy networks on the political dynamics of economy-wide, as opposed to sectoral business mobilisation. In the case of the recent politics of tax reform in Japan it would appear that concentrated sectoral policy networks may actually compromise the state's reformative capacity. The argument here is that dense industry specific policy networks exacerbate sectoral differences over tax reform and tend to create factional cleavages among state agencies and policy makers.

Introduction

This somewhat embryonic paper has its origins in a broader research project on the politics of taxation reform in advanced industrial economies and the role of institutional change in this process. While the dynamics of tax reform are both contingent and complex, at an empirical level the legitimacy of tax reform proposals is enhanced and their prospects of implementation improved if there is a broad, and preferably cross-class support for reform. Initially these observations seemed to be consistent with the broad thrust of the 'embedded autonomy' literature and its claim that state capacity is enhanced when governments were able to combine Weberian bureaucratic independence with a rich web of connections with key actors in civil society (Evans 1995, Weiss 1998). While there is a good deal of evidence that sectoral embeddedness in which key industry actors work in close collaboration with public 'pilot agencies' does bolster the state's capacity to achieve industrial transformation, the evidence, and Japanese tax and financial reform is a case in point, is more ambiguous when it comes to economy wide economic reform.

My tentative argument is that comprehensive tax reform, such as the introduction of a broad-based consumption tax, requires industry wide and preferable cross-class political support.

This is consistent with Guy Peters (1991) observation that successful tax reform requires a shift from 'self-interest' to 'public interest' politics. The irony here is that while developmental states such as Japan, with their particularistic patterns of political representation and government-business relations, may enjoy heightened transformative capacity as a sectoral level, the institutional apparatus associated with such a system of state-economy relations may compromise the prospects of achieving economy-wide reform. This is especially True of the Japanese case since the 'bubble economy' and the associated decline in the LDPs ability to aggregate interests through elaborate compensation regimes. The paper aims to enhance our understanding of the tensions between sectoral and economy-wide mobilisation and the associated implications for the state's reformative capacity by reviewing the extant literature on the factors effecting business mobilisation (Vogel 1989, Polsky 2000, Bell 2006) Having briefly reviewed this literature the empirical section of the paper will assess its efficacy in terms of explaining patterns of business mobilisation in relation to tax reform in Japan. The paper concludes with an evaluation of the relative significance of state institutions, partisan actors and economic circumstances on the dynamics of class-wide business mobilisation.

Understanding business mobilisation

In many ways business mobilisation is confounding. Structural theories of business power downplay the need for the corporate sector to engage in overt or 'instrumental' political activity (Bell 1995, Hacker & Pierson 2002), while the on the supply side, the influential work of Mancur Olson and many after him has focused our attention on the collective action problems associated with business lobbying (discussed below). Moreover, in the increasingly liberal political economy of the late 20th and early 21st century there are arguably more demands on corporate leaders to deliver short-term shareholder value as opposed to investing time and resources in political projects which promise longer term returns (Bell 2006). Yet despite the persuasiveness of such arguments, the fact remains that from time to time business interests do mobilise politically and with considerable impact. Indeed, in the case of tax reform, business interests have had considerable influence and, in the Australia case for example, were important instigators of reform efforts (Eccleston 2000). How then can we explain such bursts of political activity from the business sector? The next section of the paper provides a brief synopsis of the extant literature on the topic which will serve as a guide for our analysis of business mobilisation in relation to tax reform in Japan.

As noted above, Olson's *Logic of collective action* (1965) arguably provides the most influential insights into the challenges of collective political activity on the part of business. The essence of this argument is that the benefits which any one firm would accrue from lobbying for general shifts in public policy (which would benefit society at large) would generally be too small to justify the investment of time and resources. Moreover, because public policy reform (such as putting the national tax base on a more secure footing) is a public good, rational corporate actors will be tempted to free ride and let others, such as partisan leaders, shoulder the burden of advocacy work. While this general framework is compelling, a line of reasoning that is of particular relevance to this paper is Olson's acknowledgement that collective business action does occur, especially in the case of 'privileged groups'. The argument here is that political activity by business is most likely where a few powerful firms dominate a specific industry sector as they will be likely to capture a fair return for lobbying on industry specific policy issues (Olson 1965, Polsky 2000, Bell 2006). While this analysis, and the privileged groups case in particular, give insights into sectoral business mobilisation we need to look further afield to explain cases of cross-class business interest group activism.

Perhaps the most influential work on the historical variation in business mobilisation is David Vogel's *Fluctuating Fortunes: The political power of business in America* (1989). In contrast to Olson's rational choice analysis, Vogel employs a historically grounded method and emphasises the importance of political and economic context in explaining class-wide business mobilisation. In the US in particular, with its liberal political culture, business interests prefer to maintain and arms length relationship from the state. This dynamic can and does change when business interests broadly conceived are threatened by rival political movements (the New Deal or the anti-corporate politics of the1960s) or economic crises such as that experienced during the late 1970s.[1] In short, in the American context at least, broad-based business mobilisation is best regarded as an unusual response to extraordinary political or economic threats. While Vogel provides significant insights at a macro-historical level of analysis, it says less about the mechanisms through which structural challenges ultimately result in business mobilisation (Polsky 2000, 459).

Firstly, even amidst serious economic and political crises the collective action problems described by Olson still need to be mitigated. Reflecting this, subsequent research has highlighted a number of ideational and institutional factors which have the potential to reduce the transaction costs surrounding political mobilisation and lessen the risks of free riding in relation to advocacy. In terms of corporate organisation, institutional structures, such as peak industry associations and business round tables which encourage deliberation around

[1] Doner & Schneider (2000) make a similar argument that competitive pressures resulting form internationalisation have prompted class-wide business mobilisation.

important policy issues clearly have the potential to enhance intra-class dialogue and cooperation (Martin 1994, Polsky 2000).

In addition to institutional the organisation of firms strategically located policy entrepreneurs also have a significant role in building reform related coalitions and reducing transaction costs associated with mobilisation. Such entrepreneurs play a pivotal role in linking policy problems and to viable solutions and then framing policy initiatives in such a way that they appeal to a diverse coalition of actors (Martin 1994). Innovative entrepreneurs can also narrow the discourse around policy options increasing the prospects of a consensus emerging (Plotke 1992). While such entrepreneurs can be located within business or the state (Bell 2006), in an innovative article Andrew Polsky (2000) argues that partisan entrepreneurs have the greatest incentive to build new partisan regimes, or coherent sets of processes and ideas which are capable of mobilising a broad coalition of actors behind a given political project. Where partisan entrepreneurs can have the greatest potential to facilitate cross-class business mobilisation is through the deployment of ideas which 'add to the credibility the story which its leaders tell and leaves others political actors with no good reason to continue the quest for better alternatives' (2000, 466). Overall Polsky argues that broad-based business mobilisation seems to be contingent on a perceived crisis or opportunity, a shared interest among key actors in relation to appropriate policy solutions and entrepreneurs prepared to absorb the political risks and transaction costs associated with business mobilisation.

While this emphasis on structural context, interpretive frames and entrepreneurial actors adds significantly to our understanding of the contingent factors which shape business mobilisation, it arguably downplays the influence of the broader institutional context in which business is located and the role of the state in particular (Bell 2006). While this failure to consider the institutional structure of the state and its influence business mobilisation is largely a product of the fact that the literature described above seeks to explain temporal variation in American business power, rather than being comparative, it is nonetheless essential to give greater consideration institutional variables if we want to explain variations in business mobilisation between states and modes or 'varieties' of capitalism.

In many ways focusing on the institutional determinants of business mobilisation and state-economy relations is nothing new. There is of course a long tradition in the neo-corporatist literature of emphasising how the organisational structure and capacity of labour organisations underpins specific forms of state-economy intermediation (Swenson 1991, for a summary see Bell 1995). More recently the 'varieties of capitalism' literature has shifted the spotlight to the role of firms and corporate organisation in creating distinctive social systems of production (Hall & Soskice 2001). While these approaches highlight how the historical organisation and capacity of key economic actors (both labour and business) can have a profound influence on the structure of nationally distinctive political economies, I would argue that they tend to down play the influence of broader regime characteristics such as prevailing political culture and state institutions and the patterns of interest representation which public structures create, or as Amyx has recently argued in her work on financial reform in Japan(2004, 12) 'insufficient attention has been paid to state structures and agent characteristics in our studies of associational systems'.

Of the extant literature on the impact of state tradition and structures on patterns of business mobilisation the majority concentrates on liberal market economies and highlights how the fragmentation of state structures combined with an autonomous and competitive business culture hinders the formation of authoritative associational structures which in turn serve as the basis for more concentrated networks linking state and civil society. An early and influential exposition of the relationship between state institutions and associational organisation and engagement in the policy process was Atkinson and Coleman's research on Canadian policy networks (Atkinson and Coleman 1989). They argue that the patterns of business mobilisation and the prospects for developing collaborative forms of state-economy relations would be influenced by prevailing state structures and cultures leading to the conclusion that 'meso-level phenomena cannot be explained in isolation from broader political phenomena' (1989, 67). More specifically, they predict that in liberal market systems where the state lacks institutional autonomy interest groups tend to be disorganised and fragmented hindering the formation of strong associational structures and capable of supporting collaborative forms of state-economy relations.

Martin Smith (1993) and Stephen Bell (1995) have built on Atkinson and Coleman's research by highlighting the state's seminal role in creating and sustaining associational structures. In particular Bell's (1995) Australian research affirms earlier claims that in liberal states a combination of weak state structures, fragmented economies and a firm-centric business culture 'produce, in broad terms, the expected pattern of fragmented business associations engaged in traditional forms of policy advocacy, lobbying and pressure pluralist political activity'(p.25).

The broad goal of this paper is to extend the research agenda described above to considering the impact of state structures and political culture on the cross-class business mobilisation in coordinated economies because while there is an established literature on the benefits of sectoral business mobilisation in coordinated economies there has arguable been less research on the prospects of for cross-class business mobilisation in this context. Empirically the case study material below describes patterns of business mobilisation in Japan with particular reference to the issue of tax reform. The argument being advanced is that historically entrenched patterns of sectoral business mobilisation and engagement with the state actively hindered the prospects of achieving cross class business support for tax reform.

The disaggregated nature of Japanese business representation

In many ways Japan's distinctive political economy in which, until recent times, a strong bureaucratic state and concentrated industrial interests have effectively subordinated elected political representatives has a long history. The power and authority of the Japanese state and its close relationship to big business had its origins in the Meiji Restoration of the 19th Century (Wilson 2003, 89). As has been well documented this system of concentrated webs of interrelated firms or *keiretsu* and authoritative state agencies such as MITI and the Ministry of Finance provided the foundations of the state-led development model central to Japan's post-war economic growth (Johnson 1982). Yet these structural foundations were augmented by other institutional features of the so called '55 system.

Central among these was Japan's electoral system and its heavy reliance (up until 1994 at least) on multi-member electorates which encourages intra-party competition. In practice the Japanese electoral system underpinned the broader system of particularistic interest representation which has dominated modern Japanese politics because once established in the Diet politicians, and LDP members particular, could afford to overlook their electoral constituents and would instead focus on building policy expertise and links with business which would ensure their careers in politics and beyond. This is the basis of what is referred to as *zoku* politics, or the politics of policy tribes in which ambitious politicians devote their professional careers to promoting the cause of a narrow sectional interest or client group (Curtis 1999, 53-54).

The system of zoku politics in which key industrial sectors work closely with authoritative and expert 'pilot agencies' while protected by loyal zoku members in the Diet was effective in designing and subsidising sectoral industry and development policy (Weiss 1998). Indeed during the rapid economic growth experienced up until the late 1970s ensured that relationships between key state and private actors with shared interests were institutionalised and supported by 'circles of compensation through which the Japanese state allocated benefits' (Wright 1999, 947). Reflecting the importance of state structures on patterns of business representation, the polycentric structure of the Japanese state has actively promoted the fragmentation of interest representation and the creation of sectoral industry associations or *gyokai* leading to the formation a multiplicity of disaggregated policy communities. Despite various political and electoral reforms of the early 1990, many commentators have argued the ability of the Japanese state to coordinate and restructure the national economy has deteriorated in recent years (Wright 1999). Whereas at the height of the economic boom state agencies had the political authority and financial resources to guide and cajole disparate tribes towards national economic goals there are now real limits to this type of compensatory politics. Secondly, a strong revisionist literature argues that the relative power (and solidarity within) key state agencies such as MoF has declined relative to political leaders in recent times and that partisan actors are more likely to promote the narrow policy concerns of their constituents rather than national reform issues. Finally, Japanese firms themselves have become transnational in scope and as a consequence industrial interests are not as beholden to state actors as they once were. If anything, the greater political autonomy enjoyed by Japanese firms has resulted in a deepening of interest group fragmentation. According to Gerald Curtis:

> In the early years of LDP rule…..powerful interest groups such as Nokyo, Keidanren, Sohyo and the Japanese Medical Association, exerted considerable influence over public policy. Japan in the 1990s was characterized by a public opinion that was uncertain and ambivalent about national goals. It was also characterized by the fragmentation and weakening of formerly large and powerful interest groups with the importance of peak organizations among business and labour declining creating a more pluralistic system of interest representation. (1999, 53)

At a sectoral level the Japanese state-economy relations may be renowned for their high levels of embeddedness and their close and at time productive patterns of state-economy relations but, as this brief overview has demonstrated, many of the structures which facilitate this sectoral integration actively hinder the prospects for class-wide mobilisation and have undermined many peak associational structures. During the 1990s, despite the rhetoric of state-led development, it was increasingly apparent that there was an acute need for economy-wide reforms and it was not obvious if any one agency or actor had the capacity to govern the Japanese economy. The case study presented below describes the role of Japanese business and the effectiveness of associational representation around the issue of tax reform from the late 1970s to the present day. Tax reform and the introduction of proposals to increase a national consumption tax have been fiercely contested in Japan over the past quarter of a century and provide a clear test of the ability Japanese business to form effective cross-class coalitions and peak associational structures (Kato 1994, Ishi 2001).

Business mobilisation and tax reform in Japan

Like so many other aspects of the Japanese political economy, Japan's post-war tax system was a product of the United States occupation. The Shoup mission of 1949 saw American economists devise a taxation blueprint which featured a reasonably comprehensive and progressive income tax base, complemented by a broad based consumption tax (Ishi 2001, Ch. 2). However, in an omen for the future of the Japanese VAT, the introduction of the consumption tax proposed by the Shoup Mission was postponed on a number of occasions before eventually being abandoned in 1953 (Ishi 2001, 270-271). The second development of note in post-war period was the extensive use of tax policy as an instrument of industrialisation and economic development. This coordinated use of a range of policy instruments to promote industrial investment and production was at the heart of what Johnson (1982) famously described as the 'development state'. As far as the tax base was concerned this led to a highly schedualar system with countless exemptions and concessions devised with a view to promoting industrial development and appeasing the ruling party's key constituents reinforcing the dynamics of the *zoku* politics described above (Kato 1994, 72). These were the years of the Japanese miracle economy and with economic growth exceeding an average of 10% per annum between 1955 and 1972 there were few pressures on public finances (Suzuki 2000. ch4.). It seems that all ships float on an incoming tide.

Like all other developed economies Japan's budget and tax system came under pressure in the economic downturn of the 1970s. It could be argued that owing to its developmentalist brand of capitalism Japan was hit harder that most with its underdeveloped welfare system and dependence on very high levels of economic growth. In combination these structural factors culminated in a formal 'declaration of fiscal crisis' and for the first time in the post-war period the Japanese Government ran a significant budget deficit.

The responsibility for dealing with this unprecedented fiscal crisis fell squarely on the shoulders of the Ministry of Finance (MoF). While there is much debate concerning the ultimate power of central state agencies in the Japanese political system, few would dispute the claim that the MoF is 'arguably the most powerful and prestigious ministry in Japan.' (Suzuki 2000, 11). A combination of policy diffusion (the success of VAT style consumption taxes in Europe), the fact that Japan had no comprehensive consumption tax and therefore should utilise this tax base, and ironically, perceived political advantages, led the MoF to recommend the introduction of a VAT style of consumption tax (Kato 1994, 77-80). To this time taxation had been regarded as highly specialised field of policy making which was not generally of wider political interest or concern. Traditionally discussion was confined to senior MoF officials, select representatives of business and a few senior members of the LDP governing party with a particular interest in taxation issues. This led to tax policy being made by what Kato has described as 'an exclusive and intensive network' (Kato 1994, 81). This process is also reasonably institutionalised with deliberations being conducted by the Government Tax System Research Council (GTSRC), which while being dominated by the MoF, included representation of the groups mentioned above. Beyond this, the LDP has its own tax research council which generally liaises with the GTSRC and historically endorses their proposed tax policies. While this institutionalised system of negotiation and deliberation surrounding policy making included selective business representation it soon became apparent that when the tax policy agenda shifted from being *distributive* (an instrument of active industry support) to being *redistributive,* then any business consensus in relation to tax reform would be more fragile.

Despite misgivings on the part of business, failure to introduce a VAT in Japan in the late 1970s was remarkable for two reasons. Firstly there was a political consensus that drastic policy action had to be taken to address the budget deficit, in the language of John Kingdon (1984), a policy window had been opened. Secondly Prime Minister Ohira was a strong advocate of a VAT and secured cabinet support for a new consumption tax in early 1979. Reflecting the selective nature of business involvement in the development of the Ohira reform proposals, business groups from the Keidanren down expressed concern on a number of fronts. While the GTSRC had made concessions to some stakeholders, there was a consensus that consultations had been too rushed and the tax reforms inadequately explained. As political opposition built on a number of fronts, including within the LDP, Ohiro was forced to shelve his tax reform proposals two weeks prior to the 1979 election. While the LDP was able to secure a narrow majority, Ohiro and his promotion of a consumption tax, was blamed for this poor electoral showing and tragically the Prime Minister collapsed and died during the ensuing factional battle over the LDP leadership. This failed attempt to introduce a VAT in late 1970s demonstrated that even with the strong support of powerful state agencies such as MoF combined with the committed leadership from Primer Minister Ohira tax reform was only going to be politically possible with broad-based business and community support (Kato 1994, 111). It seemed that the introduction of a VAT was going to be an effective test of the class-wide business mobilisation.

By the mid-1980s the fiscal problem still loomed large. And since the failed 1979 attempt to introduce a new consumption tax, the 'Olsonian' policy alternative favoured by big business of balancing the budget via spending cuts had been discredited (Ishi 2001, 321). Significantly in terms of business interest in the tax reform debate, the Nakasone administration, hoping to provide income tax cuts, increased levels of corporate taxation (Kato 1994 147-148). Business from the Keidandran down was outraged with this policy demonstrating the difficulties of balancing the competing demands of powerful sectional interests and the broader electoral concerns when framing tax reform packages. However, these class-wide increases in business taxation and impact that they had on the material interests of corporate Japan forced a reassessment of business attitudes to a VAT (Kato 2003, 175,). As it became more obvious that addressing the budget deficit required either introducing a new consumption tax or eliminating the many tax concessions and exemptions that underpinned the developmental state, in an example of what Hacker & Pierson (2002) describe as political 'feedback' some significant sections of the business community reassessed the policy priorities. For example, the Keidandran came to support a broad based consumption tax during 1985, although they had a preference for a single staged consumption tax rather than a VAT believing that it would have a smaller impact on small to medium business and the retail sector (Kato 1994, 161-162). Yet business preferences on tax reform remained fragmented with *Nissho* (Japanese Chamber of Commerce and Industry), who count a significant number of small to medium sized firms in its membership, strongly opposed the tax leading to a formal split in the GTSRC (Kato 1994, 168).

Nakasone was a relatively powerful and charismatic leader and unusually for a Japanese politician was prepared to stand up to business. Unlike Ohira, he was not very interested in the detail of policy and was happy to defer most decisions to the bureau dominated government policy councils such as the GTSRC. Nakasone's political instinct was to stand up to special interests that dominated Japanese politics and address the deficit and provide tax cuts to wage earners through broadening the income tax base, a strategy which was popular with the wider electorate who were growing tired of concessions granted to key LDP constituents. While these popular income tax cuts were proposed in 1986, they did alienate many traditional LDP supporters and failed to significantly increase revenue yield leading to speculation, which was fueled by the MoF and Nakasone's Finance Minister Takeshita, that a broad based consumption tax would have to be introduced after the national elections to be later that year. Given the lukewarm business support for a broad based consumption tax and growing concerns among the wider electorate that it would be regressive in its impact, Nakasone was forced to provide a commitment 'not to introduce a large scale indirect tax' (Ishi 2001, 326; Kato 1994, 165).

Away from the heat of the hard fought election 1986 campaign (at least by Japanese standards) Nakasone and his administration began to consider how best to salvage the VAT agenda. While there was a growing recognition of the need to introduce a broad based consumption tax Japan's traditional system of policy making was incapable of the type of interest aggregation needed to build a broad coalition of support for tax reform. For example, Rather than using existing institutional structures to build a broader coalition for tax reform Nakasone deliberately 'stacked' the membership of the GTSRC with members he knew were advocates of a consumption tax (Kato 1994, 166). Perhaps more seriously, the LDP party apparatus failed to act as an effective link between decision makers and the broader constellation of interests the party traditionally represented. In Andrew Polsky's (2000) terms there was an absence of partisan entrepreneurs capable of enhancing support for the tax reform agenda. The senior LDP heirs to Nakasone's leadership urged him to press ahead with reforms regardless of the political fallout because they did not want to inherit a fiscal crisis when they took control of the party. With Japan's elite committed to a VAT it came as no surprise when in December 1986 the GTSRC outline a proposal to introduce a 5% VAT which formed the basis of legislation to be introduced into the Diet the following year.

1987 saw intense lobbying around the VAT proposal which was in many ways unprecedented in modern Japanese politics. Concerned about the potential impact on small firms, consumers and the broader economy and incensed by Nakasone's deceit, *ad hoc* coalitions sprang up to oppose the tax proposal. Even the fact the VAT revenue would be used to fund income tax cuts did not seem to quell voter's anger. In terms of broad theories of state action, this was classic pressure pluralism as the desperate Nakasone Government reacted by offering numerous concessions to sectional groups. After the LDP vote collapse in a March 1987 bi-election the LDP backbench became openly hostile the Nakasone tax reform and threatened to veto the legislation in the Diet as well as demanding better representation in the policy process through a reinvigorated LDPTSRC. By May 1987, facing defeat in the Diet, Nakasone was forced drop the 5% VAT.

Despite Nakasone's resounding defeat the budget deficit remained. Even although the Nakasone Government did achieve some meaningful expenditure cuts the estimates put the real budget deficit in the 1986 financial as high as 26 trillion Yen (Suzuki 2000, 177). Given this context the new Takeshita Cabinet (which came to power in November 1987) had little choice other than to revisit the VAT issue. In a demonstration of strategic learning on the part of both state and societal actors this third attempt was charaterised by increased cooperation and deliberation among key stakeholders. At the level of interest group politics there was growing awareness of the need to broaden the tax base which resulted growing interest group support for reform. The 'people's conference on tax reform', which had been such an effective coalition against the VAT in 1986, met in March 1988 and while cautious, was much more muted in its opposition to the Takeshita propsal. The vast majority of business associations that had previously been outspoken in their opposition to the introduction of a VAT now supported its introduction, including Nissho members (small businesses who had been the most outspoken critics of a VAT). The last real bastion of business opposition were the large retailers' groups, and they too agreed to support the new VAT (Kato 1994, 199-200). Yet, as will be argued below, this cross-class consensus in relation to consumption tax reform was the fragile product of specific economic and political conditions.

The state's policy making strategy was also modified in an attempt to build stronger links with the vast array of private stakeholders and enhance social embeddedness. The GTSRC conducted extensive consultation including a broad cross section of business and, in an unprecedented move, even the peak labour organization (with close links to the Japanese Socialist Party), Rengo (Kato 1994, 207). Beyond 20 separate consultation held across Japan by the GTSRC, to ensure support among the LDP's traditional constituents a reinvigorated LDPTSRC also held unprecedented consultations. In order to bolster electoral support for the package numerous concessions were made to firms to ease compliance burdens.

In addition to the growing cross-class political support for the introduction of a consumption tax rapid increases in stock and property values over 1987-88 also influenced the reform debate in two important ways. More specifically Ishi (2001, 328-29) argues that the start of the bubble economy had two important effects. Firstly it increased economic inequality in Japan as wealthy investors were the main beneficiaries of rising asset prices. The excesses of the bubble economy tended to highlight the massive tax concessions which investment income enjoyed relative to wages. This growing concern about income inequality enabled policy makers to frame the tax reform debate in terms of improving the fairness of the tax system. Secondly, the bubble economy led to significant natural revenue growth which, in contrast to the late 1970s and much of the 1980s, meant structural tax changes did not necessarily have to raise more revenue. This growth in revenues allowed the Takishita government to propose a VAT with a modest rate while offering significant compensation to key interest groups. In short, the Takishita Bill of 1988 was a much more politically considered attempt to introduce a broad based consumption tax. More significantly, given this papers interest in causes of class-wide business mobilization is the fact that fiscal dividend of the bubble economy allowed the Takishita government to effectively compensate business generally (through generous exemptions and the proposed use of the unusual 'accounts' method of calculating the VAT which resulted in significant cash-flow advantages) and hostile sectoral interests in particular. Indeed, as scholars such as Calder (1988) have argued, cross-sectoral compensation became a key LDP strategy to address policy crises in the 1970s and 80s.

Despite the fact that few analysts expected serious political fallout from the introduction of the new (3% VAT), the infamous 'Recruit scandal' swept all before it during the second half of 1988 as the tax legislation passed the Diet (Kato 1994, 211). This corruption scandal, which involved senior bureaucrats and LDP members accepting bribes, affected the tax reform debate because the main proponents of the VAT in both the LDP (including both Nakasone and Takeshita) were involved, seriously undermining their credibility. Secondly, a central justification for the reforms was to improve the fairness and equity of the tax system – After the scandal broke and the architects of the package were exposed, the electorate began to doubt if the reforms would actually achieve these goals. As even those with a casual interest in Japanese politics will know, after being reluctantly accepted by the Japanese public the Recruit scandal led to a renewed attack on the VAT and its LDP sponsors. In the Upper House (House of Councilors) election in July 1989 the LDP suffered a serious defeat prompting some significant revisions to the original VAT legislation. However the fall out from the new consumption tax was short lived as the opposition parties were unable to outline a more popular alternative to the tax. While the credibility of the LDP and the economic impact of the consumption tax would be called into question on numerous occasions in the following decade, in the short term at least the LDP recovered and were able to secure a victory in the 1990 general election ensuring the consolidation of an amended VAT.

Just as the bubble economy of the late 1980s enhanced the political viability of consumption tax reform in Japan, the persistent recession of the 1990s placed unprecedented strains on public finances and exacerbated the political challenges associated with fiscal reform. Whereas the bubble economy provided the Takishita Government with the financial resources to provided generous compensation and transitional arrangements to dissident business groups, the fiscal climate confronting Japan in the 1990s could not have been more different. There was a long held view in the MoF and tax policy circles that the 3% consumption tax introduced in 1989 would have to be increased to consolidate Japan's growing public debt and expenditures associated with the aging population, yet the recession of the early 1990s clearly was not an appropriate time to increase VAT rate. In an attempt to both improve the adequacy of the Japanese tax base and stimulate demand in the post-bubble economy the post-1993 Coalition Government elected to cut income and corporate taxes immediately and increase the VAT to 5% in 1997 by which time it was anticipated that the Japanese economy would have resumed its growth trajectory (Kato 2003, 191; Ishi 2001, 340, Steinmo & Akaishi 2006). However the 1990s came to known as the 'lost decade' with the economy faltering under the weight of an ailing banking sector, weak domestic demand and increasing international competition. In this context not only was it difficult to compensate interests that would be adversely affected by increasing the VAT rate, but the consumption tax itself was seen as exacerbating the ongoing recession.

In the early years of the 21st Century, with weak economic growth is slowly taking root in Japan, the fiscal issues facing the world's second largest economy remain as a acute as ever. Despite the fact that influential groups in the tax policy arena, such as the GTSRC, Nippon Keidanren and Rengo have urged the LDP Government to increase the consumption tax as a matter of priority, Prime Minister

Koizumi refuses to act, instead devoting his leadership to a long term agenda of privatizing the Japanese postal system and its associated banking network.[2] While most explanations of this reluctance to confront the tax reform issue (despite the budget deficit approaching 14% o GDP in 2005 – among the worst in the developed world) attribute Koizumi's aversion to the political risks associated with increasing the VAT rate, according to insiders such as Hiromitsu Ishi (Chair of the GTSRC) part of this reluctance is because of entrenched sectional opposition from Japanese business. In Ishi's words the 'zoku politics is still very strong'[3]. Indeed close links between sectional opponents of the consumption tax and Diet members extend well beyond the LDP with the recently deposed leader of the Democratic Party of Japan, Katsuya Okada's reluctance to increase the consumption being attributed to his family's extensive interests in the retail sector.

Conclusion

What does this account of the politics of the Japanese tax reform contribute to our broader understanding of the roles of political culture, firm and state structures and prevailing political and economic conditions in the dynamics of class-wide business mobilization? First and foremost it highlights the complex combinations of institutional, ideational and economic forces which shape patterns of state-economy relations generally and the dynamics of cross-class business mobilization in particular. In terms of research methodology this demands a grounded and ideographic approach to the study of business politics.

In terms of our theoretical understanding of the dynamics of business mobilsation the case study suggests that formal state structures and informal, although equally well entrenched political practices, lie at the core Japan's patterned pluralism and sectoral patterns of state-economy relations. Japan's post-war *Zoku* politics is the modern manifestation of century old practice which has been shaped and reinforced by the modern polycentric bureaucracy, electoral system and practice within the LDP. While Japan's *keiretsu* corporate structures have reinforced this pattern it would difficult to argue that firm structures have played a dominant role in creating Japan's sectoral political economy. Perhaps it would be more reasonable to argue that the organisation and culture of both firm and state have been mutually constitutive in this process. On the balance the evidence in this paper highlights the foundational role of state structures in shaping patterns of state-economy relations and, as Amyx (2004) has recently argued, and in stark contrast to classic accounts of developmental capacity, the structure of the Japanese state actively hinders class-wide business mobilisation.

[2] For example, the Nippon Keidanren in its *Japan 2025* policy blueprint called on the Government to increase the consumption tax from 5% to 16% by 2014.

[3] Interview with Hiromitsu Ishi January 2005.

Yet at a more detailed level of analysis the case of tax reform and the Takeshita proposals of the late 1980s in particular demonstrate that class-wide business mobilization is possible despite the institutional constraints described above. This example certainly adds weight to Andrew Polsky's (2000) claims that partisan elites play a crucial role in cross-class business mobilsation with political LDP leaders attempting to placate sectional interests in relation to contested policy issues with generous compensation. In the case of the 1988 consumption tax proposal this was achieved by introducing the VAT at a low rate and generous exemptions and withholding provisions.

In contrast to the Takeshita reforms, the Japanese experience during the 'lost decade' has been much more sobering as partisan elites have lacked the resources and incentives to aggregate interests and push ahead with contested reform proposals. This has led long time observers of Japanese tax politics such as Junko Kato (2003, 233) to conclude that as the LDP has come under greater electoral pressure during the 1990s it has tended to fragment with senior members increasingly beholden to sectional and regional interests. Not withstanding the recent activism of the Nippon Keidanren and other prominent groups, in the absence of the resources and exceptional political leadership Japanese politics remains fragmented and sectoral industry associations or *gyokai* continue to exercise influential with dissident business groups, such as the Japan Retailers Association. remaining entrenched in their opposition to increasing the consumption tax and influential in the Diet.

More broadly this paper affirms many the increasing number of revisionist accounts of Japan's contemporary political economy which highlight the governance limits of the Japanese state (for a summary see Wright 1999). It would appear that in the case of taxation policy in particular there is a lack of collaborative institutions capable of aggregating the vast array of interests that are affected by proposals such as increasing the value added tax. This is in stark contrast to other policy arenas where deliberation is generally limited to a relatively narrow ranged sectoral stakeholders. This important distinction helps us understand how the Japanese state can possess significant capacity in relation to policies concerning industrial transformation (where interest aggregation is achieved through a web of collaborative policy making committees) (Weiss 1998), yet struggle to build political support for comprehensive tax reform. In part this divergence reflects the central theme of this paper: that sectoral patterns of business politics may actually hinder the achievement of cross-class solidarity on policy issues of national significance and limit the capacity of the state to achieve economic reform. As Colin Crouch (2005) has recently argued, ideal types concerning models of capitalism and state capacity have the potential to obscure the diversity of processes that occur in modern capitalist systems.

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