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Exiting Etatisme? New Directions in State Policy in France and Japan

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NEW DIRECTIONS IN STATE POLICY IN FRANCE AND JAPAN

by

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NEW DIRECTIONS IN STATE POLICY IN FRANCE AND JAPAN

France and Japan have long been seen as embodying the possibilities for state-led economic development (Shonfield 1965; Cohen 1977; Katzenstein 1978; Johnson 1982; Zysman 1983; Hall 1986; Tyson and Zysman 1989).[1] In the postwar period, both countries experienced far-reaching economic and social transformation guided by state technocrats. Their apparent success was celebrated and, in some countries, notably Korea, emulated.

Over the past twenty years, however, all of the exemplars of state-led economic development have experienced profound crisis. In the early 1980s, France's vaunted *dirigiste* model was repudiated by a leftist government that had been elected on a pledge to take *dirigisme* to new heights (Cohen 1989; Hall 1990; Levy 1999; Levy 2000). Japan's statist system, once the object of envy and fear among Japan's trading partners, is now blamed for the country's decade-long period of economic stagnation. And in the wake of the 1998 financial meltdown in East Asia, the Korean offshoot of the Japanese model has been recategorized as "crony capitalism."

The predominant interpretation of these crises portrays globalization (and, in the case of France, European integration) as having rendered state intervention obsolete. Whatever the merits of state activism in the past, today's internationalized environment leaves no place for free-spending, interventionist ways. In perhaps the most extreme version of this line of thinking, Peter Hall and David Soskice reduce the "varieties of capitalism" from three to two by eliminating the statist category altogether, while appending Japan to the Germanic "coordinated" model and excluding France from the typological exercise (Hall and Soskice 2001). To the extent that discussions of politics and the state have entered into the scholarly discussion, it has been in a primarily reactive and negative capacity. Scholars emphasize the reluctance of state authorities to cede power, particularly in Japan, which has prevented successful adjustment to a changing international economic environment.

At first glance, the comparison of France and Japan would seem to bolster this interpretation. If Japan is a case of blocked adjustment, France is an example of statist rollback. Twenty years after the Socialists' break with *dirigisme*, virtually nothing remains of the institutions and practices associated with the *dirigiste* model. Planning, sectoral industrial policies, and ambitious *grands projets* have been abandoned; the vast majority of nationalized companies have been privatized; credit, price, and capital controls have been lifted; restrictions on lay-offs and temporary and part-time employment have been eased; and a macroeconomic orientation emphasizing inflationary growth coupled with large devaluations has given way to one of the lowest inflation rates in Europe and a strong franc, culminating in European Monetary Union (EMU). By all accounts, France has become a much more market-oriented political economy, whose performance rests on the calculations of profit-seeking businesses, as opposed to state technocrats.

First impressions can be deceiving, however. Alongside the dismantling of the *dirigiste* model, French authorities have launched a number of expensive new programs, notably in labor markets and social protection. As Figure 1 reveals, state revenues, which totaled 42.6 percent of GDP in 1983, at the height of Socialo-Communist voluntarism, have continued to rise in the ostensibly less interventionist post-*dirigiste* period, reaching 46 percent of GDP in 1999 (OECD 2000; Ministry of Finance 2001). Thus, not only has

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the post-*dirigiste* French state failed to shrink; by some measures, it has become bigger than ever.

This chapter uses a comparison of France and Japan to recast understandings of the changing place of the state in today's global economy. We advance two main claims. The first is that the road to *dirigiste* rollback is paved with new state interventions. Moreover, these interventions are not simply transitional in nature. Rather, they constitute a core feature of a more market-centered political economy.

In France, de-*dirigisation* was purchased at the expense of expanded state activity in the social arena. Getting the state out of industrial policy required getting the state into social and labor market policy. The policy innovations of the past twenty years have been designed to pacify and demobilize potential opponents of market-led adjustment. Once regarded as a "welfare laggard," France now has the biggest welfare state outside, and labor market spending also approaches Scandinavian levels.

Our second claim, inspired by the Japanese case, is that the failure or unwillingness to construct a European-style welfare state tends to generate three pathologies among statist political economies: 1) the diversion of industrial policy from economic modernization to job protection; 2) a growth in new state activities unaccompanied by the benefits of a market-led political economy; 3) limits on the possibilities for economic liberalization.

As Japan's economy began to slow in the 1970s, Japanese authorities consciously decided to avoid created a European-style welfare state. Officials, particularly within the Ministry of Finance, feared that generous social policies would lead to runaway government spending, and both bureaucrats and leaders within the conservative LDP believed that a welfare state would weaken the incentive to work and lead to social and economic degeneration. The problem, however, is that lacking a safety net to protect the losers of market-led adjustment, Japanese authorities have found it difficult to move strongly in a liberalizing direction. Worse, many developmental policies have been diverted by considerations of job preservation. Japanese authorities are spending vast amounts propping up debt-laden banks, which are propping up, in turn, debt-laden companies because were those banks and their customers to shut down, millions of Japanese workers would lose their jobs, and Japan has no social safety net to take care of them. Moreover, the construction of a welfare state is now a virtual fiscal impossibility, as economic stagnation and an aging population have severely limited the ability of governments to construct new social programs. In Japan, employment itself is the main instrument of social protection. The absence of a welfare state has meant that the ruling party has increasingly relied on costly measures to preserve employment that have actually slowed down the transition to a more market-driven political economy.

Our essay will show that France and Japan have taken very different paths over the past twenty years. Contrary to prevailing depictions, neither path has entailed the eclipse of the state. Indeed, notwithstanding the supposed imperatives of globalization, state spending as a share of GNP has increased in both countries. In France, spending expanded, as new state missions supplanted traditional industrial policy activities. In Japan, state spending has been more fluid, but since the 1970s, spending has generally trended upwards as the state has engaged in a wide array of new activities, many driven by the political imperatives of the ruling party.

Our essay is divided into five sections. Section 1 examines the origins of the crisis of statism in both countries. Section 2 explains why France and Japan responded to this crisis in different ways. Section 3 describes the French path of adjustment, which has combined the dismantling of *dirigiste* industrial policy with the expansion of state initiatives in other areas, notably labor markets, social protection, and the promotion of small business. Section 4 analyzes the halting liberalization agenda in Japan and growing use of industrial policy instruments for social purposes, especially job preservation. Section 5, the conclusion, explores the implications of the French and Japanese experience for our understanding of statist political economies and institutional change.

SECTION 1 – THE CRISIS OF THE STATIST MODEL

In the postwar period, France and Japan relied heavily on state guidance to rebuild and modernize their economies. Although each county pursued a distinct policy mix, the French and Japanese approaches shared a number of core features. These included: 1) meritocratic elite schools that recruited and trained the nation's best-and-brightest youth for high-level positions in the state administration; 2) multi-year planning processes that established the priorities and parameters of the nation's economic development; 3) a variety of policy instruments that permitted state authorities to influence and channel resources to key sectors or even individual firms (strategic use of trade policy, subsidized credit, research aid, price-rigging, etc.); 4) a political foundation of conservative hegemony that allowed planners to slight the needs of labor, favoring investment over consumption.

For some thirty years, statist arrangements served France and Japan well. Both countries modernized and prospered, becoming among the leading economies of the world. Beginning in the late 1960s in France and the 1970s in Japan, however, the statist model encountered a series of challenges and difficulties.

New Economic Challenges

The first challenge was economic. The statist approach was well-adapted to efforts at industrial catch-up – to channeling resources to clearly identifiable strategic industries, copying and transferring existing technologies from the US, and supporting domestic champions. As France and Japan approached US levels of development and technology, however, identifying "winners" became much more challenging. Moreover, technologies had to be developed, not simply copied and adapted. Finally, the champions of the next phase of industrialization were not necessarily well-established multinationals; they could be renegades or start-ups largely unknown to the planners (Piore and Sabel 1984). In this less predictable environment, state planners were unable to replicate the successes of the early postwar period, and embarrassing failures multiplied, from the French Concorde to the Japanese software industry (Zysman 1977; Padioleau 1981; Cohen and Bauer 1985; Ziegler 1997).

A Less Hospitable International Environment

If the tasks confronting state authorities were more difficult, the international environment in which they operated was more constraining. The European Common Market, constructed in the 1960s, greatly weakened the capacity of French planners to selectively protect markets. In the 1980s, Japan likewise came under pressure from an increasingly assertive United States to open markets and reduce its bilateral surplus. Moreover, the US, Japan's leading export market, also began to limit Japanese access in such key sectors as automobiles and semiconductors.[2] US actions also undermined one of the key pillars of Japan's developmental model – an undervalued yen. With the collapse of the Bretton Woods system the value of the yen spiked sharply. In the wake of the 1985 Plaza Accord, the yen jumped again from about 260 yen to the dollar to close to 120 yen to the dollar by 1989.

In the case of France, the pressures of European integration undermined the *dirigiste* model in a second, more fundamental way (Hall 1990; Loriaux 1991). The 1983 U-turn and repudiation of *dirigisme* were touched off by a currency crisis. The French franc was overvalued because France's rate of inflation was much higher than that of its trading partners, making it difficult for French businesses to compete. Traditionally,

[2] CAN ADD MORE DETAILS – OMAS, VERS, ETC. FOREIGN AND EXCHANGE CONTROL LAW (1980).

France had accommodated high rates of inflation through periodic “aggressive devaluations” that not only neutralized price differentials, but also conferred a temporary price advantage on French companies (Hall 1986). Under the rules of the European Monetary System (EMS), however, any devaluation required the consent of other EMS countries. Led by Germany, these countries resisted a large devaluation and demanded that France curtail government spending, so as to reduce inflationary pressures. President Mitterrand was forced to choose, therefore, between France’s traditional statist growth strategy and European solidarity. His advisors were divided into two basic camps (Bauchard 1986; Hall 1986; Cameron 1996; Favier and Martin-Roland 1996). One side advocated a fortress France strategy, encompassing withdrawal from the EMS, a sharp devaluation of the franc, and tightened exchange and trade controls. The other side favored European solidarity, backed by a severe austerity program to eradicate inflation once and for all and stabilize the franc's position within the EMS. After much agonizing, Mitterrand opted for the latter camp, and the process of *dirigiste* rollback began.

<u>The Erosion of Conservative Hegemony</u>

The third and perhaps most important challenge to the statist model was political. At its most fundamental level, the *dirigiste* project entailed shifting resources from consumers to businesses and from declining sectors to emerging sectors. In both France and Japan, this strategy rested on a political foundation of conservative party hegemony (Pempel and Tsunekawa 1979; Zysman 1983; Pempel 1990). The LDP governed Japan without interruption from the 1955 to the 1993, while in France, the Communist party was excluded from government from 1947 to 1981 and the Socialists from 1958 to 1981. Conservative parties in both countries slighted the needs of labor, while favoring core constituencies of business, agriculture, and liberal professions.

The labor-exclusionary strategy was feasible only as long as the conservative hold on power remained secure, however. In France, a first shock to conservative hegemony occurred with the near revolution of May 1968. President Charles de Gaulle, who had dominated French politics for a decade, was no longer the unquestioned leader. Indeed, one year later, de Gaulle resigned from office when a referendum designed to relegitimate his rule failed to secure a majority. Conservative hegemony was further eroded in 1971, when France’s Communist and Socialist parties forged a powerful “Union of the Left.” In the 1974 presidential election, the center-right candidate, Valéry Giscard d'Estaing outpolled his Socialist rival, François Mitterrand by a mere 50.8 per cent to 49.2 per cent. The left swept nation-wide municipal elections in 1977 and was widely expected to triumph in the 1978 parliamentary elections. Although Giscard weathered this challenge, his popularity quickly began to sink, and he would be ousted by Mitterrand in the 1981 presidential election. In such a hotly-contested political context, conservative parties needed every vote, and the needs of labor received increasing attention.

The contested political environment of the 1970s transformed *dirigiste* policymaking. More accurately, political pressures <u>diverted</u> *dirigisme* from its postwar modernizing mission (Berger 1981; Cohen 1989). Anxious conservative leaders had no stomach for painful, if much-needed, rationalization of declining or uncompetitive enterprises. Indeed, their initiatives often ran in the opposite direction. While embracing rhetoric of liberalization and market-driven adjustment, the Giscard administration nationalized the bankrupt French steel industry and created a special agency, the *Comité interministériel de l’aménagement des structures industrielles* (CIASI), to bail out companies in difficulty. In 1978, a government-commissioned report revealed that fewer than one dozen firms, most of them uncompetitive and many in declining sectors, were receiving more than 75 per cent of all public aid to industry (Cahiers Français 1983: 16). Worse still, these resources tended to be used, not to undertake much-needed restructuring and positioning in viable market niches, but rather to delay lay-offs and adjustment.

These problems only intensified under the Mitterrand administration, an alliance of Socialist and Communist parties. Like Giscard, the left found it difficult to shift resources from traditional to emerging sectors. Having claimed that there were no declining sectors, only outmoded technologies, the government was obliged to attempt to turn around lame ducks. Supporting industries like shipbuilding or coal deprived the authorities of resources needed for more promising sectors, however. The electronics industry, for example, received less than one-third the public aid promised by the government (Le Bolloc'h-Puges 1991: 203-207).

Finally, Mitterrand -- like Giscard before him -- proved unable to resist pressures to protect jobs at all costs. Indeed, having pledged that *dirigiste* policies would enable industry to create jobs, rather than eliminating them, Mitterrand was trapped by his own campaign rhetoric. Furthermore, job cuts would strike at the core of the left's electorate -- unskilled and semiskilled blue-collar workers in heavy industry. The government, therefore, opted to buy social peace. But this strategy yielded increasingly untenable economic outcomes. By 1983, a number of firms were so heavily subsidized that it would have been far cheaper for the government to pay workers not to produce. In shipbuilding, for example, it was estimated that each job paying 100,000 francs in annual wages cost the government 150,000 to 450,000 francs in subsidies (Cohen 1989: 230-231).

The political pressures that diverted *dirigiste* policy-making in France made themselves felt in Japan in the 1970s (Calder 1990; Calder 1993). The hegemony of the LDP rested on a conservative coalition similar to that of France, encompassing big business, agriculture, and the petty bourgeoisie. As in France, labor was essentially excluded and internally divided although in Japan, the marginalization was even more extreme. The so-called "1955 system" remained relatively stable for over a decade, but beginning in the late 1960s and accelerating in the 1970s, a wave of progressivism began to spread across the country. By the early 1970s, progressives, supported by the Japan Communist Party (JCP) and Japan Socialist Party (JSP), had taken over the governorships of Tokyo, Osaka, Kyoto, and numerous other lower visibility regions. The results filtered up to the national level as well, with the LDP's margin over other parties declining consistently. The Communists experienced a small boom in electoral support, winning up to 20 percent of the vote in Lower House elections in some urban areas in the 1972 elections. Progressives directly challenged many aspects of the *dirigiste* state, demanding greater attention to local issues, less heavy-handed central planning, and policies that ameliorated some of the externalities of rapid development.

The LDP was not to be outmaneuvered, however. Rather than succumbing to the opposition, the LDP co-opted many of its themes. Successive LDP governments increased spending on programs to improve the quality of life – environment, housing, regional development – and in the process won the support of groups outside the LDP's traditional support base, particularly Japan's growing urban voters. In this context, the institutions of Japan's developmental state came to serve increasingly political aims. Industrial policy, as in France, became a hostage to electoral politics. MITI began to focus on declining industries.[3] Similarly, Japan's vaunted Fiscal Investment Loan Program (FILP), which had helped channel funds from the national postal savings system, public pensions, and other sources to developmental projects in the postwar period, was redirected toward political ends. The LDP used FILP funds to channel capital to a web of public corporations that provided services and financing to LDP constituencies as well as to groups that the LDP was trying to win over.

The transformation of the LDP and its electoral strategy is best symbolized by the rise of Kakuei Tanaka. A career politician, who took over the helm of the LDP and reigned as prime minister between 1972 and 1974, Tanaka was an indicator of the

[3] GET SCOTT HANLON CITE; TILTON ARTICLE ON CARTELS, PEKKANEN).

diminished power of the bureaucrats. Unlike nearly every Prime Minister before him, Tanaka had not been a career bureaucrat and had not even graduated from college. Rather, he had risen through the ranks of the LDP. More than any other politician, Tanaka represented the transformation of the LDP from an elite and technocratic party to a catch-all party that would hold onto power by any means necessary, including massively increased patronage.

SECTION 2 - RESPONDING TO THE CRISIS OF STATISM: WHY FRANCE AND JAPAN DIVERGED

If the statist models of France and Japan have confronted many of the same kinds of pressures, the two countries have responded in fundamentally different ways. In France, after a series of failed efforts to reform the *dirigiste* model, governments of left and right moved to dismantle the model. Simultaneously, to prevent protest, they extended a series of social protections to the losers of market-led adjustment, notably elder workers and the unemployed. Japanese authorities, by contrast, refused to construct an expensive system of social protection. This penny-wise strategy proved dollar-foolish, however: much like France in the 1970s and early 1980s, Japanese authorities responded to demands for social protection by diverting industrial policy from its modernizing mission, protecting jobs and delaying economic adjustment. The divergent evolution of French and Japanese policy-making was rooted in three main factors: 1) the international environment; 2) domestic political institutions; 3) a strategic choice about social policy.

International Factors

The first factor was international. As noted above, France's repudiation of *dirigisme* was precipitated by international pressures, by a crisis of the French franc within the European Monetary System. If the agenda of liberalization has often been associated with an external force, that force has not been the same for France and Japan. In the case of Japan, pressures to liberalize have come primarily from US lobbying, from demands that Japan open its markets to US exports and roll back arrangements restricting competition. The political problem for would-be liberalizers in Japan is that such measures might be portrayed as capitulating to US pressures.

In France, economic liberalization has been associated with a more positive external process – the construction of Europe. European integration has provided a handy justification for liberalization: liberalizing reforms are portrayed as a European imperative, the price of constructing a pan-European entity (that France can hopefully steer …), rather than as a simple policy choice (Cohen 1996). In point of fact, measures like privatization or financial market deregulation went far beyond the imperatives of membership in good standing in the EMS, but they could be cloaked in the useful constraint of Europe. Nor did this process end in 1983. European competition policy is regularly blamed for preventing France from bailing out lame ducks, although it is by no means clear that French authorities would wish to do so if given the legal opportunity. Likewise, the austerity budgets of the mid-1990s were necessary to qualify for European Monetary Union, but they also dovetailed with the desire of French governments to get their fiscal house in order.

European integration has further facilitated liberalization by holding out the promise of Europe-wide common policies to relay the flagging efforts of French authorities. When President Mitterrand chose European solidarity in 1983, he had a certain vision of Europe in mind: the Europe of high-tech industrial projects like Airbus and Ariane; the Europe of generous payments to the "losers" of economic modernization (farmers and backwards or ailing regions); the Europe of bold new ambitions. In short, Europe would enable France to pursue economic and social strategies that were no longer viable at the national level. Europe would also bolster state sovereignty by allowing France to regain control over policies that were effectively run by the Germans. The post-1983 strategy of "competitive disinflation," culminating in EMU, was a clear effort to wrest monetary policy from the control of the Bundesbank. If the practice of European integration has often disappointed French expectations, these expectations have nonetheless lent a positive hue to economic liberalization in a manner that is largely absent from the Japanese context.

Politico-Institutional Factors

The second feature that pushed French and Japanese policy-making in divergent directions was the political system. Reformist prime ministers in Japan have generally been unable to marshal a coalition behind their agenda. Even when the LDP has enjoyed solid majorities in parliament, reformist prime ministers have been unable to control the LDP. Reformists have been checked by conservative rivals within the party, and they have rarely stayed in office more than one or two years. Despite widespread dissatisfaction with the statist model in Japan and more than a decade of economic stagnation, fundamental reform remains elusive.

The politico-institutional context in France offered far more favorable terrain for liberalizing reform. President Mitterrand enjoyed a huge parliamentary majority, as a result of a 1981 landslide. Although his Socialist party governed in alliance with the Communists, Mitterrand had more than enough MP's to reform without the Communists and to survive even a pretty substantial defection among the Socialists. Moreover, under France's system of "rationalized parliamentarism," many reforms can be enacted without a vote. Mitterrand also held the weapon of calling new parliamentary elections. Thus, however unhappy French leftists may have been about the break with *dirigisme*, they had no way to check Mitterrand's new direction.

Mitterrand held a second valuable trump card not possessed by his Japanese counterparts -- that of time. Contemplating his options in 1983, the French president knew that he would have a free hand for the next three years. With or without the support of the Communists, his position was unassailable until 1986, when the next parliamentary elections were scheduled. Indeed, in some respects, Mitterrand's time horizon extended beyond 1986, since his seven-year term as president ran until 1988. Under the dual executive system of the Fifth Republic, a defeat in 1986 would not remove Mitterrand from office. While the right would gain control of parliament, Mitterrand would remain as president. The left would then get a second chance two years later with the presidential election of 1988. Were Mitterrand to secure reelection, he could repeat the maneuver of 1981, dissolving the conservative-controlled parliament and appealing to the voters for a leftist majority with which to govern.

Thus, in forging economic strategy in 1983, Mitterrand was looking to the political implications for 1986 or even 1988. The president's time horizon was three to five years (not the year or two characteristic of embattled Japanese prime ministers). In the context of the *longue durée* conferred by the Fifth Republic, it was not illogical to take a chance on a strategy that while unpopular in the short term, might yield significant benefits a few years down the line. The contrast with the situation of Japanese leaders could not be more striking.

Contrasting Approaches to Social Policy

The third factor differentiating France and Japan's response to statist crisis was a strategic choice regarding social policy. Welfare policy played a critical role in France's move away from *dirigisme*. In a logic first articulated by Karl Polanyi, the extension of market forces was softened, made politically acceptable through the expansion of social protections for those most affected by liberalization (Polanyi 1944). On the one hand, beginning in 1983, state authorities made a market, imposing liberalization from above. Austerity, privatization, deregulation, and labor market flexibility all heightened the vulnerability of French workers. On the other hand, successive governments, especially those on the left, expanded the welfare state in number of ways, so as to cushion the blow to the working class and, equally important, to undercut the possibilities for union mobilization (Daley 1996; Levy 1999). Early retirement programs, labor market training, subsidies for low-wage hires, and a guaranteed minimum income were part of a panoply of measures designed to ease the social dislocation prompted by the move to the market -- policies that took French state spending to unprecedented heights.

In Japan, by contrast, the LDP leadership opted not to expand the welfare state. Four factors played a role in shaping this strategic choice. The first was Japan's macroeconomic orientation. Japan's developmental model relied on expansionary monetary policy that was balanced by deflationary fiscal policy, a priority that was well entrenched within the Ministry of Finance. Another key component of Japan's developmental state was low taxation, designed to stimulate private capital accumulation. Both of these priorities acted as constraints on the expansion of the welfare state. Indeed, one can look at Japan's relatively small welfare state as a component of its overall development strategy (Gao 2001).

The LDP's ideological orientation also played an important role in blocking the development of Japan's welfare state. In the late 1960s and early 1970s, there was wide discussion about whether Japan should create a welfare state as it caught up with other Western nations economically. The choice in the end made by the LDP was to create a "welfare society," a notion that was explicitly intended to represent an alternative to a European-style welfare state. One of the more interesting justifications was the view that welfare states created dependence on the state and would weaken the productive drive of workers. This supposed phenomenon was captured by the terms "advanced country disease" and "English disease," both examples of how welfare states could lead to economic decline (Pempel 1998: 189). One outspoken organization called "Group 1984" even developed an elaborate theory of how indulgence created by wealth invariably leads to societal rot and, eventually, to the downfall of great civilizations, such as the Roman Empire (Gao 2001: 215). These views resonated within the conservative LDP and provided ready ideological justification for forgoing a European-style welfare state.

A third factor behind Japan's limited welfare state was the way in which industrial restructuring was conducted. The two oil crises in the 1970s necessitated massive industrial restructuring -- shifting the labor force from structurally depressed industries to growing sectors and inducing the exit of redundant workers from the labor market. Whereas France used generous early retirement provisions to blunt resistance to industrial restructuring, the Japanese government used employment maintenance programs to assist employers who retained, retrained, and rehired redundant workers. Such a policy choice was conducive to the widespread Japanese practice of mandatory corporate retirement at age 55 or younger. Most workers seek other employment after mandatory corporate retirement, and in many cases, their employers assist in job searches and offer posts in subsidiary companies. Usually, wage levels of post-retirement jobs are much lower than previously. From the firm's perspective, post-retirement workers are relatively cheap, which, in turn, creates job opportunities for these elderly workers. The institutionalization of corporate mandatory retirement made it unnecessary for firms to rely on welfare programs to induce retirement. Instead, corporations called on the government to provide state subsidies for the existing practices of early retirement and re-employment (Miura 2002).

A fourth reason why Japan's social spending remained limited is that the left posed a much less serious threat than in France. Japan never experienced anything like France's near-revolution of May 1968. Moreover, Japanese unions in the private sector chose to collaborate with employers in order to secure employment. In fact, they demanded government commitment to employment maintenance programs. Thus, the LDP did not need to reconfigure the state's compensatory strategy to demobilize

Japanese workers and undercut the capacity of trade unions to block industrial restructuring.

Japanese authorities toyed only briefly with the idea of creating a full-fledged welfare state. In the early 1970s, the LDP increased spending, especially on regional development and social programs. Under the Sato and Tanaka administrations, the government expanded public spending with an increase of over 20 percent in the general account and approximately 30 percent in public works. Tanaka's decision to increase social spending was in reaction to the growing progressive tide that was translating into an electoral slide for the LDP. Tanaka declared 1973 the "First Year of the Welfare Era." Tanaka's expansionary fiscal policy fueled already active private investment leading to inflation, which coincided with the outbreak of the first oil crisis. By 1974, the writing was already on the wall for Japan's incipient welfare state, with Prime Minister Fukuda turning against welfare programs and urging a retrenchment. "The First Year of the Welfare Era" turned out to be the first and last year of the welfare era, after which tight fiscal policy and a narrow tax base foreclosed the possibility of an expansion of social programs.

In sum, the LDP did not chose to expand the welfare state partly because of its macroeconomic and ideological orientation and partly because social demands for welfare programs were contained and diffused through a strategy of full employment. The latter was facilitated by the extensive use of public works and an early retirement age in the private sector. Such choices had profound ramifications for Japan's political economy in subsequent decades. Politically, they allowed the LDP to hold together an increasingly diverse coalition of supporters. In addition to the LDP's traditional support base – agriculture, big business, petty bourgeoisie – the LDP's new strategy helped it win the support of new constituencies, such as construction interests in the 1970s and a growing urban middle-class in the 1980s. Even labor support grew for the LDP, as the party changed course and responded to new political demands (Mochizuki and Garon; Pempel 164). From an electoral standpoint, then, the LDP's strategy worked marvelously, and the party enjoyed a resurgence of popularity in the 1980s.

The continuity of LDP rule, however, should not be misunderstood as a return to *dirigisme*. Rather, the transformation represented a new political logic, one in which the resources of the state were used to bolster support for the LDP. Increasingly the institutions of the developmental state became captured by the political interests of the LDP. Rather than forward-looking industrial planning, Japan invested state resources in wasteful public works and inefficient or declining sectors, leading to an overall drag on productivity growth throughout the 1980s and 1990s.[5]

Although France and Japan have long shared the core features of the developmental-state model, these countries also differed in critical ways. As this section has shown, three sets of differences -- in the international setting, the politico-institutional system, and the deployment of social policy -- pushed France and Japan's respective responses to statist crisis in divergent directions. In the next two sections, we examine each country's pattern of reform more closely, starting with the French case.

SECTION 3 – FRANCE: DISMANTLING *DIRIGISME*; REDEPLOYING STATISM

In France, beginning in 1983, a leftist administration that had been elected on a campaign to intensify *dirigisme* began instead to dismantle *dirigisme*. The 1983 U-turn touched off a range of reforms that struck at the core of the *dirigiste* model (Cohen 1989; Hall 1990; Schmidt 1996; Levy 1999; Levy 2000). These changes, inaugurated cautiously by the Socialists from 1983 to 1986, were amplified when the right returned to power under a neo-liberal banner from 1986 to 1988, and confirmed and completed by

[5] MAY ADD DATA ON LABOR AND PRODUCTIVITY IF WE CAN FIND IT.

subsequent governments on both sides of the political spectrum. Four sets of changes figured most prominently.

The first change concerned macroeconomic policy. For much of the postwar period, French authorities stimulated the economy through a combination of deficit spending and lax monetary policy, with much of the money flowing to industry (Zysman 1983; Hall 1986; Loriaux 1991). The effects of the resulting inflation on competitiveness were negated by periodic “aggressive devaluations” that not only compensated for price differentials with France’s trading partners, but also conferred a temporary advantage on French producers, albeit at the expense of worker purchasing power.

The Socialists broke with this strategy in 1983. Under the so-called *franc fort* policy, the French franc was informally anchored to the Deutschmark. Since devaluations were no longer an option (let alone "aggressive devaluations”), France would gain the edge through "competitive disinflation," that is, by running a rate of inflation lower than that of its trading partners. Toward this end, Keynesianism demand stimulus gave way to austerity budgets, wage indexation was abandoned, and most important, monetary policy was tightened, with real interest rates ranging from 5 to 8 per cent for over a decade (Fitoussi 1995). Since the early 1990s, the French inflation rate has been among the lowest in Western Europe, while the balance of trade, after nearly twenty years in the red, has registered steady surpluses.

The second set of reforms pertained to France's public enterprises. In 1982, the left nationalized twelve leading industrial conglomerates and 38 banks. When combined with the Liberation-era nationalizations carried out by General de Gaulle, this latest program, costing 47 billion francs, placed thirteen of France's twenty largest firms and virtually the entire banking sector in state hands (Stoffaës 1984). Public enterprises received tens of billions of francs in subsidies, but were pressured to expand employment and invest in areas deemed strategic (if not profitable) by the government.

The 1983 U-turn brought a fundamental shift in the government’s relationship to the public enterprises. Nationalized companies were released from their planning targets and instructed to focus instead on profitability. While slashing capital grants and subsidies, the left offered no resistance when public enterprises closed factories and withdrew from strategic sectors. This shift in public-sector management set the stage for the right to launch a campaign of privatizations upon its return to power in 1986. Before the privatization process was interrupted by the 1987 stock market crash, thirteen financial and industrial groups had been sold off, netting 84.1 billion francs to the French treasury (Zerah 1993: 183). Since 1993, a second round of privatizations has been conducted by governments of both the right and the left, reducing the once-vast holdings of the French state to little more than energy production, public transportation, and some weapons manufactures.

The third major policy shift after 1983 was the abandonment of state efforts to steer private industry. The guiding spirit of this change was that firms would receive less government assistance, but would be subject to fewer restrictions, so that they could raise the necessary resources by their own means (Hall 1990). The hefty budgets for bail-outs of loss-making companies, sectoral industrial policy programs, high-tech *grands projets*, and subsidized loans quickly dried up, triggering a wave of bankruptcies. As a counterpoint, however, French business gained a number of new freedoms. The deregulation of financial markets, initiated in 1985, enabled firms to raise funds by issuing equity, reducing their dependence on state-allocated credit. The removal of price controls in 1986 allowed companies to reap the full benefits of successful competitive strategies. The elimination of capital controls in the late 1980s facilitated the expansion of production abroad and gave managers an "exit" option if domestic conditions were not to their liking. Taken together, these and other reforms helped boost corporate profitability from 9.8 per cent of value added in 1982 to 17.3 per cent in 1989 (Faugère and Voisin 1994: 32).

The revival of corporate profits was also fueled by a fourth set of developments, the reform of France's system of industrial relations (Groux and Mouriaux 1990; Howell 1992; Howell 1992; Labbé and Croisat 1992). State authorities de-indexed wages and lifted a number of restrictions limiting managerial prerogatives, most significantly, the administrative authorization for lay-offs (the requirement that lay-offs of ten or more employees for economic reasons receive the approval of an inspector from the ministry of labor). They also expanded the scope of workplace bargaining. In a context of high unemployment and weak and divided trade unions, French employers were able to use this new bargaining arena to introduce labor market flexibility largely on their terms. Studies of initial firm-level deals revealed that most accorded no compensation to employees in return for acceptance of greater flexibility and that up to one-third of these agreements actually violated French labor law. Not surprisingly, much of capital's gain in the post-1983 period would come at labor's expense. From 1982 to 1989, the share of value added received by capital increased from 24.0 per cent to 31.7 per cent, surpassing the levels of the early 1970s (Faugère and Voisin 1994: 28-29).

The reforms since 1983 have left no *dirigiste* stone unturned. Looking across the wealthy democracies, one would be hard-pressed to find any country that moved so far away from its postwar economic strategy as the France of François Mitterrand and Jacques Chirac. Certainly, compared to other statist political economies, such as Japan and Korea, France moved earlier and more aggressively against its postwar policy model.

If the practices and institutions associated with *dirigisme* have been dismantled with astonishing speed and thoroughness, the same cannot be said of the French state. On the contrary, state spending and taxation have increased somewhat in the post-*dirigiste* period, as new initiatives have been launched in such areas as labor market policy, social protection, and the promotion of small- and medium-sized enterprises (SMEs). This section describes each of these new state activities in turn.

<u>Labor Market Programs</u>

French labor market policy has developed in a number of directions. State intervention centered initially on early retirement, a strategy designed to square the circle of "job loss without unemployment" (Daley 1996). French authorities recognized the need for companies to be able to restructure in order to restore profitability and competitiveness, but such restructuring would not come at the expense of the workforce. Rather, government programs would permit employees over the age of 55 -- or, in some cases, 50 -- to retire at close to full pension.

The expansion of early retirement to accommodate and humanize restructuring began under the Giscard presidency. Between 1974 and 1980, the number of early retirees more than tripled from 59,000 to 190,400 (DARES 1996: 100). The left tripled the figure again to over 700,000 workers in 1984. Such measures were expensive, costing as much as 1 million francs per retiree, but they were assumed to be temporary. Officials expected that once French firms restructured and the economy recovered, job creation would begin anew, and early retirement programs could be wound down. Employment creation has remained sluggish, however, and early retirements have continued at a rate of 450,000 to 600,000 per year since the mid-1980s. The effects of early retirement on the French labor market are striking. Today, fewer than one worker in three is still employed at age 60, and France's labor force participation rate for men aged 55 to 64 is among the lowest in Western Europe, at just over 40 percent (Scharpf and Schmidt 2000: 350).

With the return to recession and rising unemployment in the early 1990s, center-right governments deployed a second labor market strategy. The right's efforts focused on the reduction of labor costs, particularly at the low end of the wage spectrum, where a relatively generous minimum wage (6,800 francs per month) and heavy social security charges (roughly 50 percent of wages) are said to dissuade job creation. In 1994, Gaullist Prime Minister, Edouard Balladur attempted to create a sub-minimum wage for youths 20 percent below the legal minimum, before retreating in a hailstorm of protest. Subsidies and tax breaks for low-wage hires proved less controversial. Under Balladur, employers hiring low-wage workers were exempted from family allowance contributions, while a program inaugurated in 1995 by Balladur's Gaullist successor, Alain Juppé provided subsidies of 5,000 to 15,000 francs for jobs paying less than 1.3 times the minimum wage.

The center-left government of Lionel Jospin added two further labor market initiatives during its tenure from 1997 to 2002. The first was a youth employment program, the *Programme Emploi Jeunes* (PEJ), which occupies some 350,000 young people. The PEJ was targeted at youths with no significant work experience. In contrast to previous state-sponsored, make-work projects, the PEJ provides full-time employment for an extended period (five years). The government hoped that this extended tenure would enable participants to acquire the skills and experience necessary to secure permanent employment once the subsidies ran out. Under the highly generous terms of the PEJ, the state pays 80 percent of the minimum wage and all social security contributions, leaving only 20 percent of the minimum wage to the charge of the employer. Employers in the private sector were barred from participating, however. Fearful that private companies would substitute subsidized hires for existing personnel, the government restricted the PEJ to non-profit and public organizations. The PEJ was expensive, costing some 35 billion francs, although some of the money was recovered from other youth employment programs that were terminated.

The second high-profile measure by the Jospin government was the reduction of the workweek from 39 hours to 35 hours. Although conservative critics and the national employer association denounced the reform as a job-killer that would force companies to lay off workers as a result of higher labor costs, the government took a number of measures to assuage business concerns. The reform was phased in over a five-year period, giving employers time to adjust and to extract wage concessions from employees as the price for shorter working hours. Employers were also allowed to introduce considerable flexibility into work schedules, which can now vary considerably from week to week. Finally, the government tendered significant subsidies to companies that signed collective bargaining agreements reducing work time. The subsidies are greatest at the bottom of the pay scale (21,500 francs per year for a minimum-wage hire), declining gradually to 4,000 francs for jobs paying more than 1.8 times the minimum wage. The cost of the reform is estimated at 110 billion francs, although again, part of the money is being shifted from other programs, notably the Balladur and Juppé government’s subsidies for low-wage hires.

Looking at labor market policy globally, Figure 2 reveals that the number of French workers enrolled in some kind of public labor market program has expanded two-and-one-half-fold in the post-*dirigiste* period -- rising from slightly under 1.2 million in 1984, at the height of industrial restructuring, to nearly 3 million in 1999 (DARES 1996; DARES December 2000).[6] This total is in addition to the 2 million French workers who are formally unemployed. Aggregate spending on labor market policy has shown a similar increase, expanding from slightly over 2 percent of GDP in the mid 1980s to 4.2 percent of GDP in 1999. Today, France spends as much as on labor market intervention as Sweden, the Mecca of active labor market policy.

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6 Figure 2 also suggests that French labor market expenditures have become more “active” over the years, encouraging recipients to work (“active”), rather than to withdraw from the labor market (“passive”). Whreas the number of employees in passive early retirement programs declined slightly from just over 700,000 in 1984 to less than 600,000 in 1999, subsidized jobs in the private sector expanded from 320,000 to 1.6 million, subsidized jobs in the public sector from 8,000 to 509,000, and positions in training programs from 143,000 to 298,000.

<u>Social Protection</u>

The French state has been equally prominent in the social policy arena (Levy 2000). Once classified as a "welfare laggard," Figure 3 reveals that France has developed the largest welfare state outside Scandinavia, exceeding even Germany laboring under the costs of unification. As can be seen in Figure 4, French welfare spending rose from 21.3 percent of GDP in 1980 to 26.5 percent in 1990, to 29.5 percent in 1998 (OECD 2002). The two largest welfare programs, pensions and health care, have both experienced significant growth since the early 1980s. Spending on pensions increased from 7.7 percent of GDP in 1981 to 9.8 percent in 2000 (Ministry of Finance 2001: Statistical Annex, Table VII.2). France's pay-as-you-go pension system is among the most generous in the world and, in contrast to most other countries, it has experienced only limited retrenchment measures in recent years (Charpin 1999; Myles and Pierson 2001). French health care spending increased from 7.4 percent of GDP in 1980 to 9.6 percent in 1998, as France passed Austria, Belgium, Denmark, Holland, and Sweden to become the number two spender in the EU, behind Germany (OECD 2000: Table A7). The French health care system is not without problems, but thanks in part to this increased commitment of resources, the French system was rated the planet's best by the World Health Organization.

French authorities have not only expanded existing social programs; they have also launched new ones. In 1988, the Socialist government of Michel Rocard, established a national social safety net or guaranteed income, the *revenu minimum d'insertion* (RMI), for all adults over the age of twenty-five. The RMI replaced a patchwork of local and targeted social assistance programs that had left large segments of the population uncovered, notably the long-term unemployed and persons suffering from psychological problems, alcoholism, and/or chemical dependency. Benefits are available on a means-tested basis to all citizens and long-term residents over the age of twenty-five. The RMI provides a monthly allowance of 2500 francs along with the promise of support services to help "insert" (the "I" in "RMI") recipients back into society and, in some cases, into a job.[7] Claimants are also eligible for housing allowances and free health insurance. Although the "insertion" dimension of the RMI remains underdeveloped, the program does provide non-negligible financial assistance to some 1 million of France's neediest citizens, at an annual cost of 25 billion francs.

The Jospin government launched two new social programs. The *couverture maladie universelle* (CMU), which began operating in 2000, makes health care available free of charge to low-income groups. The CMU originated with a pledge by the Juppé government in 1995 to extend public health insurance to the 200,000 French citizens (0.3 percent of the population) who lacked such coverage. The Jospin government honored Juppé's pledge, but also addressed the far greater problem of access among those who actually possess heath insurance. France's public health insurance reimburses just 75 percent of the costs of medical treatment on average (Join-Lambert, Bolot-Gittler et al. 1997). Although 85 percent of the population reduces co-payments by subscribing to a supplementary insurance, for the remaining 15 percent, low reimbursement rates tended to place all but emergency medical treatment out of reach. The CMU greatly attenuated this problem by providing free supplementary health insurance on a means-tested basis to an estimated 5 million people at a cost of some 10 billion francs annually.

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[7] Although job placement is one of the objectives of the RMI, the program has no employment search requirement. For many recipients -- older, unskilled workers or persons suffering from psychological problems, alcoholism, and/or chemical dependency -- employment is a remote possibility, at best. In addition, the RMI has been criticized for creating poverty traps. A claimant who accepts a low-wage, part-time job can lose as much in benefits as s/he earns in wages. Even for a full-time, minimum-wage position, the effective tax rate is estimated to exceed 60 percent (Bourguignon and Bureau 1999).

In 2002, the Jospin government established a new welfare entitlement, the *aide personnalisé à l'autonomie* (APA), which helps defray the costs of in-home assistance for the elderly. Like the RMI, the APA replaced a locally variable program, the *prestation spécifique de dépendance* (PSD), which had been established by the Juppé government in 1997. The APA provides up to 7,000 francs per month, depending on the severity of the incapacity and the financial resources of the claimant, for home-assistance expenses. Some 800,000 elderly citizens are expected to benefit from the APA, as against 135,000 for the PSD, at a cost of 23 billion francs per year.

The commitment to expanding France's welfare state extends beyond partisan lines. The RMI was established by a unanimous vote of the French parliament. While it is true that governments of the left enacted the CMU and APA, in both cases, the left built upon earlier initiatives of the right. Moreover, Gaullist President Jacques Chirac was elected in 1995 thanks to a campaign that stressed the need for heightened state intervention to heal France's "social fracture" and renew the "Republican pact" between state and citizen.

An interesting feature of French political discourse is that the same distrust of market forces and faith in state guidance that animated *dirigiste* industrial policy can now be found in social policy. Jacques Chirac would have never dreamed of calling for a new round of nationalizations or a revival of sectoral planning. Yet it was entirely legitimate, even electorally savvy, for him to call for intensified state intervention in the social arena. This kind of redirection of the sphere of legitimate state intervention can be seen in the third area of intensified activism, the promotion of small- and medium-sized enterprises (SMEs).

Promotion of SMEs

While winding down industrial policy programs for the "national champions," state authorities have developed an array of instruments to promote SMEs (Levy 1999). The guiding principle of these programs is to encourage SMEs to "make leaps," to accelerate the pace of their development. State subsidies of up to 50 percent or success-conditional loans are available for a variety of risky ventures, including: integrating composite materials or electronics into existing products; developing new products; computerizing production operations; and hiring managers and engineers. All of these actions are designed to usher SMEs to a new stage in their development, whether in the form of new products, new production processes, or a new management structure.

State authorities see no contradiction between their claim to have moved beyond *dirigisme* and the multiplication of public programs and tax credits, costing some 100 billion francs annually, in support of SMEs. Part of the reason is that they regard SMEs as more needy than the national champions, as more susceptible to various forms of market failure. Large firms and conglomerates possess the financial and managerial resources to think strategically; they do not require government programs to assist them in these tasks. By contrast, many SMEs lack the resources or know-how to act strategically. The various measures proffered by state agencies have been devised with the idea of addressing traditional weaknesses or problems confronted by SMEs: a limited awareness of new process and product technologies; underdeveloped managerial structures; a lack of capital and access to bank loans. French officials believe that small, well-targeted programs can help SMEs overcome these obstacles, bolstering what has traditionally a weak segment of France's economy.

State authorities reject the *dirigiste* label for a second reason. In their view, the character of SME promotional policies is very different from past *dirigiste* methods. State officials are no longer picking winners and forcing firms to merge; they are merely trying to create a supportive environment for private managers. They are not imposing competitive strategies or planning targets, but rather underwriting the strategies developed by small businesses. Moreover, many of the tools of intervention operate through private consulting companies, as opposed state technocrats. Thus, the new SME policies are more market-conforming, more respectful of private initiatives than traditional state intervention.

For all these changes, though, the underlying assumption behind the policies toward SMEs is that the heads of small firms do not fully understand their own interests and that the state must encourage (and, in the process, become quite involved in) such desirable practices as: investment in risky innovation; improvements in quality control methods; the introduction of new materials into products; modernization of plant and equipment; use of sophisticated software; hiring of managers and engineers. Nor is coercion entirely absent from the relationship. While state officials are not telling private managers what to do, they are paying 20 to 50 percent of the costs for them to do certain things. Ironically, it could be argued that at no point in French history has the state meddled in so many firms and in so many prerogatives of management as under today's ostensibly post-*dirigiste* regime.

Economic Liberalization and State Activism

France's break with *dirigisme* eliminated a number of interventionist policies, but it also created pressures for new kinds of state intervention. As described above, the dramatic expansion of early retirement opportunities played a critical role in facilitating market-driven industrial restructuring. Instead of protecting jobs through bail-outs of uncompetitive companies, French authorities allowed firms to reorganize, while protecting worker income streams through early retirement. Early retirement helped salve the left's guilty conscience, but more important, it effectively demobilized France's working class, undercutting trade union capacity to mount resistance to industrial restructuring. The vast majority of French workers were more than willing to quit smelly, physically taxing, alienating jobs, to receive 90 per cent of their previous wages without having to report to work. In such a context, France's already anemic trade unions were completely incapable of mobilizing their members to fight industrial restructuring. Thus, the recourse to early retirements was not simply a social strategy, but also an economic strategy -- a fundamental prerequisite for carrying out much-needed industrial restructuring.

Government policies were deployed not only to facilitate the movement away from *dirigisme*, but also to palliate the perceived limits or failings of economic liberalization. The restoration of corporate profitability and competitiveness in the mid-1980s did not bring about an appreciable reduction in unemployment. Consequently, beginning with the Rocard government in 1988, French authorities adopted a much more interventionist approach to labor markets. The Rocard government expanded active labor market policies, notably training programs, public internships, and subsidies for hard-to-place youths and the long-term unemployed. The number beneficiaries of government measures had already risen from 450,000 in 1984 to 850,000 in 1989, but it would more than double during the next five years, reaching 1,900,000 in 1994 (DARES 1996: 100). In the latter year, while France counted 3.1 million workers officially unemployed, another 2.5 million citizens benefited from some kind of labor market measure (early retirement, subsidized employment, training programs, and public internships). In the 1990s, center-right governments expanded employment subsidies, while the left multiplied public internships. The 35-hour workweek was also presented as a job-creating measure (although this claim was hotly disputed).

The persistence of mass unemployment has led French authorities to innovate in the area of welfare policy as well as labor market policy. France's "Bismarckian" welfare state was constructed on the basis of social insurance, as opposed to social assistance (Palier 2002). In other words, benefits are tendered, not as a matter of right, to all citizens (social assistance), but in return for contributions, primarily payroll taxes, paid previously to the social security system (social insurance). Prior to the 1970s, the distinction between social insurance and social assistance was of little practical significance, since conditions of full employment enabled virtually all workers and their families to meet the requirements for obtaining coverage. With the spread of unemployment, part-time employment, and temporary employment, however, people are often unable to accumulate sufficient social security contributions to qualify for insurance benefits. Aggravating the problem, surging rates of divorce and out-of-wedlock births have made it less likely that women and children will be covered under the insurance of a "male breadwinner." Thus, a large and growing segment of the population -- the long-term unemployed, part-time and temporary workers, the intermittently employed, and many single or divorced parents and their offspring -- has found itself unprotected by the traditional system of social insurance.

A number of social initiatives have been designed to plug the holes in France's Bismarckian, insurance-based system. The RMI offers basic income support to adults who have exhausted or failed to qualify for unemployment insurance. The CMU provides supplementary health insurance for citizens not covered by employers. French authorities have also France's program of family allowances toward poverty relief. The broad trend, since the early-1970s, has been toward the "socialization of family policy": "horizontal redistribution" between childless workers and families with children has given way to "vertical redistribution" between the wealthy and the poor (Lenoir 1990; Commaille 1998). The primary vehicle for this change has been the development of means-tested programs. Originally, family allowance payments were made according to the number of children, with no reference to income levels. Since the early-1970s, however, French authorities have added a number of means-tested benefits -- including housing allowances, child care subsidies, and income supplements for single parents -- to assist struggling families. As a result, the share of family allowance spending subjected to means-testing has risen from 13.6 per cent in 1970 to over 60 per cent today.

France's break with *dirigisme* in the 1980s provided a dual impetus to state intervention. The <u>promise</u> of liberalization induced authorities to commit vast resources to the transition process, to the alleviation of social pain and political resistance, in the expectation that a more flexible labor market would quickly generate enough jobs make such costly transitional measures unnecessary (or, at least, much less necessary). The <u>disappointments</u> of liberalization, the continuing high levels of unemployment not only made it impossible to wind down supposedly transitional early retirement measures, but drove new spending in the form of active labor market programs and social assistance programs. In short, "de-dirigisation" and welfare state expansion were two sides of the same (very expensive) coin. That said, the new statist coin is very different from the pre-1983 specie.

<u>The Social Anesthesia State</u>

If state activism remains a prominent feature of France's political economy, the goals and instruments of that intervention have changed dramatically. Post-*dirigiste* state intervention differs in two important ways from its *dirigiste* antecedents. The first is in the relationship to the private sector. Instead of seeking to impose specific industrial strategies on firms, state initiatives have been geared toward providing an enabling environment, especially for small business: subsidies for innovation, market prospecting, and investment in new technologies; resources for training and low-skill hires; and early retirement programs that permit firms to downsize without provoking worker resistance. All of these state programs have expanded the options available to companies, while leaving the initiative in private manager's hands. They have been market-conforming more than market-directing.

The other distinctive feature of the new state intervention concerns the losers of economic liberalization. In its original form, the *dirigiste* model shifted resources from consumption to investment, limiting real wages and social spending. By the 1970s, however, the losers of economic modernization had mobilized, and state resources were used increasingly to block change -- to bail-out uncompetitive firms, thereby preventing lay-offs and plant closings (Berger 1981; Cohen 1989). The more recent state intervention reflects a strategic shift. The concerns of modernization's losers have been addressed, but not by blocking economic reform. Rather, under what might be termed a "social anesthesia" strategy, public resources are mobilized to pacify and demobilize the victims and opponents of market-led adjustment. Many of the most expensive new policies in France over the past twenty years have reflected this social anesthesia logic: early retirement, guaranteed minimum income, need-based supplementary health insurance, employment subsidies and public internships. The social anesthesia mission has also bolstered the enabling environment strategy. Whereas the *dirigiste* state sought to steer the market, the social anesthesia state underwrites market-led, privately-determined adjustment strategies by pacifying, dividing, and de-mobilizing potential opponents.

France's social anesthesia state is not without problems and risks. The first is that recurrent state intervention will reinforce the Tocquevillean problem of a demobilized and irresponsible associational landscape. French interest groups have little incentive to organize and bargain with each other if the state is calling all the shots. Recently, the French employer association recently withdrew from the national health insurance board, arguing that the board's corporatist principles of operation were rendered moot by recurrent government meddling. Moreover, lacking partners and buffers, state authorities often find themselves on the front line, as every aggrieved party in French society – from displaced workers, to uncompetitive farmers, to overworked truckers – turns to the state for relief. In an extreme example, workers in a factory slated for shutdown occupied the factory and threatened to dump toxic chemicals into the river unless the state (not the company) dispatched a labor official to negotiate a better severance package!

A second problem of the social anesthesia strategy is that it is very expensive. Many social initiatives, such as generous early retirement programs, were envisaged as temporary. Workers would be pensioned off, companies would restructure, then job creation would resume anew, and early retirement programs could be wound down. Instead of winding down, however, social anesthesia programs have been preserved. What is more, new initiatives -- such as a guaranteed minimum income – have been added, as mass unemployment has claimed new victims. While one can certainly sympathize with the effort to protect the poor and vulnerable, the cost of these programs has pushed the French state to the limits of its taxing capacity and, critics argue, undermined competitiveness and job creation.

A third problem is that social anesthesia is largely passive; it pays people not to work. If this represents an improvement over bailing out uncompetitive companies in order to prevent lay-offs, one can imagine better uses for the money. Once again, a comparative perspective is revealing. Social democratic countries like Sweden spend as much or even more than France on social programs, but the social democratic approach is centered around the so-called "work line," the notion that every adult should be employed (Titmuss 1987; Esping-Andersen 1990; Huber and Stephens 2001). As a result, passive measures tend to be limited, with much of the spending concentrated on "active" measures that facilitate employment, such as education and training, relocation assistance, and low-cost public childcare. Under the "active" or "social investment" model, there is an economic pay-off beyond simply keeping displaced workers from protesting and blocking lay-offs. France's social anesthesia strategy offers few such benefits, few if any gains in human capital and employment. Bringing the two cross-national comparisons in this section together, one can say that French state spending has brought greater economic gains than Japanese spending (not to mention French spending in the 1970s and early 1980s), but that it is still a far cry from the Swedish, social democratic, social investment/workline model.

The fourth problem of the social anesthesia strategy is that the anesthetic appears to be wearing off. A minimum income of $500 per month may be acceptable as a stop-gap, but not as a way of life. In the long run, the RMI is no substitute for social integration through a steady job, for upward social mobility. Many of the supposed beneficiaries of social anesthesia policies harbor great bitterness toward a government that offers them meager allowances and a succession of dead-end internships and substandard part-time or temporary jobs. This dissatisfaction probably cost Lionel Jospin the presidency in 2002, as leftist voters flocked to three different Trotskyist parties, preventing Jospin from qualifying for the run-off election with President Chirac. This dissatisfaction has also helped fuel the rise of the xenophobic, racist National Front of Jean-Marie Le Pen, which has become the number one party by far among both blue-collar workers and the unemployed.

For all its limitations, the social anesthesia state has enabled France to jettison dysfunctional *dirigiste* industrial policies, to create a competitive, productive, export-oriented, and reasonably dynamic economy, while limiting the social fall-out. Seen from a Japanese perspective, this is no small achievement. As the next section relates, such market-making reforms have largely eluded Japanese policy-makers, and the absence of a welfare state has been a key factor blocking reform.

SECTION 4 – JAPAN: THE DIVERTED DEVELOPMENTAL STATE

Japan has certainly not stood still over the years. Several of the most significant developmental tools of the postwar Japanese state have been eliminated, such as credit controls, price controls, and foreign exchange controls. To many scholars and observers, these rather profound changes represent the demise of the developmental state. But on closer inspection, a more nuanced picture of Japanese reform emerges. Key practices and institutions associated with the developmentalist state have persisted, even when they have become completely dysfunctional. As described below, the FILP program remains in place, long after it ceased to contribute to economic modernization. The preservation of FILP, the existence of numerous deficit-running public corporations, and the slow process of deregulation all attest to the limits of Japanese liberalization.

In the 1990s, conditions appeared especially propitious for liberalizing reform in Japan. The bursting of the bubble economy in 1991 and the prolonged recession that ensued convinced political elites and the population at large that the Japanese system needed to be repaired. The ending of LDP hegemony in 1993 and the onset of coalition governments introduced new political forces that often favored structural reform. Yet Japan's experience in the 1990s has been primarily one of "blocked adjustment," with various projects that were supposed to dismantle the developmental state being halted midway, rolled back, or undermined.

We argue that this blocked adjustment in Japan has been caused primarily by the underdevelopment of the welfare state. Without an adequate social safety net to demobilize political opponents, it is politically difficult to scale back state intervention. The strategy of expanding welfare programs in order to pursue market liberalization was never seriously considered in Japan. Instead, state intervention has increasingly served the function of employment protection. In practice, this intervention means undercutting liberalizing reforms that would lead to higher unemployment and bankruptcies in the short terms. In this section, we discuss how the failure to use social protection strategically in Japan has contributed to blocked adjustment. We look at three cases -- labor market policy, pro-competitive reform, and financial regulation -- to illustrate the process of blocked adjustment.

Labor Market Reform

Japan's social protection system during the postwar period can be characterized as "welfare through work" (Miura 2002). The essence of this system is that employment maintenance functionally substitutes for income maintenance programs: unemployment insurance and early retirement programs are not needed in an economy where everyone can find a job. For Japan, the commitment to full employment offered a cheaper alternative to a formal welfare state. The problem, of course, is what to do when the economy falters and employers need fewer workers. One solution is to loosen restrictions on lay-offs, while improving social programs to take care of the displaced workers. Japan resisted such a social insurance approach, however.

In the 1990s, Japanese governments responded to economic stagnation by increasing spending for public works and new forms of state intervention, rather than creating or upgrading the social protection system. This fiscally unsustainable Keynesian policy reached its peak under the Obuchi cabinet, but even Koizumi's restrictive fiscal policy has not succeeded in achieving the primary balance—revenues minus bond issues equaling expenditures minus debt-servicing costs. Japan's outstanding long-term debt is 30 percent higher than GDP in 2003, and the OECD estimates that the debt-to-GDP ratio will rise above 150 percent in 2004, the highest among industrialized countries. The current outstanding debts are approximately 110 percent higher than 10 years ago. Keynesian demand stimulus did little to revive Japan's economy, while absorbing fiscal resources that might have been used for social protection.

The lack of a welfare state in Japan has imposed huge costs and rigidities on Japanese companies. Employers' commitments to lifetime employment often deter them from strategically restructuring their corporations in response to changing business conditions. The lack of generous income-maintenance programs also prevents Japanese firms from undertaking massive dismissals, some such corporate decisions can be expected to incite unions' resistance and government intervention.

When moribund companies finally do shed workers, the costs and risks that individuals have to bear are large indeed, due to the weak social protection system. The persistently high level of employment security for regular workers does not guarantee full employment. In fact, unprecedented jobless rates since the late 1990s indicate that the job protection mechanism embedded in the Japanese management system is eroding. Even after the burst of the bubble economy in 1991, Japan's jobless rate remained low until 1994 when it reached 3 percent. The unemployment rates jumped in 1999 from 3.7 percent to 4.7 percent, reflecting the financial crisis in 1998, then rose to 5.4 percent in 2002. These figures suggest that recurrent recessions throughout the 1990s eventually compelled Japanese employers to turn to dismissals at the end of the decade. Even worse, the jobless rate among males aged 15-24 rose to 12 percent, and the rate for both men and women in this age group came to 10 percent, indicating that the difficulty in dismissing costly old workers has had the effect of restricting new hiring.

Under pressure to cut costs, Japanese employers have begun pushing for changes in the Japanese labor code. From the perspective of *Varieties of Capitalism*, Japanese employers in a coordinated market economy should prioritize quality upgrading over cost cutting. But prolonged recession has compelled Japanese employers to shed labor where possible. Employers are also looking to ease restrictions on lay-offs and part-time or temporary employment.

Japanese employers have met with little success in weakening employment security for core workers. In the late 1990s, the OECD ranked Japan first among member countries in employment security, as measured by the difficulty in dismissing workers(OECD 1999), and Japan has made no major labor market changes since then. Neo-liberal scholars and employers persistently demand the legalization of dismissal procedures that would make laying off workers easier, but unions and opposition parties have been successful in blocking such legislation.

By contrast, deregulation of the temporary labor market has proceeded quite substantially in the last five years. The 1999 Temporary Staff Work Act facilitated a rise in the number of temps from 306,000 in 1998 to 612,000 in 2001 (*Jinzai Haken Hakusho* 2003). Its revision in 2003 lifted additional restrictions, although unions' involvement in deciding the extension of work contracts became obligatory. As restrictions on temporary factory workers were relaxed, the Japan Staffing Services Association estimates that the number of registered staff will rise to 2 million. The asymmetry between the stable employment security and the deregulated temporary labor market shows that the central feature of Japan's social protection (i.e., employment protection) remains intact, but at the expense of a large and growing number of unprotected workers.

Partly because regulation on the temporary labor market has been liberalized, and partly because the labor cost of regular workers came to be considered unbearable for many firms, Japanese labor markets have become *de facto* more flexible than the past. Currently, 20 percent of the total labor force is employed part time, one of the highest rates among the OECD countries. The increasing presence of irregular workers poses a new policy challenge because the existing social protection system has been constructed based on the long-term employment of male workers. Thus, this system risks leaving irregular workers out of the already frail social safety net. New state activities in social protection initiated in the 1990s, such as the creation of long-term care insurance and some measures for rearing children, failed to address this new problem, as they were driven by the financial pressures resulting from the unexpectedly rapid aging of the Japanese population. The fundamental reform of unemployment insurance has not been even on the agenda (Miura 2002).

Japan's decision not to construct an elaborate social insurance system has slowed corporate adjustment and impeded labor market reform. Companies are reluctant -- and, in many instances, facing union and government resistance, unable -- to lay off core workers, since these workers would have no means of replacing their lost income. The effect, however, is to hinder corporate restructuring, profitability, and capacity for future hires. The lack of a formal safety net has also blocked efforts to reform Japanese rules governing lay-offs.

Japanese employers are not the only losers under the current arrangements, however. A large and increasing number of Japanese workers find themselves laboring in precarious temporary or part-time work positions with few guarantees; many workers are not finding jobs at all; and even core full-time workers are sometimes losing their jobs, with devastating social and economic consequences.[8] Through it all, the fiscal resources that might have financed decent unemployment benefits have been squandered on a succession of ineffective and often-corrupt Keynesian stimulus packages. State spending and debt have increased dramatically, but without generating labor flexibility for Japanese employers or social protection for Japanese workers.

Pro-Competitive Reform

Japan's process of deregulating the developmental state illustrates the pattern of blocked adjustment. Whereas Japan pursued pro-competitive reform steadily from the 1990s to the present (Noble 2002), the extent to which regulatory changes have led to increased competition has varied across sectors. In cases where deregulation has threatened key LDP constituencies, strong reactions against deregulatory measures have often led to a pattern of blocked adjustment.

The creation of the Deregulation Subcommittee in 1995 launched the decade-long process of regulatory reform. The Deregulation Subcommittee was initially conceived during the Hosokawa cabinet, the first non-LDP government since 1955, then materialized under the Murayama cabinet, an unusual coalition of the Socialists and LDP. The Deregulation Subcommittee is directly attached to the Prime Minister's office. It proposes items for deregulation every year, which may be implemented as the government's regulatory reform plans. After several reorganizations, the Deregulation Subcommittee was recently replaced by the Council for Regulatory Reform, where neo-liberal scholars and independent-minded business leaders continue to press the government to pursue further liberalization. Deregulatory measures in the last decade

[8] Perhaps relatedly, the number of people committing suicide exceeded 30,000 for the fifth straight year in 2002, of whom around 60 percent were aged 50 or older, while 7,940 killed themselves because of "economic or livelihood problems," the highest number since the government began the tally in 1978.

include public utilities (electricity and gas), transportation, telecommunications, and financial services (security, banking, and insurance).

Whereas some of these deregulation measures contributed to enhancing competition, deregulation in other sectors has been blocked. Social regulation and retail licensing are two such examples. Social bureaucrats skillfully manipulate the logic of safety and security to justify existing regulations. In addition, the LDP constituencies in the retail sector have succeeded in nullifying deregulation by creating measures that modify drastic changes. One interesting case is liquor licensing.

Small liquor retailers have organized a powerful organization with 120,000 members and constitute an indispensable electoral base for the LDP, which has struggled to gain support from independent urban voters. Regulations have protected many of these retail stores. Until recently, a retail liquor license has been required to sell alcohol, which presented significant entry barriers to new market participants. One regulation set spacing requirements, prohibiting competing stores to be opened within a designated distance from existing ones. Another regulation limited the number of licenses based on population. Eventually, the regulation that set spacing requirements was abolished in January 2001, and in September 2003, the population limit was abolished in September 2003. However, the ruling parties passed an emergency bill in July, allowing local tax authorities to restrict new liquor sellers in areas of intense competition. The new law is effective until August 2005, which gives enough time for conservative politicians to survive the general election in November 2003 and the upper house election scheduled in July 2004.

Protective measures for NTT (Nippon Telegraph and Telephone Corp.) and drug store regulation also illustrate the slow process of deregulation. These cases are symbolic in a sense that discontented private companies either actually sued or suggested filing a lawsuit against the regulators.[9] In July 2003, KDDI and four other new telecommunications common carriers filed a suit against the Ministry of Public Management, Home Affairs, Posts and Telecommunications, to force it to cancel approval given to NTT to raise interconnection charges. Similarly, a comprehensive discount chain store, Don Quixote, as well as the Japan Association of Chain Drugstores has suggested that they may sue the Ministry of Welfare and Labor for its intervention prohibiting it from selling drugs at night. Since pharmacies and drug stores are required to have pharmacists, offering extended hours not only increases personnel costs but also makes it harder for firms to attract enough pharmacists. Don Quixote set up a TV telephone through which customers are able to receive professional advice from pharmacists even at midnight, but the Ministry of Welfare and Labor claimed that this might violate the law. Although the Ministry of Welfare and Labor eventually admitted the TV telephone advisory system, this case also illuminates how difficult it has been to achieve regulatory reform.

Financial Reform

Finance in Japan is the quintessential example of blocked adjustment. On the one hand, finance is clearly one of the areas where there has been a veritable storm of

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[9] These recent cases illustrate that the enactment of the Administrative Procedural Law in 1993, stipulating the rules under which administrative guidance can be implemented, empowered the private sector vis-à-vis the government's sometimes arbitrary intervention. The number of administrative litigation cases has slowly increased, and more important, the use of administrative litigation has become a much more common option for companies to pursue in order to increase profit opportunities and avoid managerial responsibility (*Nikkei Shinbun*, 2003.8.7. page 1). On the one hand, administrative litigation or the threat of it might strengthen the forces favoing deregulation, but on the other hand, the cases above show that pursuing true deregulation often requires drastic action *against* the government. Moreover, it is unclear if the private sector will actually be successful.

deregulatory activity. Since the 1980s, successive governments have eased market entry, decontrolled prices, and allowed the introduction of a wider array of financial products. Japan's version of the "Big Bang," launched by Prime Minister Hashimoto in the second half of the 1990s, set out to transform Japan's entire financial system and to boost Tokyo's role as a global financial center. On the other hand, the flurry of deregulatory activity has not led to a retreat of the state from financial markets. The government has wielded the instruments of the state to micro-manage its financial system, albeit in new ways that depart from the developmental model. Rather than leveraging state control over finance to promote developmental ends, successive governments have used existing state instruments and created new instruments to minimize bankruptcies and lay-offs.

Banking is a case in point. In the wake of the collapse of Japan's asset bubble, Japanese banks have been saddled with massive non-performing loans. Successive governments have balked at forcing banks to absorb losses by writing off bad loans, however. As a result, non-performing loans have festered, while new non-performing loans have accumulated, due to Japan's continuing economic sluggishness. Governments have not been aggressive in forcing firms to write off non-performing loans because doing so would lead to bankruptcies and lay-offs.

Japan's banking system has kept a multitude of so-called "zombie" firms afloat. Banks do not foreclose on "zombies" because they do not want to take losses, and the government does not force the banks to do so because it does not want to see lay-offs and bankruptcies. The government has instead deployed the resources of the state in an attempt to manage a soft-landing with minimal impact on the labor market. In this way, the resolution of the banking problem has become intimately intertwined with corporate restructuring more generally.

Successive LDP-led governments have increasingly used the state to micro-manage the non-performing loan problem by getting involved in the business of restructuring firms. The ruling coalition revised the Financial Revitalization Law to allow the Resolution and Collection Corporation (RCC), which was set up to purchase non-performing loans and to dispose of them, to rehabilitate companies. In response, the RCC has expanded capacity in this area, and its rehabilitation business now employs about 130 people and according to media reports is expected to increase its staff even further.

At the behest of the LDP, the RCC has focused on small and medium firms. Small- and medium-sized firms are a key constituency of the LDP and one that is extremely large in Japan with such firms accounting for a very high percentage of all firms compared to other advanced industrial democracies. If the financial system were truly to be liberalized, many of these firms would go out of business. The LDP has shown a bias toward such firms and has attempted to salvage small and medium firms as much as possible. The RCC has teamed up with private banks to rehabilitate firms, setting up trust funds to lend to them. The trust funds give banks three to five years to restructure after which the RCC will call in loans. The RCC has also used public funds from sources such as the Development Bank of Japan to lend to such small and medium firms. In addition, the FSA has been relatively lenient toward smaller regional banks and refrained from setting any numerical targets for the disposal of bad loans for such banks. Heizo Takenaka, the Economy and Financial Services Minister, who is widely viewed as a reformer, has backed this move commenting, "I don't mind if you criticize this as 'one country, two systems.'"[10]

The government has not neglected struggling large firms. In fact, another entirely new organization, the Industrial Revitalization Corporation of Japan (IRCJ), has been created. Like the RCC, the IRCJ links the resolution of the non-performing loan program

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[10] "Takenaka: Tough on Major Banks, Lenient Toward Small," The Nihon Keizai Shimbun Wednesday morning edition.

with corporate restructuring. While some have viewed the creation of the IRCJ as an indication of dissatisfaction with the RCC's pace of reform, thus far, it appears that a division of labor is developing, with the IRCJ focuses on a large-scale restructuring efforts and firms that have a relatively high chance of successful corporate rehabilitation.

The government created the IRCJ as part of it an anti-deflation package passed in April 2003. With an infusion of 10 trillion yen allocated from Japan's deposit insurance system, the IRCJ coordinates restructuring plans with the corporation and creditors. Part of this process involves buying debt from non-main bank lenders, which, as Steven Vogel has noted, actually reinforces the main-bank system. Reducing the number of creditors streamlines the process of restructuring by reducing the number of partners involved. Like the RCC, the IRCJ clearly represents an attempt at dealing with the non-performing loan problem with minimum lay-offs and bankruptcies. Indeed, the IRCJ is supposed to serve as an alternative to bankruptcy proceedings, although it is not yet clear how many firms will choose to use the IRCJ to restructure their operations.

If the IRCJ and RCC illustrate how new state capacities have been deployed to avoid more radical change, the Fiscal Investment and Loan Program (FILP) illustrates the difficulty of fully dismantling the institutions of the developmental state. As discussed earlier, the FILP system played a critical role in providing funds to finance Japan's economic development. But over time, the amount of funds in the FILP system increased exponentially as deposits to the postal savings system and public pension contributions grew. The system evolved into a massive public financial system and a virtual parallel government with public corporations that received FILP funding serving an increasingly broad array of quasi-public functions, particularly ones that served the political ends of the LDP. Ironically, the FILP system expanded despite the fact that its original function – allocating scarce capital to strategic ends – declined.

As the size of the FILP grew, so, too, did political intervention. The allocation of funds, as mentioned earlier, reflected the LDP's strategy of responding to political pressures from progressive opponents through compensation and cooptation. The allocation of FILP funds shifted from development to welfare-enhancing investments, such as housing, the environment, construction, and credit for small- and medium-size business. For the LDP, the public corporations became a useful tool for funneling particularistic benefits to the party's constituencies. Public corporations also provided lucrative second careers for bureaucrats. Retiring bureaucrats could parachute – *amakudari* – into public corporations under the jurisdiction of their former ministries. This option became even more attractive for bureaucrats after regulations were passed forbidding bureaucrats from parachuting into positions in the private sector that are under the jurisdiction of their former ministries for a period of two years. Public corporations came to serve as a useful temporary landing spot for bureaucrats during this period.

The gradual penetration of the pension system led to a political backlash, however. Corruption, *amakudari*, and financial mismanagement led to growing public calls for reform. Eventually, Prime Minister Hashimoto was pressured into reforming the FILP system, and FILP reform was included in a major administrative reform law in 1998 -- The Fundamental Law on the Reform of Government Ministries and Agencies. These legal changes, which took effect in 2000, broke the link between the Ministry of Finance's second budget and the source of funds – postal savings and national pensions. The Posts and Telecommunications Agency gained control over postal savings investment and a new special public corporation acquired responsibility for managing national pension investments. The MOF did not completely lose out. In fact, MOF actually gained a new power, the right to issue a new type of bond – FILP bonds – to continue funding the second budget.

While FILP reform did lead to significant changes in the system, none of these changes represents a withdrawal of the state from finance. The government still controls the funds, but authority simply resides under different ministries -- indeed, ministries that are potentially easier for the Japanese Prime Minister and cabinet to control (although it is still not clear the extent to which the government has been able to influence investment decisions) One critical reason that the government has not ceded its former developmental tool is that the FILP system has become increasingly intertwined with stabilizing the financial system and counter-acting the effects of deregulation. Deregulatory changes associated with Japan's financial big bang, such as corporate accounting reform and limits on cross-holdings, have had the effect of creating downward pressure on the stock market, weakening the financial position of banks. Because Japanese banks are large stockholders, drops in their stock portfolio values affect their capital adequacy ratio. For instance, corporate accounting changes that require firms to assess the value of assets using current market prices rather than book values, i.e., based on purchase price, have weakened the incentive for corporations to hold onto assets and led to sell-offs causing stock prices to decline. To compensate for these effects, Japanese governments have tapped into funds from the postal saving system to intervene in the stock market to prop up prices engaging in what have been dubbed PKOs – price-keeping operations. Moreover, the recent restructuring of FILP appears to have enhanced the ability of the government to conduct such operations, with regulatory changes now explicitly allowing postal savings and national pension funds to be invested in domestic stocks and actually setting numerical targets.

SECTION 5 - CONCLUSION: IMPLICATIONS OF THE FRENCH AND JAPANESE EXPERIENCES

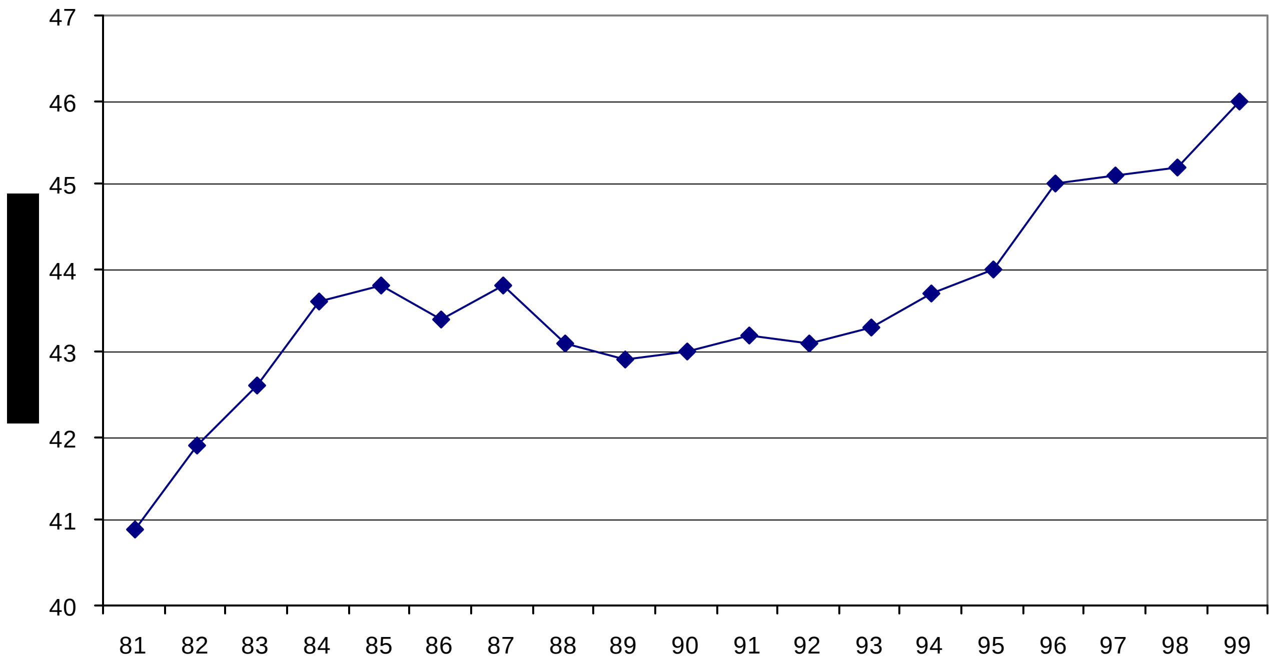
The experiences of France and Japan over the past twenty years offer three main insights into the transformation of statist political economies. *The first is that the road to a more market-centered political economy is paved with new state interventions. Specifically, getting the state out of industrial policy may require getting the state into social and labor market policy.* French authorities have paid a very high price to anesthetize the victims and potential opponents of de-*dirigisation*. In recent years, French reformers have begun to grapple with the challenge of reducing social spending and shifting from "passive" labor market expenditures, like early retirement, that pay people not to work, to "active" measures that channel people to paid employment. Post-*dirigiste* reform remains a work in progress, and many are unhappy with the contours of the social anesthesia state. For all these qualifications, France has clearly broken with the *dirigiste* industrial policy model and reaped significant benefits from a more market-oriented political economy. Japan, by contrast, remains mired in an increasingly dysfunctional statist system nearly fifteen years after the bursting of the bubble economy. In resisting the development of a welfare state, Japanese authorities thought that they were keeping the growth of the state in check; instead, they were depriving themselves of an essential instrument for conducting meaningful state rollback. The absence of a welfare state has led Japan into a pattern of "blocked adjustment" (partial, limited, contradictory liberalization), impeding a clear move to the market, in the French manner.

The second conclusion suggested by the French and Japanese experiences is that there is no "state-free" option for statist political economies. The alternative to the French social anesthesia approach is not a leaner and meaner neo-liberalism. Rather, if the case of Japan is indicative, the alternative to the French approach is diverted and dysfunctional *dirigisme*. Instead of addressing the concerns of increasingly vulnerable and politically powerful workers through social insurance programs, Japanese authorities have used traditional *dirigiste* instruments to prop up employment. This approach has certainly not held state spending in check. On the contrary, the combination of recurrent bank bail-outs and patronage-ridden, Keynesian public works programs has driving Japanese government spending, deficits, and debt to alarming levels. Thus, the choice in a statist political economy is not <u>whether</u> to increase state spending, but <u>how</u>. Whereas French authorities have used state spending to purchase de-*dirigisation*, their Japanese counterparts have used state spending to perpetuate dysfunctional industrial policies.

The third lesson from the French and Japanese experiences is that dismantling specific policies or tools associated with a particular statist framework is not the same thing as dismantling that framework itself. State intervention can morph and migrate. In France, state intervention has migrated. While voluntarist industrial policy has become a thing of the past, labor market and welfare expenditures have grown to near-Scandinavian proportions. In Japan, state intervention has morphed. While formal policy instruments, like FILP, have remained intact, their mode of operation has changed, with support for economic modernization giving way to support for the status quo. Because state intervention can morph or migrate, in gauging institutional change, it is important to examine what is new, not just what is old. If we confine our investigation to existing forms of state intervention, to the question of whether these forms are surviving or being undermined, we may be committing the analytic equivalent of searching for the key under the lamppost. In the French case, such an investigation would yield the erroneous conclusion that the state has become a non-factor, that it has been scaled back, rather than redeployed. In Japan, if we looked only at the structure or size of state policies, we would reach the equally erroneous conclusion would be that the state's role in the economy has changed very little.

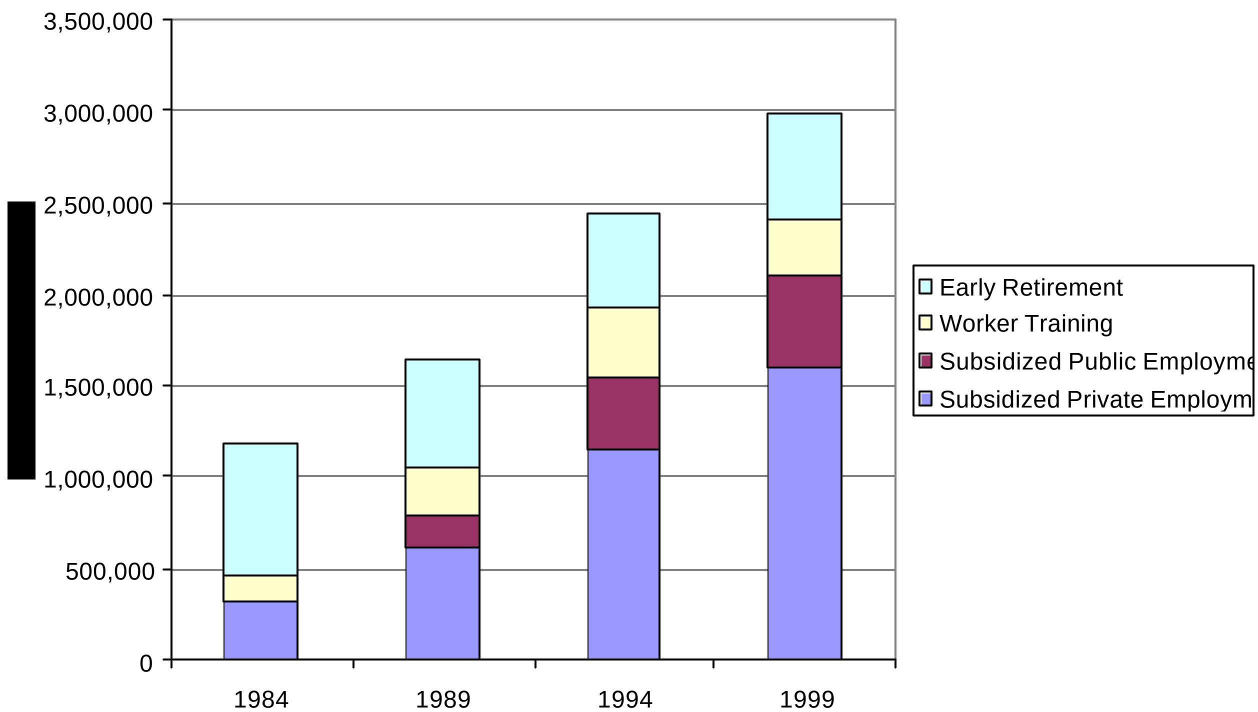
The fourth and final lesson, suggested primarily by the French experience, is that to the extent that globalization or European integration necessitates changes in state intervention, national responses may take the form of a redeployment of the state, as opposed to a shrinking of the state. This vision stands in contrast to strong globalization claims about convergence, but also to path-dependent analyses emphasizing the persistence of long-established arrangements. French authorities have not perpetuated postwar *dirigiste* arrangements; they have dismantled these arrangements. There has been real change. At the same time, the French state has not shrunk, as the logic of globalization would anticipate. Between *plus-ça-change* continuity and globalization-driven convergence, France may be on a third path -- where old forms of state intervention have been discredited and cleared away, but new forms have emerged in their place. Borrowing from Schumpeter, we might conceive of this redeployment path as a kind of "institutional creative destruction."

FIGURE 1 - TOTAL FRENCH TAX REVENUES AS A PERCENTAGE OF GDP, 1981-1999



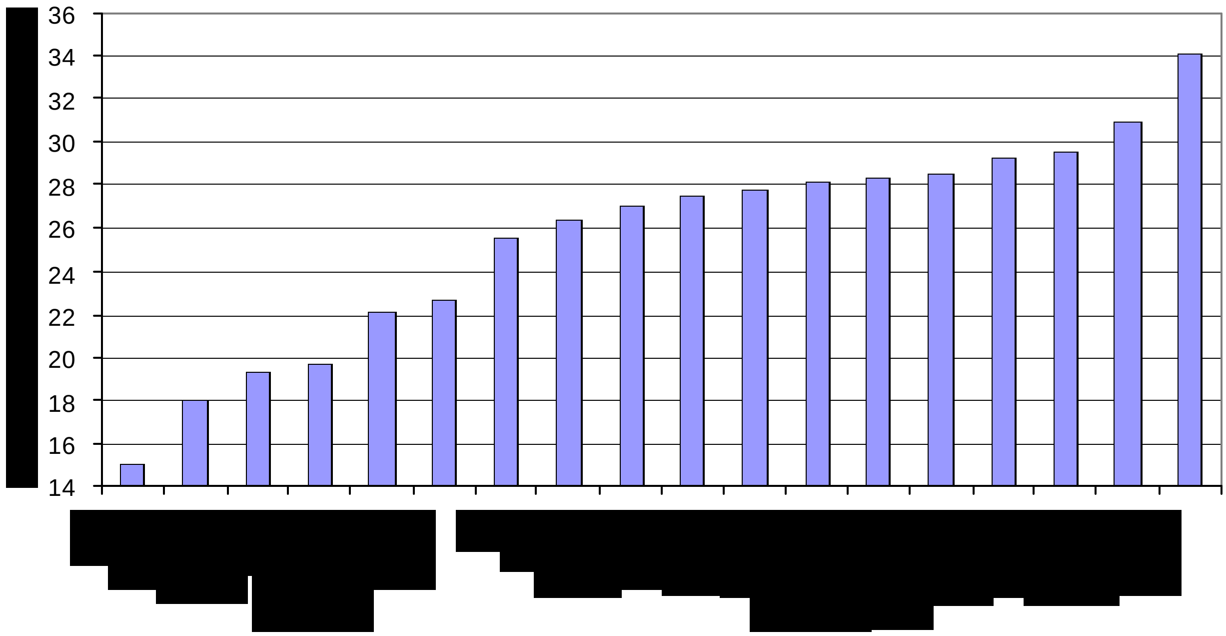
Sources: OECD (2000); Ministry of Finance (2001)

FIGURE 2 - NUMBER OF FRENCH WORK
IN PUBLIC LABOR MARKET PROGRAM



Source: DARES (1996, 200

FIGURE 3 - 1998 PUBLIC SOCIAL EXPENDITURES AS A PERCENTAGE OF GDP, SELECT OECD NATIONS



Source: OECD (2002)

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