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Small Business and the Dual-Structure-View
Firms and Industrial Organization in Japan (2)

by

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Small Business and the Dual-Structure-View

Firms and Industrial Organization in Japan --(2)

Introduction to Part I

chapter 2: Monopoly, Corporate Profits,
and the Dual Structure

chapter 3: The Image and Reality of Small Business,
and Policies for Them,

of the book forthcoming in 1995

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[Any comment, advice, suggestion, and question is very welcome. But, please
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Part I. SMALL BUSINESS AND DIVISION OF WORK: The Dual Structure,
A Gap between Image and Reality of Small Business,
and Subcontracting Relationship

[Introduction to Part I]

In Part I, focus centers on small and medium-sized firms (hereafter, SMEs) in Japan, especially before 1970. I focus on SMEs with five reasons. First, as shown in chapter 1, Japanese economy has been dominated by SMEs. In 1986, of 13.3 million manufacturing employees, 74.4 percent were in SMEs, and 72.3 percent in 1957. Second, Japan's industrial success depends, more than anything else, on the success of machinery industries, especially the fabrication and assembly-type industries. As I mention in detail in Part I, SMEs and division of work with them, called shitauke (subcontracting) relationship, supported it. Third, however, the conventional view asserts that, at least before 1970, SMEs had been exploited and suffered from shiwayose (burden-shifting) under the dual structure. And we face four basic questions: how such exploited SMEs could support the success? how could they become so active and creative? why such long exploited SMEs have not disappeared and instead increased the number and expanded their production capacities? and, after all, is the conventional view right? Fourth, when one accepts the fact mentioned in chapter 1 that each Japanese large firm is rather slim and their total share is rather small, he usually sticks to the view that large firms subordinate many SMEs under keiretsu relationship and, therefore, their actual presence and power is much larger than their size suggests. This view totally depends on the conventional view, and if it is right, it must be the secret of the success. Therefore, we have to investigate what it is and whether it is right. Fifth, what was the role of the government policies for SMEs must be of critical importance, since, if Japan's success depends on SMEs, the famous industrial policy must have contributed much.

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I focus on SMEs before 1970 with three reasons. First, as shown in chapter 1, in 1970 the size of Japanese GNP was already larger than G7 countries other than US and per capita income was catching up theirs. Because of this, however, most readers at home and abroad have interest on Japanese economy after 1970, especially in 1980s, except for some historians and Japanologists. Before 1970 the growth rate was much higher, and the growth process to Japanese economy in 1970 is more dynamic than the next stage, though heavily misunderstood and quite often mythified. Japanese economy after 1970 achieved further expansion on the prior development process, therefore, it is much worth attention. Second, the conventional view of Japanese economy before 1970 is symbolized with two keywords, the Dual Structure and Monopoly Capital (or Keiretsu). The support for the dual-structure-view weakened rapidly by 1970, but most of the keywords of the time are still used in analyzing the Japanese economy even today, which, as shown below, is a source of misunderstanding and confusion on today's Japan. Also basic questions on SMEs before 1970 arise: why and how the dual structure was collapsed? who destroyed? what was the role of the government? and, after all, was the dual-structure-view right? Third, in 1970 the Japanese automobile industry, a symbol of Japan's industrial success, manufactured more than three million passenger cars, of which exported nearly one million. The number of production grew from 20 thousand in 15 years, and as shown in chapter 4 the basic features of today's car manufacturing system were formed by 1970. Thus, the development process of this industry by 1970 is worth attention.

The core of Part I is chapter 4 where I examine the formation and mechanism of the interfirm relationship for division of work, called shitauke(subcontract). However, two chapters are necessary for preparation, since SMEs and their relationship with large firms are so deeply misunderstood. Chapter 2 is the gateway to Part I and also to the whole volume. I focus on the keyword of the time, the dual structure, and directly examine the validity of the view by comparing the profit rate of large firms with that of SMEs. Under the dual structure large firms must be enjoying advantageous position, and therefore their profit rate should be

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significantly higher. I show, however, the profit rate of SMEs are twice as high as that of large firms, and conclude that the view of the economy before 1970 is totally wrong. It implies that the industrial policies, especially SME policy, built on the basis of such faulty analysis and the contemporary views of the Japanese economy which share reliance on the same use of terms are all wrong.

Chapter 3 answers the four basic questions listed above as the third reason. Following the negative answer in chapter 1 to the last question: is the conventional view right? I go into the details of the reality of SMEs under the "dual structure." Two propositions follow the discussion: (1) a wide gap has existed between the image and reality of SMEs since 1950s; (2) the image of SMEs has changed more radically than the reality. Thus, the problem that SME policy was ostensibly designed to address did not exist. Therefore, if the elimination of the "dual structure" is the standard for measuring the effectiveness of SME policy, the policy could not have been "effective." So many new SMEs continuously entered simply because entrepreneurs found the business promising. Neither miracle nor peculiar environments for SMEs have existed. This chapter also includes a critical review of SME literature and detailed introduction to Japanese SME policy. There has been no miraculous SME policy, either.

In chapter 4, I examine the formation and mechanism of subcontracting relationship in the Japanese automobile industry. Though so much literature exists on subcontracting relationship, most of them, especially those on SMEs before 1970, entirely depend on the dual-structure-view, and their research agenda are fruitless. I examine the system for two questions: under what incentive system have SMEs joined and maintained the relationship, and made continual commitment? and how has the system functioned? Subcontracting relationship in this industry quite often has long-term character, which implies that participants commit in offering a kind of monopolistic position to the partner. How has each participant protected himself from the evils of monopoly is also a critical question. Because of the success of this industry, readers often mistook that it was powerful and efficient from the start, and lack in the knowledge and even

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the interest on the process to the success. Long sections are for a critical review of the literature, the industrial history, and popular misunderstandings.

Even when impressed by the description on what occurred in the Japanese automobile industry, never to mistake the message. Decentralization and the division of work among independent firms is not effective everywhere, "Toyota-production-system" is not easy to imitate and not the way to success for everybody. In Part IV, I focus again on organizations and inter-firm relationship.

2-1. Introduction

The first half of the postwar period almost entirely corresponds to the High Growth Era of the Japanese economy (1951-1973, see Nakamura[1993, p.164].) During this time, the economy grew at a stable 10 percent annual average real rate, much faster than in the most recent decades, whose growth was itself much higher than that in other OECD countries. Although interest in Japan's economy has intensified in recent years, the early postwar years remain worthy of study, partly because current economic strength is built upon earlier growth.² Furthermore, nearly all the keywords used to analyze the economy in recent years were employed in earlier postwar decades as well, implying that the conventional understanding of the economy in earlier years was and remains effective today. I will show, however, the conventional wisdom was totally wrong, and that the keywords used to analyze the economy in recent years deeply contaminate the result, that is, the image and understanding of today's Japanese economy.

At the core of Japan's early postwar growth is the decade from the mid-fifties onward. At the time, Japanese were divided over the causes and character of rapid growth, the future of the Japanese economy, and the role of government in the growth process. Debate was sharp and exuberant, but suffered from ill-defined terms and poor reasoning, even among scholarly treatments. Prominent terms of the day (or keywords) included: monopoly capital, dual structure, exploitation, subordination (or dependence), Shiwayose (using as the cushion, or burden-shifting), finance capital, Keiretsu loan, loan concentration, corporate groups, capital Keiretsu,

¹ This chapter is a revised version of chapter 1 of Miwa[1990], whose original was published in 1988.

² For instance, it was in 1971 that the number of exported Japanese passenger cars exceeded one million and that the Japanese Yen began to appreciate against US Dollar from the previously fixed rate of 360:1.

grouping (group-ka³), Mainbank, Keiretsu-ka, Shitauke (subcontract), large enterprises versus small and medium-sized enterprises, modernization, and rationalization. It is uncontroversial to state that monopoly capital and dual structure were the most important among them. Despite strongly divided views, all participants in these debates used these terms, thereby implying common acceptance of their validity.

Over the three decades since then, Japan has attained remarkable industrial success and has significantly raised its level of per capita income, industrial technology, and its presence in the world economy. Views of Japanese economy among observers both at home and abroad have also changed. Several previously common terms of analysis have been dropped, but most are still popular and are used for industrial and policy analysis. These includes: Mainbank, corporate groups, Keiretsu loans, Shitauke, Shiwayose, and large versus small and medium-sized enterprises. In this chapter, I focus on a keyword⁴ of the time, the dual structure. I examine directly the validity of the view by comparing the profit rate of large firms with that of small business. Under the dual structure large firms must be enjoying advantageous position, and therefore their profit rate should be significantly higher. Thus, in the following sections I show empirically that the view of the economy in 1950s and 1960s, which relies wholly on the concepts of dual economy and monopoly capital for explanation, is wrong. I suggest that contemporary views of the Japanese economy which share reliance on the same use of terms are also faulty. Thus, I conclude that the industrial policies and structures built on the basis of such faulty analysis, especially small business policy, are wrong. Section 2-2 is for the definition of the problem, 2-3 is for empirical tests, and 2-4 is for concluding remarks. This chapter is the gateway for the total volume.

³ In Japanese, "ka" attached at the end of a noun means "make or put into." Therefore, group-ka corresponds to grouping and keiretsu-ka to put into keiretsu.

⁴ Quite often in this volume I use this term instead of "concept," since, as shown below, nearly all popular phrases are too ill-defined to use as analytical concepts.

2-2. Definition of the Problem

The government's Economic White Paper in 1956 is famous for declaring "we are no longer in the postwar period," and the next White Paper asserted the existence and emphasized the seriousness of the "dual structure" of the Japanese economy. This argument gained immediate acceptance and "dual structure" became one of the most popular phrases of the time. This view apparently struck a responsive chord in the public, and these came to be keywords in studying Japanese economy. Here the words "dual structure" suggest that there are two distinctly separate sectors in the economy and that one sector consists of small, traditional enterprises (hereafter, SMEs) with low productivity and low wage, and the other of large firms with modern technology, high productivity, and high wages.

Closely related with "dual structure" is the view that large firms in the modernized industrial sector subordinate, control, and exploit SMEs in the traditional sector. This view took for granted that large firms had and could exercise power to exploit SMEs, whose freedom of choice was tightly restricted and likened to a "hold-up" situation, and the group of large firms was called "monopoly capital." Many Japanese recognized this situation as a "social problem" to be solved by government intervention, and the policies for small business were designed for the "medium and small enterprises problem."⁵

Most Japanese, not only people in business and journalism but also politicians, bureaucrats and scholars, supported this view unanimously and strongly. Only Ryutaro Komiya[1961a, 1961b, 1962] challenged it⁷ and no survey article critical on the view was written before Miwa[1988] on which this chapter depends. Komiya[1962] challenged the view by testing the hypothesis that, when "monopoly" or "monopoly capital" had and could

⁵ Small business corresponds to "chu-sho" kigyo in Japanese whose direct translation is "medium and small" enterprises. Here I follow the Japanese order.

⁶ For the details of policies for small business, see the next chapter.

⁷ For a brief introduction to the situation of the debates, see Miwa[1990, pp.5-7].

exercise power to exploit SMEs, their profit rates should be significantly higher than that of SMEs. He found that in 1953-59 the average profit rate (net profits before tax)/(paid-in capital), of large firms, firms with more than ¥100 million in capital, was lower than that of any other classes of firms, and that there was a wide difference of profit rate between large firms and SMEs.⁸

There was almost an unanimous support for the dominant view, and, presumably because of this unanimity, there were no serious debates on the causes and functions of the "dual structure" and remained untouched a wide variety of views of them. I identify at least four types⁹ of view all of which lead to the same assertion Komiya[1962] denied. Therefore, Komiya[1962] can be interpreted as a test for the validity of them, and his findings imply at least some of them are invalid.

(1) As a result of both Keiretsu loans, where large banks make loans preferentially to closely related large firms (at the core of them are ex-zaibatsu-type corporate groups), and the government policies for large firms through subsidies and preferential loans, there establishes the "loan-concentration mechanism," which makes the profit rate of large firms higher than that of SMEs.¹⁰

(2) Large firms enjoy an advantages in using labor market, which makes their profit rate higher than that of SMEs.¹¹

⁸ Komiya[1962, p.219].

⁹ See, Miwa[1990, pp.9-10].

¹⁰ See, for example Shinohara[1959, 1961]. For the details of "loan-concentration mechanism" see chapter 5, and for keiretsu loans and corporate groups chapters 6 and 7.

¹¹ For example, Kawaguchi[1962a, p.83] asserts under the title of "function as the cushion for employment fluctuation," that is, Shiwayose in labor market: "In depressions large firms evade wage reduction and dismissal of their workers by making subcontractors reduce the wage of their workers and dismiss them through reducing the volume of orders to them. Sometimes large firms dismiss their workers and push them into the pool of potentially unemployed in rural areas and at the bottom of the social ladder in cities. Recently they actively exploit their advantage in labor market under dual structure..." This quotation is only to show a rough image of logic the view (2) depends on. We see in detail Shiwayose in capital market in chapter 5, but nowhere for that in labor market. It is neither logically persuasive nor empirically supportable as suggested below.

(3) Large firms enjoy their advantageous position in product markets. They purchase products of SMEs that pay low wages to workers, and sell their products at higher prices than those of SMEs, which makes their profit rate higher than that of SMEs.

(4) The markets where SMEs dominate are easy to enter, and competition in such markets tends to be harder than that in others, which makes the profit rate of large firms higher than that of SMEs.

Unanimous and strong support for the view does not mean that it is expressed by well-defined words and with a wide agreement. The definition of large firms, that is, the distinction of large firms from SMEs, has critical importance, and there was almost no such definition except the one adopted in the Small and Medium-sized Enterprise Basic Law enacted later in 1963.¹² Komiya[1962] measured the scale of firms in terms of the volume of paid-in capital, and divided them into six classes. His conclusion does not depend on the definition of large firms. Wherever is the line between large firms and SMEs, the average profit rate of large firms is lower than that of SMEs.

Komiya[1962]'s finding immediately gathered wide attention and keen reaction of enthusiastic supporters of the dominant view,¹³ but I find its clear impact neither on the view of the Japanese economy nor on the debates on policies for SMEs.

In the next section, following Komiya[1962], I carry out the same test for 1960-84 and find that the same conclusion holds also during this period. Komiya[1962]'s conclusion is drawn for rather a short period in 1950s, the earlier stage of the High Growth Era, and criticized as a result on chance. My finding implies that his conclusion is robust and applies not only throughout the High Growth Era but also the second half of the postwar period. This conclusion strongly suggests that some of the views leading to the higher profitability of large firms are invalid, which implies that the

¹² This definition is used in this volume, unless otherwise stated, for example, in chapter 1.

¹³ See, Miwa[1990, pp.10-11].

dominant view of the time which still remains today as conventional is totally wrong.

2-3. Firm Scale and Profitability: 1960-1984

The Small and Medium-sized Enterprise Basic Law was enacted in 1963 with broad public support and enthusiastic political backing. Ironically, however, with rapid economic growth in the 1960s, support for the dual-structure-view weakened rapidly. By 1970, the White Paper on SMEs had a subtitle: "The Transfiguration of the Dual Structure and the Variety of SME Problems." Either the situation surrounding SMEs or the public's image of SMEs had changed.¹⁴

Let me list up for our test three different positions identifiable from the literature. Position 1 asserts that the view was valid in 1950s and the first half of 1960s but in the second half of 1960s the dual structure disappeared. Position 2 asserts that throughout the period under study the dual structure has been serious. Position 3 asserts that the dual-structure-view has been invalid since 1950s. Position 1 and 2 are further divided into two subpositions.

[Position 1]: The dual structure was serious in 1950s and the first half of 1960s, but it changed rapidly. Therefore, the profit rate of large firms should be higher than that of SMEs before the change in the second half of 1960s, and the difference should disappear after the change.

[position 1-1]: Komiya[1962]'s result was drawn by chance, and the remaining period before the change should show the large firms' higher profit rate.

[position 1-2]: The data used in Komiya[1962] have inescapable bias, and his finding resulted from it. As this bias holds throughout the period, the remaining period before the change should show the same result as Komiya[1962] and large firms' profit rate after the change should be much lower than that of SMEs.

¹⁴ Even in 1980s there remained strong support, both actual and potential, for the dual-structure-view, and we observed a revival of this view when the Japanese economy suffered from depression after the Second Oil Crisis. See, for example, Takahashi[1982].

[Position 2]: There has been no change in the seriousness of the dual structure. Therefore, the profit rate of large firms should be higher than that of SMEs throughout the period.

[position 2-1]: Komiya[1962]'s result was drawn by chance, and the remaining period throughout should show the large firms' higher profit rate.

[position 2-2]: The data used in Komiya[1962] have inescapable bias, and his finding resulted from it. As this bias holds throughout the period, the remaining period throughout should show the same result as Komiya[1962].

[Position 3]: The dual-structure-view has been invalid since 1950s as was suggested by Komiya[1962]. Throughout the period the profit rate of large firms should not be higher than that of SMEs, as was shown for 1953-59 in Komiya[1962].

See Table 2-1 and Figure 2-1. Following Komiya[1962], I use data in Hojin kigyo tokei nenpo (Financial statement of incorporated business, annual) of Ministry of Finance, which classifies into six groups all incorporated business firms in Japan in terms of the scale of paid-in capital. Table 2-1 shows before-tax rate of profit on equity (paid-in capital) of corporate enterprises in all industries. In column 2 to column 6 is the five year average of profit rate in each year for each group. In column 7 to column 9 is the number of years below average profit rate for the period 1960-84, 1960-74, and 1975-84. For readers' convenience, in column 1 I adopt from Komiya[1962] the average profit rate for 1953-59. For 1960-84 I neglect the group of firms with less than ¥2 million in capital because they are too small, and divide firms with more than ¥100 million into two groups, ¥100 million - ¥1 billion, and more than ¥1 billion¹⁵. Figure 2-1 shows the profit rate in each year for three selected groups.

¹⁵ In 1960 and 1970 the numbers of corporate firms with more than ¥100 million in paid-in capital are 2,541 and 7,201, and firms with more than ¥1 billion 415 and 1,185. The numbers for the former are too big to be grouped together and called "large firms."

SMEs are represented by Group A with ¥5 - 10 million and Group B with ¥10 - 50 million, and large firms by Group C with more than ¥1 billion.¹⁶

----- Table 2-1, Figure 2-1 -----

Table 2-1 and Figure 2-1 show that Komiya[1962]'s result for 1950s holds also for 1960s and 70s. Only after the First Oil Crisis remarkable change begins to appear, however, the direction of the change is the opposite to the common sense view that the relative profitability of SMEs improves after the deterioration of the dual structure in the second half of 1960s. As Figure 2-1 shows, the profit rate of SMEs were almost twice as high as that of large firms in 1960s and 70s.

Table 2-2 uses after tax profit rate data instead of before tax rate in Table 2-1, and Table 2-3 uses data for manufacturing sector instead of all industries in Table 2-1. Neither requires any modification of the above results.

----- Table 2-2, Table 2-3 -----

Position 1-1 and 2-1 should be rejected, because we obtained the same result for 1960s as Komiya[1962]'s for 1950s. Position 1-1 and 1-2 should be rejected, because we obtained the same result for 1970s as those for 1960s and Komiya's for 1950s.

There remains position 2-2 and Position 3. Although our tables and figure do not help, we should choose Position 3 with three reasons: (1) the difference of the profit rate in 1960s and 70s is too big to be attributed to the alleged bias of data¹⁷; (2) the observed change around 1980

¹⁶ The size of paid-in capital of a firm with the same number of employees has changed dramatically in the process of rapid economic growth. Judging from matrix tables in Chusho kigyo keiei bunseki (Financial statements of small business in Japan, annual) of Bank of Japan which show the correspondence of the number of employees of a firm with its volume of paid-in capital, the average volume of paid-in capital of a firm with 100-199 employees were ¥5 million in 1956, ¥10 million in 1962, and more than ¥20 million in 1968.

¹⁷ For example, the survivor rate of SMEs is lower than that of large firms and data are made of the figures collected from survivors.

requires a change in the bias of data, however, there is even no trial for explanation; (3) in 1970s and 80s, support for the dual-structure-view disappeared almost entirely. Hence, we reach Position 3, that is, the dual-structure-view has been invalid since 1950s.¹⁸

2-4. Concluding Remarks

The conclusion that the dual-structure-view has been invalid since 1950s directly leads us to the denial of the view conventional even today that at least until around 1970 large firms occupied and enjoyed the position in the Japanese economy decisively advantageous to SMEs. It has such implications as follow.

(1) The framework implicitly assumed in common in debates, discussion, and even in academic researches in this period has fatal defects. We have to examine closely the validity of the basic framework and assumptions of the arguments, in reading literature and documents for studying Japanese economy of the time.¹⁹

(2) The basic framework of economic policy such as SME policies was formed in this period backed by the dual-structure-view, and we have to examine the appropriateness and effectiveness.²⁰

(3) The basic concepts and keywords introduced and used popularly in the debates and researches reflect the dual-structure-view. Some are used no longer today, however, most of them, such as Mainbank, Keiretsu loans, corporate groups, Shitauke, Shiwayose, and large versus SMEs, are widely used as the basic terms in analyzing industries and discussing policies for industries. We have to examine closely the definition of such concepts and

¹⁸ Readers may ask why the big difference of profit rate narrowed or even disappeared in 1980s, but it is not the question under discussion here and I have no clear answer. As I will refer in the next chapter, however, the deterioration of the relative profitability of SMEs in 1980s corresponds to the decline of start-up rate among SMEs (the ratio of SMEs new in a given year to all SMEs) and the net rate of business increase in 1980s. See note 18 of chapter 3.

¹⁹ Remember that our conclusion suggests at least some of the four types of view listed in section 2-2 are invalid.

²⁰ I do it for SME policy in chapter 3.

phrases and clarify the meaning of them. We cannot be too careful in using them for the analysis of today's Japanese economy to avoid the unconscious acceptance and intrusion of the dual-structure-view.²¹

What we have to do is not so easy as to simply forget and abandon consciously such phrases as "monopoly capital" and "dual structure."

²¹ It is my advice for readers to try hard to understand Japanese economy without using them, at least at the start. I believe, and as I show in this volume, we need not use them even for the study of the Japanese economy in 1950s.

Table 2-1 Rate of Profit on Equity (Paid-in Capital) of Corporate Enterprises
in Japan (Before Tax, All Industries)

Firm Size by Equity (¥million)	Profit Rate					Number of Years Below Average Profit Rate			
	1953-59	1960-64	1965-69	1970-74	1975-79	1980-84	1960-84	1960-74	1975-84
2-5	22.4	32.4	30.7	34.6	22.2	16.1	7	0	7
5-10	20.9	34.1	31.4	35.4	23.0	17.8	6	0	6
10-50	21.2	28.7	31.2	35.5	24.4	20.9	1	0	1
50-100	18.7	25.3	26.7	30.4	23.1	24.4	2	0	2
100-1,000		20.5	23.3	25.6	22.0	22.3	12	10	2
1,000+	13.1	16.2	19.8	21.3	17.8	19.5	23	15	8

Note: Figures for 1953-59 are adopted from Ryutaro Komiya [1962], Supplemental Table A.

Source: Ministry of Finance, Hojin Kigyō tokei nenpo (Financial statement of incorporated business) (Tokyo: Ministry of Finance, annual). Adopted from Miwa [1990, p.13], Table 1-1.

Table 2-2 Rate of Profit on Equity (Paid-in Capital) of Corporate Enterprises
in Japan (After Tax, All Industries)

Firm Size by Equity (\$million)	1953-59	Profit Rate (5-Year running average)					Number of Years Below Average Profit Rate			
		1960-64	1965-69	1970-74	1975-79	1980-84	1960-84	1960-74	1975-84	
2-5	8.3	16.5	18.2	20.3	11.0	4.8	6	0	6	
5-10	8.1	17.2	18.3	20.1	11.1	7.4	3	0	3	
10-50	9.3	14.5	17.8	18.6	11.3	8.4	2	0	2	
50-100	8.9	13.0	14.3	14.9	8.3	9.1	10	7	3	
100-1,000		10.9	12.7	12.4	7.7	8.3	17	13	4	
1,000+	7.5	9.9	12.7	12.5	7.5	8.7	22	15	7	

Note: Figures for 1953-59 are adopted from Ryutaro Komiya [1962], Supplemental Table B.

Source: Ministry of Finance, Hojin kigyō tokei nenpo (Financial statement of incorporated business) (Tokyo: Ministry of Finance, annual). Adopted from Miwa [1990, p. 15], Table 1-2.

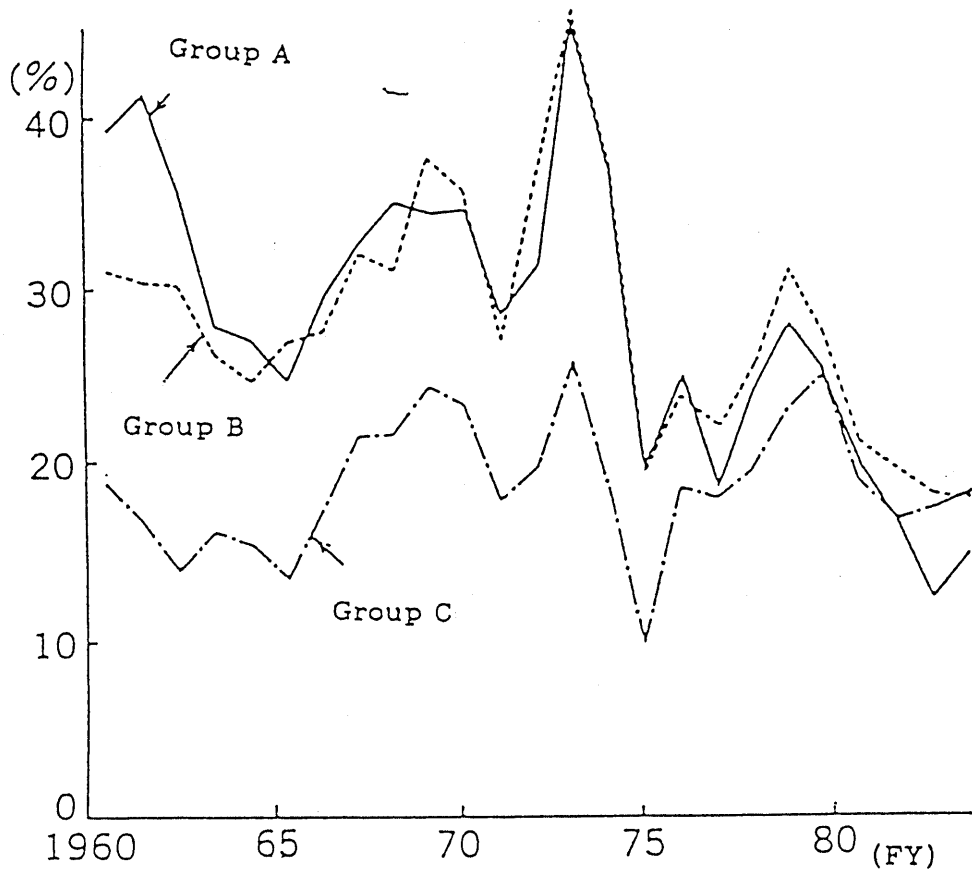
Table 2-3 Rate of Profit on Equity (Paid-in Capital) of Corporate Enterprises
in Japan (Before Tax, Manufacturing)

Firm Size by Equity (\$million)	Profit Rate (5-Year running average)					Number of Years Below Average Profit Rate			
	1953-59	1960-64	1965-69	1970-74	1975-79	1980-84	1960-84	1960-74	1975-84
2-5	23.5	34.0	30.1	33.3	22.3	13.4	6	0	6
5-10	20.4	36.0	33.1	35.2	23.7	18.2	4	0	4
10-50	22.4	30.7	31.8	35.3	24.2	21.4	1	0	1
50-100	19.2	27.2	27.6	31.1	19.1	24.5	2	0	2
100-1,000		20.9	24.7	26.2	21.5	22.8	8	7	1
1,000+	17.0	18.3	21.2	22.0	16.8	18.5	25	15	10

Note: Figures for 1953-59 are adopted from Ryutaro Komiya [1962], Supplemental Table A.

Source: Ministry of Finance, Hojin Kigyō tokei nenpo (Financial statement of incorporated business) (Tokyo: Ministry of Finance, annual). Adopted from Miwa [1990, p.15], Table 1-3.

2-1.
Figure 1 Rate of Profit on Equity (Paid-in Capital of Corporate Enterprises in Japan (Before Tax, All Industries; in per cent)



Group A: Enterprises with ¥5-10 million in capital.
Group B: Enterprises with ¥10-50 million in capital.
Group C: Enterprises with more than ¥1 billion in capital.

Source: Adopted from Miwa, *Nihon no kigyō to sangyō soshiki*, Figure 1-1, p. 13

[1990, p. 13]

Chapter 3. The Image and Reality of Small Business, and Policies for Them¹

3-1. Introduction

Japanese phrase "chusho kigyo (small and medium-sized enterprises, hereafter SMEs)" rings heavy and serious for Japanese, especially for scholars in social science. At any time, however, there was a wide variety in the image of which it reminded each Japanese, and the dominant image has changed greatly with time.

In 1980s we find two different types of dominant image of SMEs. One, which became dominant gradually among scholars who were specialized in the studies of Japanese SMEs, emphasizes the activeness and creativity, and their contribution to rapid growth of the Japanese economy. The emergence of this image was paralleled with and backed by two world wide trends. First, since 1970s people began to be deeply interested in SMEs in all countries, and research on them got strong support and activated. Second, the industrial success of Japan gathered attention, which accompanied the recognition that a huge number of SMEs supported it and made it possible. The other dominant image was clearly revealed in TV programs, and reports and articles in newspapers and magazines provided everyday in the process of rapid Yen appreciation after Plaza-Accord among G5 countries in September 1985.² The representative expression was "SMEs in distress by Yen appreciation," which reflected wide support among producers of TV programs and journalists (and at the same time, of course, audience of the programs and readers of the reports) for the image that especially SMEs were vulnerable to and seriously damaged by Yen appreciation and depression caused by it.³

¹This chapter is a revised version of chapter 2 of Miwa[1990], whose original was published 1989.

² Yen exchange rate appreciated gradually from ¥263 (against US\$1) in February 1985 to ¥242 at just before the Accord, and jumped to ¥210 by the end of September, and further rose to ¥160 in May 1986.

³ As the history shows, Japanese economy soon went into a big boom, later called "Bubble Economy," and the depression was not serious.

The purpose of this chapter is to answer the following questions. How were the two SME images mutually related? Why did and could they coexist? What has made it occur, if the relative strength of public support for each image has changed? How big was the scale of the change and how widely did it occur? Hasn't a gap existed since 1950s between the "image" and "reality" of SMEs? Has the change in the image, if it has occurred, reflected the change in the reality? If it has reflected, how exactly? How accurately has the heated controversy over the roles and means of SME policy reflected the image and reality of SMEs and their changes? Have the policies been responsive to the change in the reality? Has the SME policy been appropriate and effective? Have the policies contributed much to the rapid growth of Japanese economy? What are appropriate SME policy?

Two propositions follow the discussion below: (1) a wide gap has existed between the image and reality of SMEs since 1950s; (2) the image of SMEs has changed more radically than the reality, and the change in 1980s in the image only reduced the gap. In short, the problem that SME policy was ostensibly designed to address did not exist. If the elimination of the "dual structure" is the standard for measuring the effectiveness of SME policy, the policy could not have been "effective."

Following chapter 2, we go into the details of the image and reality of dual structure and focus on the relative position of SMEs in the Japanese economy. Note that, as shown in chapter 1, SMEs have occupied the dominant portion of the Japanese economy. In section 3-2 I introduce three representative images of SMEs at the beginning of 1970s, and comment on the recent trend among scholars specialized in SME studies to reexamine their past studies and methods. Section 3-3 is a brief review of the change in SME image, and accompanied controversies. Section 3-4 examines the gap between the image and reality, and section 3-5 discusses the implication of the gap for SME policy. Section 3-6 is for concluding remarks.

The conclusion of this chapter implies that the conventional view of the relative position of SMEs in the Japanese economy has been totally wrong. The view that large firms have subordinated and controlled SMEs, therefore, their relative importance in Japanese economy is materially much bigger than their share in employment and value added suggests, is only an

illusion. So many new SMEs continuously entered simply because entrepreneurs found the business promising. Neither miracle nor peculiar environments for SMEs have existed. There has been no miraculous SME policy, either. It directly leads us to a close examination and reevaluation of Shitauke (subcontracting) system in the next chapter.

3-2. Definition of the Problem

Three Representative Images of SMEs

Figure 3-1 shows the result of "Image Survey of SMEs," carried out in December 1971 by Small and Medium Enterprise Agency of Japan and adopted in the annual report of 1972 to the Diet (the so-called White Paper on Small and Medium-sized Enterprises in Japan; hereafter, SME White Paper). The survey was carried out to financial institutions, managers of large enterprises, and SME owner-managers. As shown in 3-3, the timing of the survey, around 1970, was the period when the dominant image of SMEs among scholars and bureaucrats, and therefore the direction of SME policy and the relative weight on each policy objective began to change.

---- Figure 3-1 -----

The Figure classifies a wide variety of images into three categories. Image 1 is immediate and represented by such phrases as "private firm," "family-run enterprise," and "one-man enterprise." Image 2 is gloomy and closely related to the dual-structure-view, and is represented by "subcontractor," "dependent," "hand-to-mouth operation," and "small and weak enterprises." Image 3 reflects the view of independent and active SMEs, and is represented by "sharp turns," "vitality," "weeds," and "core of Japanese economy." (SME White Paper [1972, pp.260-61].)

The first image mentioned in 3-1 is to be interpreted that the supporters of Image 3 have increased tremendously at least among scholars by 1980s. The second one, however, suggests that Image 2 is still dominant among the general public. Thus, in 1980s a gap exists between the scholars'

image of SMEs and the public's.⁴ It shows a clear contrast to the direction of the gap in the heyday of the dual-structure-view, in the decade since mid-fifties onward, when Image 2 was more strongly supported among scholars than by the public.

In the following sections, we focus mainly on the change of SME image among scholars, and comment briefly on the change among non-scholars in 3-5.

Recent Trend among Scholars for Reexamining SME View

In this section, we limit attention on SMEs under Shitauke⁵(subcontract) system (or Shitauke relationship,) which shows clearly the changing image of SMEs among scholars. Recent world wide increase in interests on Japanese SMEs is centered on SMEs under Shitauke relationship. It is symbolically revealed in such statement as "Shitauke system began to be valued as well functioning interfirm communication system based on highly advanced social division of labor, which is one of the causes of the supremacy of Japanese industry (Nakamura[1985, p.90])." On the other hand, it was as "small manufacturing workshop problem" that in Japan the public first paid attention to SMEs. It was since 1920s that SMEs⁶ gathered the major attention of the public, at the center of the attention was Shitauke relationship. Thus, Shitauke relationship has been the core of the public's interests and academic studies.

The annual meeting of Japanese Association for SME Studies in June 1984 chose as the common topic, "Today's SMEs under Shitauke System and Distribution Keiretsu-Ka," which symbolically shows that the image of Shitauke relationship dominant among scholars has greatly changed. The statement in the foreword for the transactions of the meeting by Professor Taikichi Itoh, the President of the Association, symbolize it and leads us

⁴ For the details, see 3-3 below.

⁵For the details of this term, seen the next chapter.

⁶ At this moment, "small and medium-sized enterprise" was already popular, instead of "small workshop."

to the next step: "The problems in Shitauke manufacturing system has been at the core of the controversy among scholars since the prewar period, as they were regarded to represent the gloomy situation of SMEs. In the postwar period also at the start it was criticized as the symbol of the "dual structure" and the exploitation through 'Shiwayose (using as the cushion).' The view unexpectedly developed to that western countries began to pay attention to it in the process of trade conflicts, to recognize it as the secret of international competitiveness of Japanese industry, and finally to study it for their efficiency improvement. We chose the problems of Shitauke system, the story of which developed like that of 'an ugly goose' by Andersen, as the common topic in order to reexamine it closely. We have to look straight at the reality and must be free from the views dominant in the past." (Itoh[1985, p.i])

It is this Association where gather those who in 1950s and 60s most enthusiastically criticized Shitauke system as the symbol of the "dual structure" and the exploitation through "Shiwayose." Naturally there were keen conflicts of opinion and heated discussion on the common topic. How should we understand the fact that such scholars chose, facing the unexpected development of the reality, Shitauke as the common topic "in order to reexamine it closely?" What is the precise meaning of "reexamination?" What do "the problems in Shitauke system" and "the views dominant in the past" stand for? Is the object of reexamination limited to Shitauke system in recent years? Or, are they going back to 1960s and even to 50s when most scholars and the public strongly supported the dual-structure-view? In 1950s and 60s the dual structure was thought to be "structural," that is, it would persist and could not be destroyed even by strong policy intervention. Does this reexamination extend even to the basic framework which made it appear to be "structural?" What is the reason, if they go back only to a certain point of time, for example, the second half of 1960s or the beginning of 1970s? What has happened and what kind of change has occurred at this moment?

What is the exact meaning of "to look straight at the reality?" What does "the reality" mean? Do they admit that they have not been "looking straight at the reality?" What is the exact meaning of "unexpected

development?" Are they saying only that they could not expect western countries to begin to study Shitauke system for their efficiency improvement, and that they duly recognized even in 1950s and 60s that it was efficiency improving and would be a source of international competitiveness? Or, do they frankly admit that they did not understand and expect such efficiency improving function of the system?

It is too demanding to ask the transactions of the meeting satisfactory answers to the above questions, since it is just the beginning of their trial for reexamination and there were keen conflicts of opinions and hot debates on this topic⁷. In what follows, I give the answers and show that the dual-economy-view of the economy dominant in 1950s and 60s is entirely wrong.

3-3. History of the Change in SME Image

In this section, I briefly review the history of change in the dominant SME image. As it has always been closely related to SME policy and political movement, and caused hot controversy, this section also provides their review. I divide the history into three stages. The first subsection is for the "original image" of SME problems, and the second is for the second half of 1950s when SME problems emerged on the main stage of economic policy debates with the popular phrase of "dual structure." In the third, I focus on the period around 1970 when the framework of SME policy seemed to change greatly.

The Original Image

"Why have SMEs gathered so many scholars' attention, and from what standpoint have they been studied" has to be the first question to be answered in the review of the literature. I am puzzled, however, to find

⁷ In reviewing the long history of SME studies, Takizawa[1985a, p.2] positively and highly valued the accumulation of results. He argues, "SME research in Japan has a real history of more than a half century and accumulated a wide variety of rich and good results. Thus, it is not too much to say that Japan belongs to the group of developed countries in SME studies."

that there was neither wide agreement nor dominant view on the answer to the question of "what SMEs were."⁸ I choose Nakayama[1948] as the main reference for this subsection,⁹ and draw the original image of SMEs for the following discussion.

Nakayama[1948] emphasizes the importance of the relation of SME study to economic policies: "At the start, small workshops gathered wide attention as a social problem, since they suffered from disadvantage of small scale and irrational management, and were expected to be defeated and selected out of the market by large firms with modern capitalistic management. SMEs, however, remained and were not extinguished. The study of this process led us to the discovery of the social system of subordination(juzoku), and it is the essence of the problem SMEs suffered from."¹⁰ To sum up, SMEs gathered public attention because they suffered from the "problem," whose essence was "subordination." Therefore, the objective of SME policy was to respond to the problem with subordination.

Despite of the fact that there was no clear definition of the "problem" and "subordination," there has been a variety of opinion on the ratio of SMEs which did not suffer from the "problem," and on the effectiveness of policies to eliminate "subordination." At least until around 1965, however, most scholars and the predominant majority of the public supported the view that most SMEs had the "problem" and suffered from "subordination."

The Dual Structure

⁸ As is suggested by the statement of Takizawa[1985b, p.3], there were so many answers to the question of "what SMEs were," therefore no clear agreement on the definition of SMEs: "To answer the question of "what SMEs are" is regarded to be the beginning, and at the same time the final end of SME studies."

⁹ For the reason of this choice, see fn. 7 of Miwa[1990, p.26].

¹⁰ I should frankly confess that Nakayama[1948] is so full of ill-defined phrases and logical gaps that I cannot catch the exact meaning of the statement. It is, however, even now the representative literature of the time.

Several important events in SME policy occurred in the early postwar period. For example, the Small and Medium-sized Enterprise Agency (SMEA) was created in 1948 as an extra-ministerial bureau of Ministry of International Trade and Industry (MITI), the People's Finance Corporation was founded in 1949, and the Small Business Finance Corporation was founded in 1953. Together with the Central Cooperative Bank of Commerce and Industry founded in 1936, the latter two corporations became the principal means by which the government channeled loans to SMEs. However, it was not until the late 1950s that policies for SMEs drew public attention.

As mentioned in 2-2, the government's White Paper in 1956 declared, "We are no longer in the postwar period," and the next White Paper asserted the existence and emphasized the seriousness of the "dual structure." It allotted a large portion of general remarks to the analysis of the dual structure of Japanese economy, and strongly insisted the importance of policies for SMEs. It argued, "Full employment, which is the final objective of Japanese economy, is not only to decrease the number of fully unemployed but also to dissolve the dual structure through the modernization and growth of the economy." The labor force population in the next ten years was expected to grow rapidly, and it concluded that it was hard to rescue even the smallest firms out of the dual structure, so that policies should focus on the modernization of medium-sized ones in the pre-modern sector.¹¹ National Economic Doubling Plan for 1961-70, adopted by the government in December 1960, clearly followed the line of 1957 White Paper for SME policy.

At that time there was a wide agreement on the seriousness of the "problem" of SMEs, which unanimously asked for SME policy. Once the concrete direction and detailed means of SME policy were presented on the assumption that policies were effective, however, a variety of criticism spurted out and heated controversy was developed. The majority of scholars, who emphasized the importance of "subordination" and asked the policies for

¹¹ See pp. 35-40 of the 1957 White Paper.

SMEs with the "problem," criticized the proposed policies as focusing on SMEs without the "problem."¹²

In 1963, 15 years after the establishment of SMEA, the Small and Medium-sized Enterprise Basic Law was enacted with broad public support and enthusiastic political backing. It ordered the government to conduct fact-finding surveys on SMEs and submit to the Diet an annual report (the so-called White Paper on Small and Medium-sized Enterprises in Japan, or the White Paper on SMEs, first published for fiscal year 1963) on trends among SMEs and measures taken to assist them. From this date, policies for SMEs began to be carried out systematically.¹³

The Dual-Structure-Transfiguration-View

Ironically, with economic growth in 1960s more rapid than the most optimistic forecast, support for the dual-structure-view weakened rapidly. In the meantime, some SMEs without the "problem" gathered public's attention because of their remarkable success.¹⁴ The 1970 White Paper on SMEs symbolically had a title for Part 2: "The Transfiguration of the Dual Structure and the Increasing Variety of SME Problems." Either the situation surrounding SMEs or the public's image of SMEs had changed.¹⁵

The dominant view at present of Japanese SMEs, which values highly their roles and contribution to the industrial success of Japan, lies on the line of the one which began to gather public's attention in 1960s. For

¹² For a brief review of the controversy, see Miwa[1990, p.30], fn.11. On the extreme side of the controversy was a large group of Marxian economists and politicized scholars who insisted that the dual structure was "structural" and such policies could not be effective. Note that Marxian economics was predominantly influential at that time in Japan.

¹³ As I mentioned in chapter 2, the standard definition of SMEs in Japan derives from Article 2 of this Law. The definition of SMEs depends on the type of industry. In manufacturing, mining, etc., SMEs include today enterprises with ¥100 million or less in paid-in capital, or 300 or fewer employees. The amount ¥100 million has changed over time.

¹⁴ Nakamura[1964a] symbolizes the removal of public's attention. He named a group of successful SMEs "chukun kigyo (medium-sized vital enterprises)."

¹⁵ For the dual-structure-transfiguration-view, see Kiyonari[1973] and Sato[1874]. See also fn.14 of Miwa[1990, p.31].

this reason, let us see Kiyonari[1973] who strongly asserted that the traditional dual structure had disappeared in order to find what type of changes were insisted to have occurred. Here we see, though not yet so clearly, the total picture of the dual-structure-view, which prepares for the investigation in the next section of a gap between the SME image and the reality.

"Some people regard the deterioration of dual structure as obvious, and the other believe in the continuance. There seems, however, to be no room for debate between two parties," he argues. Pointing out that one of the reasons why two parties were arguing on different planes was the vagueness of the dual-structure-view, he shows his definition and argues: "The structure on which such relations are reproduced as large firms accumulate capital by keeping and exploiting SMEs based on low wage labors.... SMEs are exploited by large firms under the dual structure. They can neither accumulate capital because of low profitability, nor get permission to drop away. Thus, between SMEs and large firms there lies a tall wall hard to jump over, and they form a class with fixed members like a deposit at the bottom of the social ladder of the economy. They live in such vicious circle as low wages --> survival of SMEs with potentially unemployed labor --> too many tiny rivals --> excessive competition --> low profitability --> impossible to accumulate capital --> low productivity --> financial instability --> excessive competition."(pp.3-4) Farther, he asserts, "with high speed of wage increase, mild price rise, and rapid economic growth, the dual structure has disappeared. In the process..., SMEs found business chance and earned high income, and those who had accumulated managerial resources and had competence have become independent. SMEs depending on low wages and covering low productivity with longer working hours disappear, and instead appear many SMEs which pay high wages by high productivity through highly specialized ability. Thus, the dissolution process of dual structure has proceeded"¹⁶(pp.9-11).

There was no agreement (even no discussion, I guess) on when a group of SMEs without the "problem" had appeared, however, by the first half of

¹⁶ He does not insist that SMEs with the "problem" entirely disappeared. See Kiyonari[1973, p.11] or fn.15 of Miwa[1990, p.33].

1970s not a few people began to realize their active roles and their importance for the economy. The government also clearly expressed the intention of changing the focus of SME policy for SMEs without the "problem."

3-4. A Gap between the Image and Reality of SMEs

In this section, I investigate how and to what degree the change in the SME image dominant among scholars had reflected the change in the reality. The investigation also provides an evaluation of the effectiveness and appropriateness of SME policy.

Three basic questions for the investigation are: has the ratio of SMEs with the "problem" fallen? has the seriousness of the "problem" of SMEs still with the "problem" depreciated? how does SME policy insist their effectiveness and appropriateness? The investigation goes to ask both whether the "dual structure" ever really existed, and whether "structural changes" that caused the dissolution of the "dual structure" actually took place. My conclusion is that a wide gap has existed between the image and reality of SMEs and that the image of SMEs has changed more radically than the reality. Therefore, the answers to the above three questions are all in the negative.

My analysis is directed at the image that large firms exploit SMEs either directly or indirectly, or use them as a cushion against market fluctuations. I use as the material for investigation the total picture of dual-structure-view of Kiyonari[1973] introduced in the previous section. Roughly classified, four points emerge.

(1). Logical Consistency

Is the dual-structure-view logically consistent? How could large firms exploit SMEs for a long time? The standard economic theory tells that, in a competitive market with free entry and exit (the markets dominated by SMEs satisfy these conditions, as they are characterized with

"too many tiny rivals" and "excessive competition"¹⁷), the long-run profit rate cannot be different from the normal rate in either direction. It implies that buyers (large automobile manufactures in Shitauke relation, for example) will be unable to purchase products of SMEs (car components necessary for their production manufactured by suppliers,) when they exploit SMEs through cutting down the purchasing price below the market rate which includes the normal profit. SMEs have responded to the demand requests of large firms, which reveals that SMEs have earned at least the normal profit. It by definition implies that SMEs have not been exploited.

The Japanese economy grew rapidly even before the "dual structure" was "dissolved," and both SMEs (subcontractors) and large companies (parents) firms grew steadily. It implies that large firms provided a stable demand for products of rapidly growing SMEs at a price not less than the market rate. Such a fact is not consistent with the exploitation of SMEs.

(2). High Profit Rate for SMEs

The argument that SMEs could not accumulate capital because of low profitability by exploitation of large firms suggests that the profit rate for SMEs was lower than that for large firms under the "dual structure," and leads to a forecast that the former was lower before the first half of 1960s and that this discrepancy disappeared since then.

As shown in the previous chapter,¹⁸ this forecast (Position 1 of section 2-3) is not supported by the fact. This too is not consistent with the argument that SMEs were exploited by large firms. The profit rate for SMEs was much higher than that for large firms at least until the First Oil

¹⁷ In his total picture, Kiyonari[1973] asserts that SMEs could not "get permission to drop away," seeming to suggest that markets for SMEs were not exit free, therefore, did not satisfy the condition. However, I do not agree with him with two reasons. (1) I cannot find any persuasive reason. (2) Large firms could not fill their growing demands for products of SMEs when his assertion was true, since under such condition no incumbents expanded capacities and no firms entered. See also the third point below.

¹⁸ See section 2-3, especially Table 2-1 and Figure 2-1.

Crisis, that is, almost 10 years later than the time of the Transfiguration view declared in 1970 White Paper on SMEs which followed the alleged "structural change". Moreover, the direction of the observed change after the Oil Crisis was the opposite to that implied by it.

(3). Consistent Increase in the Number of SMEs

Consistent increases have been observed in the number of SMEs throughout the period for study. As shown in Table 3-1, between 1951 and 1984, before and after the time of the "structural changes," the number of establishments of every size increased constantly. The business closing rate per year of SMEs (the ratio of SMEs closed in a year to all SMEs) has stabilized at around 4 percent, which implies that the business opening rate has been quite high, that is, more than 4 percent.¹⁹ This too is inconsistent with the argument that SMEs were exploited, as rational entrepreneurs would not enter markets in which they would be exploited. Table 3-2 uses data for manufacturing sector instead of all industries in Table 3-1, which requires no modification of the result.

----- Table 3-1, Table 3-2 -----

(4). "Loan-Concentration Mechanism" in the Financial Sector?

Although it is widely argued²⁰ that a "loan-concentration mechanism" in the financial sector targeted loans to large firms rather than

¹⁹ See, for example, Table 2-70 of 1992 White Paper on SMEs. It shows that the business opening rate has been more than 6 percent before 1981 for all industrial sectors. The rate for manufacturing sectors, however, fell drastically from 6 percent for 1966-69 to less than 4 percent for 1976-78 and then stabilized.

²⁰ See fn.18 of Miwa[1990, p.36]. For example, Kiyonari[1973, p.4] argues that the "dual structure" was supported by such socially institutionalized mechanism as that in the financial sector. Sato[1974, p.9] insists, "there has been no fundamental change in the 'financial dual structure' regarded as the basic mechanism which supported the 'dual structure of the economy.'"

SMEs--perpetuating the notion of "dual structure"--such a mechanism in fact never existed.²¹ I will discuss on this point in details in chapter 5.

From these four points²² (or even just one or two), three propositions follow: the assertion that a large majority of SMEs were "exploited" between the late 1950s and the early 1960s is inconsistent with reality; the assertion that they have been exploited in more recent years is likewise inconsistent with reality; and "structural change," in the sense of a drastic reduction in the proportion of SMEs being "exploited," never occurred.

These propositions supply the answers to the three basic questions presented at the outset of this section: (1) The ratio of SMEs with the "problem" was not so high as the dominant view assumed. There is no evidence that indicates the further fall of the ratio, either; (2) As shown, for example, by the level and the direction of change of profit rate, the disadvantageous position of SMEs relative to large firms did not improve. This implies that the seriousness of the "problem" of SMEs still with the "problem" has not depreciated; (3) As there was no remarkable change in the position of SMEs in the economy, we have no reason to judge the SME policy effective. No ineffective policies can be appropriate. In short, the problem that SME policy was ostensibly designed to address did not exist. If the elimination of the "dual structure" is the standard for measuring the effectiveness of SME policy, the policy could not have been "effective."²³

²¹ On this point, Calder[1988, p.318] refers to a statement made by Patrick[1965]: "As Hugh Patrick points out, credit restraint was the primary tool employed by the financial authorities in dealing with balance of payments deficits and inflationary pressures during the high-growth period; this restraint fell disproportionately on small firms lacking close ties with the commercial banks."

²² Likewise, two points can be added: (5) As mentioned in 3-3, a large number of active SMEs emerged and gathered public's attention. This too is in consistent with the argument that SMEs were exploited by large firms; (6) As shown in chapter 1, the total share of large firms in Japanese economy, measured by the number of employees in large firms or by total assets of the 100 largest companies, has constantly fallen. This too is inconsistent.

²³ This also implies that Itoh[1985]'s "unexpected development" mentioned in 3-2 refers not to the real position of SMEs. Therefore, he frankly admit that they did not realize and expect correctly the efficiency improving function of the system.

This implies that at least in 1950s and 60s there was a tremendous gap between the image and the reality of SMEs, which confused SME studies, debates for SME policy, and policy itself. As mentioned above, in adopting the keywords of this time, we face a great fear of unconscious acceptance and intrusion of the dual-structure-view into the analysis of today's Japanese economy, especially of SMEs and policies for them. In the next section, I examine the details of by whom, how, and why the dual-structure-view was supported in this period.

3-5. SME Image and SME Policy

SME Image among Non-Scholars

Some readers, at home and abroad, may argue that SMEs they know are different from those discussed above, or that I focus only on a part of SMEs, especially on successful SMEs. As mentioned in 3-2, even scholars specialized in SME studies began only recently to reexamine their traditional image of SMEs, there is a large possibility that so many non-scholars still hold and support, often potentially and unconsciously, such argument.

Three points follow as the reasons for the persisting view: the lack or vagueness of the definition of SMEs confuses SME studies and debates related to them²⁴; people, especially non-scholars, tend to form their SME image from own observations only, and are rarely aware of the difference of their own image from the average.²⁵ the flood of studies

²⁴ Sumiya[1970, p.61] describes at the outset of his study on petty enterprises that "Japanese SME studies have been skeptical about quantitative analysis and do not clearly show their definition of SMEs." This is a result of the history of SME studies that they began by focusing on seriousness of the "problem" of SMEs with the "problem." See fn.24 of Miwa[1990, p.38].

²⁵ When based on statistics, the definition of SMEs tends to be in common. However, non-scholars seldom refer such statistics and rarely regard such a manufacturing firm with 300 employees or ¥100 million in paid-in capital as a SME. See also fn.23 of Miwa[1990, p.38].

and reports on SMEs with the "problem" also biases their image; the image of SMEs are quite often confused with that of labors in SMEs.²⁶

The literature leads to the following two points. (1) The SME image among non-scholars has not changed so much as that among scholars. Their average image has been the mixture of Image 1 represented by such phrases as private firm and one-man enterprise and gloomy Image 2 closely related to the dual-structure-view shown in Figure 3-1. At least in 1950s and 60s the relative weight of gloomy Image 2 was higher in SME image among scholars than in non-scholars, however, by now the situation has reversed itself. (2) Wide support among non-scholars for the dual-structure-view politicized both policies for and studies of SMEs. It strongly influenced the design and enforcement of SME policy by providing the framework of debates. It also biased the direction and even the results of SME studies by scholars.

SME Image among Scholars and SME Policies

Although many studies of SME policy address "policy ideals," "policy targets," and "policy measures," few considers "policy effects." Among those who do, Hajime Takaki, former chairman of the Central Cooperative Bank for Commerce and Industry, observed soon after the depression of the early 1970s: "There are so many different policy measures for SMEs that most of us would be amazed to discover how tiny the scale of each policy is. Policy efforts have been wide but thin. It is as though the government waters large flower pots with small sprinkling cans.... In the present severe depression, there is a strong demand for SME policy in order to encourage their owners and managers... Each policy is well designed and

²⁶ Suppose, as is often emphasized, wages in SMEs are much lower than those in large firms, which is accepted as a proof of "exploitation." Then, the observed higher profitability of SMEs implies that it is the owners of SMEs, not large firms, who exploit labors in SMEs. This explanation, however, is inconsistent with the free entry-exit assumption. For the details of the "Dual Structure" in the labor market, see chapter 5, especially sections 5-1 and 5-2, of Nakamura[1981].

sensitive, but, the scale of government's policies is too small to have any effect."²⁷

A more standard view, however, would be similar to that expressed by Yokokura[1988, pp.533-34]. First, until the 1950s, policies for SMEs were but one facet of social policy and consisted of financial and cartel policies. In the 1960s, policies to assist the modernization of SME facilities were but one facet of industrial policy.²⁸ In the 1970s and 1980s, modernization policies emphasized human resources (people), technology (information), and industrial adjustment policies such as assistance for firms to change their line of business. Second, policies for SMEs tended to be indiscriminate in focus and in the policy instruments they used. This was in part because of the great variety of disadvantages faced by SMEs, but was also due to operation of political-economic mechanisms. Nonetheless, the indiscriminate use of policies for SMEs, such as in the designation of industries under the Modernization Promotion Law of 1963,²⁹ inevitably weakened their collective impact (effectiveness). And third, policies for SMEs relied primarily on the use of financing, operating through the market mechanism, rather than competition-restricting measures and direct subsidies. Despite the indiscriminate nature of policy, this eliminate the use of policies for SMEs as protective policy. This contrasts sharply with agricultural policies, which depended on the use of import restrictions and direct subsidies.³⁰

²⁷ Nihon keizai shimbun (Japan economic journal), Jan. 12, 1975.

²⁸ For the details of "industrial policy," see the Part III of this book.

²⁹ This law was enacted as the embodiment of the Small and Medium-sized Enterprise Basic Law of 1963 and in order to modernize SMEs in each industry. The number of industries designated in the five years ending in fiscal year 1967 was 137. By 1975 the number had increased to 232. For a brief explanation, see fn.34 of Miwa[1990, p.45].

³⁰ Yokokura[1988, p.524] has commented that: "If...one compares the amount and content of the budget for SME policies with that of agriculture and fisheries, the other sector that along with SMEs has been labeled 'pre-modern,' then the following differential can be observed. Subsidies for agriculture, forestry, and fisheries in 1980 General Budget came to 1.9 trillion yen (including funds for land improvement and other activities to improve the infrastructure), while 1980 FILP (Fiscal Investment and Loan Program) investments came to 890 billion yen. In contrast, 1980 General budget subsidies for SME policies came to 61 billion yen, while 1980 FILP investments came to 3.4 trillion yen. In contrast to huge subsidies

Realizing that SME policy had strong and wide support of the public and that therefore it was one of the biggest political issues^{31,32} is indispensable for understanding both the indiscriminateness in focus and in the policy instruments of use of policies³³ and the reason why few considers "policy effects."³⁴

In addition that the problem SME policy was designed to address did not exist, and that it was so indiscriminate and thin, the following three reasons make SME policy ineffective. (1) Actually, in some cases, the direct competitors of SMEs targeted by policies are SMEs in the same industry, not "large firms" in Japan. Therefore, even when SMEs are subsidized heavily, the benefits pass through to the buyers and consumers of their products through competition among SMEs. (2) Such policies as to

expended on agriculture, those for SMEs are small, and the dependence is on FILP investments."

³¹ For example, LDP (Liberal Democratic Party,) the ruling party, after the 1971 general election increased the amount of government budget for small enterprises, as they recognized that both the progress of the Japan Communist Party (JCP), especially in the urban area, and the defeat of LDP are the result of the success of the People's Association of Commerce and Industry (Minshu Shokokai, or Minsho), an organization affiliated (informally) with JCP. See Yoshitani[1975, p.343] and Patrick and Rohlen[1987, pp.368-9].

³² This also explains why "slogans" for government policies and related reports (for example, reports of the government's advisory committees and annual reports of ministries) often contain ambiguous statements and do not reflect exactly SME policy in action. This point applies not only to SME policy but also to the other policies for industry, which readers have to remind in reading such government's reports. On this point, see also chapter 11 below.

³³ Yokokura[1988, p.531] states: "There is some tendency for an indiscriminate application of policy to be found in areas other than small business policy, but it is especially evident in the case of small business policy because of the following mechanism was at work. Specifically, because of the number of SMEs and their dominant weight in employment, together with the situation that SMEs have come to be viewed as 'weaklings,' it has always been necessary for almost all of the political parties to proclaim the expansion of small business policy as one of their key policies. On the other hand, the arms of the government (the ministries and agencies) that draw up policy have responded by actively drafting small business measures (which can be expected to meet the approval of all political parties) because they generally have a favorable impact in increasing the drafters' budgets and authority." For "indiscriminate application of policy to be found in areas other than small business policy," see Part III below.

³⁴ Note that especially in 1950s many scholars directly took part in the political movement and carried out SME studies as a part of it, which was later criticized as "subordination of scholars to politics." See fn.27 of Miwa[1990, p.40].

intervene directly to trade conditions between SMEs and large firms, in order to rescue SMEs from "subordination" and "exploitation," cannot be effective. Even when policies benefit SMEs, with new entries and the reaction of large firms (they decide to make by themselves when they are buyers) benefits disappear. (3) A firm with inferior performance, in most cases, lacks in something important other than "capital," such as management resources, market for the products, and technical know-how. This is true both for SMEs and large firms. As the reason differs among SMEs, the centrally planned policies can be effective only for limited targets.

Financing Policies for SMEs: An Example³⁵

There is wide agreement that the most important measures for SMEs were financial.³⁶ Therefore, special attention should be paid to the role of financing policies and the magnitude of their effects. The central players in carrying out government policies for SME finance are three government-affiliated financial institutions: the People's Finance Corporation (PFC), the Small Business Finance Corporation (SBFC), and the Central Cooperative Bank for Commerce and Industry (CCBCI). All were established by the government to furnish SMEs with funds for business operations (sometimes expressed as "quantitatively to complement loans available from private banks") and to promote specific policies. Here I concentrate on the SBFC because it is the newest and has the most clearly specific policy-oriented character.³⁷

The government holds 100 percent of SBFC stock, and all SBFC funds for loans come from the Fiscal Investment and Loan Program.³⁸ Until the

³⁵ This part entirely depends on Miwa[1994].

³⁶ See, for example, Yokokura[1988] and Calder[1988, p.318].

³⁷ There is no basic difference in the roles and character of the PFC and SBFC, except for the identity of their main customers. The PFC specializes in loans to smaller firms than does SBFC, but both provide only long-term loans. The CCBCI is not very different from a typical private bank and functions like a bank. The government, however, provides 70 percent of its capital (¥200 billion) and allows it to issue financial bonds in the market to raise funds.

³⁸ See Noguchi[1994] for more information on FILP.

mid-1980s more than 80 percent of SBFC loans were provided by its general loan system, with the remainder from a special loan system.³⁹ Therefore, consideration here centers mainly on the former. The SBFC provides its loans directly through its approximately 60 offices and indirectly through private financial institutions appointed as its agents, which number 846 (15,131 branches). In fiscal year 1989, 75.5 percent of SBFC loans were made directly.

The SBFC's loan rate is its designated "base rate," which is equal to the "long-term prime rate" and was at 5.5 percent at the end of 1992. As SMEs are not always able to borrow at this rate in the regular financial market, especially when the market is tight, SBFC loans necessarily includes a subsidy to SMEs. That subsidy is proportional to the amount of loan. However, this "subsidy" is not large, as the discrepancy between the base rate and the market rate seldom exceeds 0.5-1.0 percent. The SBFC and its agents check the loan applications and collateral presented by their borrowers so rigorously that it is sometimes said their requirements are severer than those of private institutions. If a default occurs on an indirect loan, the agent bears 80 percent of the loss. In sum, an SBFC general loan includes a "subsidy," although the amount is small, and loan standards are strict.

SBFC offices and their agents are open to any SME and borrowers may negotiate with them directly. They need not, in other word, acquire recommendations from third parties such as local governments, Boards of Commerce and Industry, Chambers of Commerce and Industry, or other financial institutions. At the end of the 1989 fiscal year, loans made by the SBFC and its agents to SMEs had an average value of ¥32.18 million and

³⁹ Under the special loan system, the SBFC provide special low-interest loans to be used for certain purposes, such as improving the industrial structure, preventing pollution, saving energy, etc. But readers should keep in mind that these loans constituted less than 20 percent of all loans by these institutions and that the "special low interest rate" is not as "low" as might be expected, except for unusual cases. The share of special loans rose in the mid-1980s, in connection with the depression caused by the yen appreciation after 1985 Plaza Accord, and to smooth the introduction of the consumption tax. As of December 1992, there were four types of special low interest rates. The highest is 0.05 percent lower than the base loan rate, the second highest is 0.1 percent lower, and the third highest is 0.45 percent lower. The lowest rate applies only in very rare cases, such as special loans to the textile industry at 4.85 percent and to small retailers at 4.6 percent.

an average term of 6 years and 11 months. Borrowers had, on average, ¥23.49 million in paid-in capital and 48 employees.

The effectiveness of the financing policies for SMEs depends on the state of the capital markets and the relation between SMEs and large firms. If the capital markets are competitive, below-market loans are equivalent to a direct subsidy equal to: (the difference between the loan rate and the market rate) x (the amount of loans). If the capital markets are not competitive and SMEs cannot obtain loans at or even slightly above the market rate (capital markets are divided into markets for large firms and SMEs and there is a shortage of capital in the latter), the policies may have additional policy impact.

The government-affiliated financial institutions were established in order to complement financing available from private banks. The assumption was that SMEs faced strong quantitative constraints in financing which were thought to reflect the targeting of loans to large firms, which, as will be shown in chapter 5, never occurred. As a result, below-market loans could not have had any impact beyond the direct value of the subsidy.

In order to assess the policy impact of the subsidy, we should note the ratio of policy loans to total loans for SMEs. Yokokura[1988, p.523] has shown that during 1960-80 the three government-affiliated financial institutions provided only 10 percent of the total amount of funds SMEs borrowed from all financial institutions.⁴⁰ Therefore, when policy loans are provided at 1 percent below the market rate, the average rate of funds of SMEs can be lowered only 0.1 percent, which cannot be considered very significant^{41,42,43}.

⁴⁰ See Table II of Yokokura[1988, p.523]. Calculated on the basis of loan balances, the figures were 8.7 percent in 1960, 8.8 percent in 1970, 12.8 percent in 1975, and 12.6 percent in 1980. Readers who believe there were significant quantitative constraints on loans available for SMEs should recognize that, even if so, 10 percent implies that those policies expanded the funds for SMEs by only 10 percent. Much of gain, moreover, would have been passed through to other sectors via the capital market.

⁴¹ Even lending 2 or 3 percent below market rate could lower the average rates only 0.2 or 0.3 percent, which cannot be considered effective, either.

⁴² There is a widely held view that those policies have strong "signaling effects" or "cowbell effects" (that is, policy lending has an effect of attracting private bank loans to its borrowing firms) which

3-6. Concluding Remarks

Thus, so many new SMEs continuously entered simply because entrepreneurs found the business promising. Neither miracle nor peculiar environments for SMEs have existed. There has been no miraculous SME policy, either.

At any time there is a wide variety of SME image, and the dominant image has changed greatly with time. Although at least among scholars (and some government bureaucrats), the dominant image has begun to change drastically, that of the general public, therefore of the society, still remains as Nakamura[1985, p.1] states: "There is among Japanese a robust conventional view that a huge number of SMEs is a manifestation of the historical backwardness of the Japanese economy. This view occupies the minds of so many Japanese and has them regard SMEs as backward, weak, unstable, always suffering from excessive competition, and being exploited by large firms."⁴⁴

As shown, a wide gap has existed between the image and reality of SMEs and the image of SMEs has changed more radically than the reality. The

refutes my evaluation. It is often asserted, in most cases orally, that even if the ratio of the actual loans had been less than 10 percent, their effects have been far larger than this figure suggests. However, I cannot agree with this view. First, as I explained above, most of the policy loans are provided indeterminately under the general loan system and the doors are open to any SME. Therefore, there is no room for intensive screening to provide "signals." Second, even if government selects firms with their own standards, why and how can they attract private bank loans? An underlying, seemingly tautological, assumption of belief is that in Japan, government always has the ability to beat the market, which is, at least, still open to careful investigation. Strangely, we see the same type of assertion in other fields of the study of Japanese economy, such as Mainbank, and industrial policy, which we will discuss in chapter 6 and Part III.

⁴³ For the details of SME policies, see Miwa[1994].

⁴⁴ Nakamura[1985] continues: "After two Oil-Shocks and with the further improvement in international competitiveness of Japanese industry, the support for this view began to waver and the evaluation of the role of SMEs has gradually changed." However, I think this judgement too optimistic and we are just at the beginning of the change. I have stronger sympathy to Kiyonari[1982, p.16]'s statement expressed as a reaction to the revival of the dual-structure-view in 1982: "Why have Japanese intellectuals such strong sense of closeness to the dual-structure-view? SMEs are always condemned as 'pre-modern' in exchange for deep sympathy. People begin to talk about the future of the dual structure even with the slightest worsening of the labor market conditions. However, they are not eager to therefore do not understand exactly the reality of SMEs."

gap, however, still exists and this changing process continues steadily, though very slowly. At this moment, therefore, it leads to the following undesirable results only to emphasize the image of independent and active SMEs (Image 3 of Figure 3-1) and praise them with such phrases as "wonderful SMEs", "active SMEs," "SMEs as a source of the international competitiveness of Japanese industry," and "a secret of the rapid growth of Japanese economy. First, the image of SMEs has changed more radically among scholars and bureaucrats than in the public, and even now the SME image dominant among Japanese is backward, weak, and unstable (Image 2 of Figure 3-1). Simply to put forward a totally different SME image, hostile to the dominant one, and emphasize its validity will produce emotional reaction of the public. It will retard the disappearing speed of the gap by disturbing the exact understanding of the reality through cool investigations. Second, though slogans for SME policy have changed, SME policy in action basically reflects the SME view dominant when the framework and the fundamental character of policies (still dominant now) were chosen. Without changing the SME image dominant among the public, we cannot carry out cool evaluation and fundamental reexamination of SME policy. We cannot realize the entire alteration of the present policies to cope with the reality.

A wide gap that has existed between the image and reality of SMEs is a result of the wrong dual-structure-view. This implies that there has been a wide gap also between the image and reality of other components of the dual structure, and therefore the Japanese economy itself. That is, a wide gap has existed in the same manner also in the position of large firms, SMEs' relations with large firms, capital market, effectiveness of policies for industry, and the causes of rapid growth of the Japanese economy.

With rapid growth and industrial success of the Japanese economy, the following kinds of question call wide attention: (1) What are the causes and conditions for the rapid growth of the Japanese economy? (2) What are the necessary conditions and policies for creating active SMEs among massive group of SMEs with the "problem?" (3) Recently many assert that interfirm relationship for division of work is one of the secrets of the flexibility and international competitiveness of Japanese industry. How has

it been formed and what has made it possible? How does it function? (4)
What are the effective and appropriate policies for SMEs?

By the same token, it will produce emotional reaction of the public simply to put forward a totally different view on other components of the dual structure. Also without changing the conventional view, we cannot carry out a cool examination of the reality for such questions. As conventionally used keywords are closely related to the dual-structure-view, without careful examination of their definition, we cannot even make effective questions. For example, when we study and talk about SMEs with the terms in the traditional view, we ask questions to active and successful SMEs only with such implicit qualification as, "although it is a SME." Thus, such questions have been always asked as, "how have they overcome disadvantages?" "what should the government do for them?" We have to delete such qualification in asking, and change, for example, question (2) above to, "what are the necessary conditions and policies for a huge number of active SMEs?"⁴⁵ Also question (4) to, "what are the desirable role of the government toward industry," as small size as shown is not by itself disadvantageous.

So many keywords used for the study of today's Japanese economy such as corporate groups, capital keiretsu, loan keiretsu, distribution keiretsu, subcontracting, bargaining power, technological gap etc., are closely related to SMEs with the "problem," exploited under the dual structure. When we use such terms, we unconsciously assume, for example, that large firms enjoy the advantage of large size. We cannot be too careful in using them for the analysis of today's Japanese economy to avoid

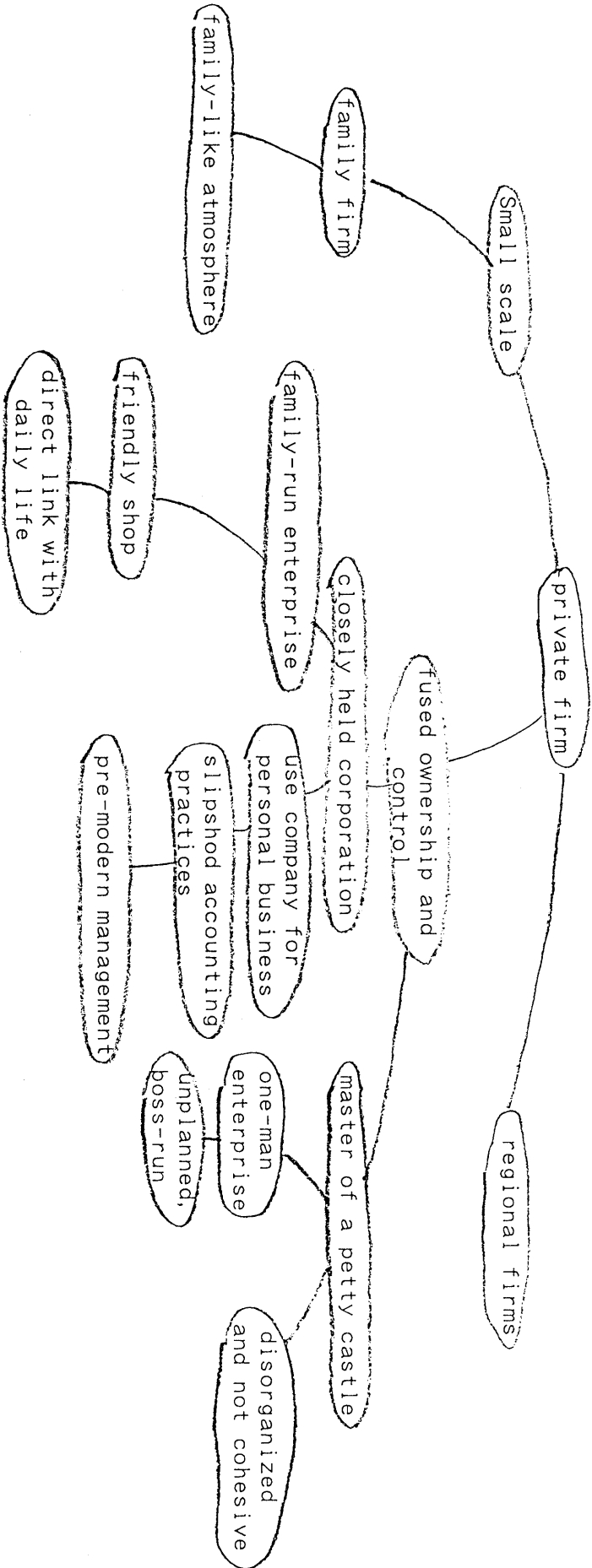
⁴⁵ The business start-up rate among SMEs (the ratio of SMEs new in a given year to all SMEs), over 7 percent around 1970 has steadily declined. As the business closing rate has stabilized at around 4 percent, the net rate of business increase has been falling and has been below 1 percent since 1981. Because SMEs are regarded as a major factor behind Japan's rapid economic growth, the declining business start-up rate gathers wide attention. See 1992 White Paper on SMEs and Miwa[1994]. The most important point here is that this has happened even under present Japanese policies for SMEs, which suggests that they are not effective. Such low start-up rate in recent years is consistent with the low profitability of SMEs shown in Table 2-1 and Figure 2-1.

such unconscious acceptance and intrusion of the dual-structure-view⁴⁶.

⁴⁶ I find quite often in the literature on the Japanese economy, especially Japanese industry, unconscious acceptance of such kind of framework of analysis and value judgement and intrusion of preoccupied view with the adoption of such keywords. I agree with Komiya[1970, p.13]'s comment as the explanation: "Especially in Japan, Marxism, Marxian Economics, Marx-Leninism, or ideology started from Karl Marx still has tremendous influence on the controversy over issues related to modern capitalism....This applies not only to the supporters of the position basically depends on Marxism but more or less also to critics of Marxism." In my view, up to the present there has been no remarkable change in this point.

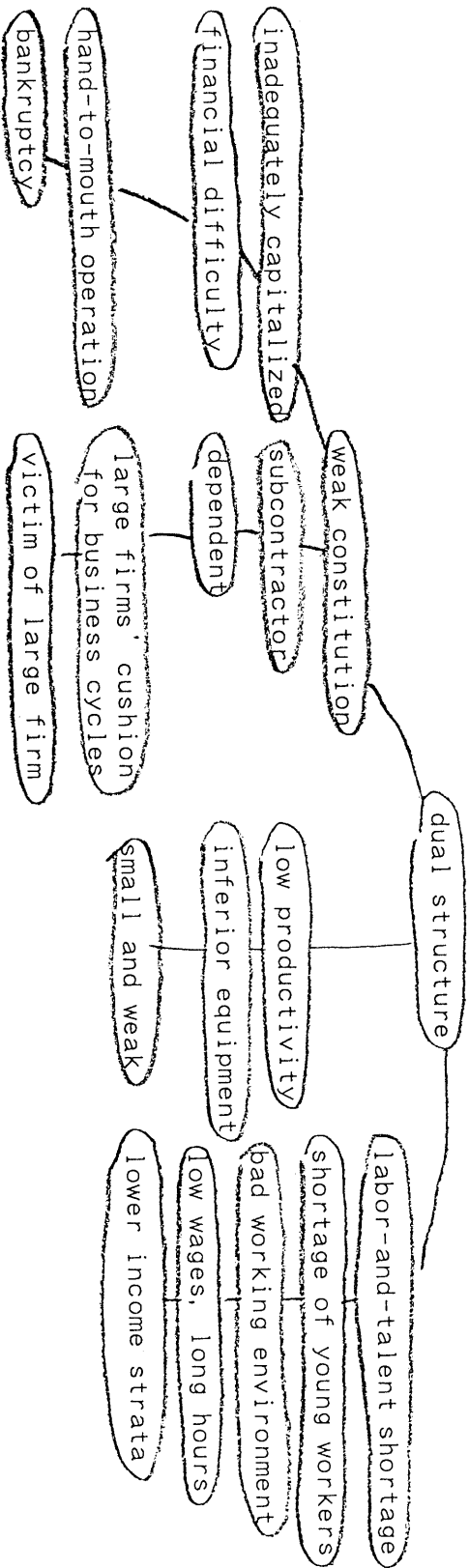
Fig 3-1, Three Images of Small Business

"Image 1"



Source: "Image Survey of SMEs," SME Agency, Dec. 1971. Adopted from 1972 SME White Paper, p. 259.

"Image 2"



"Image 3"

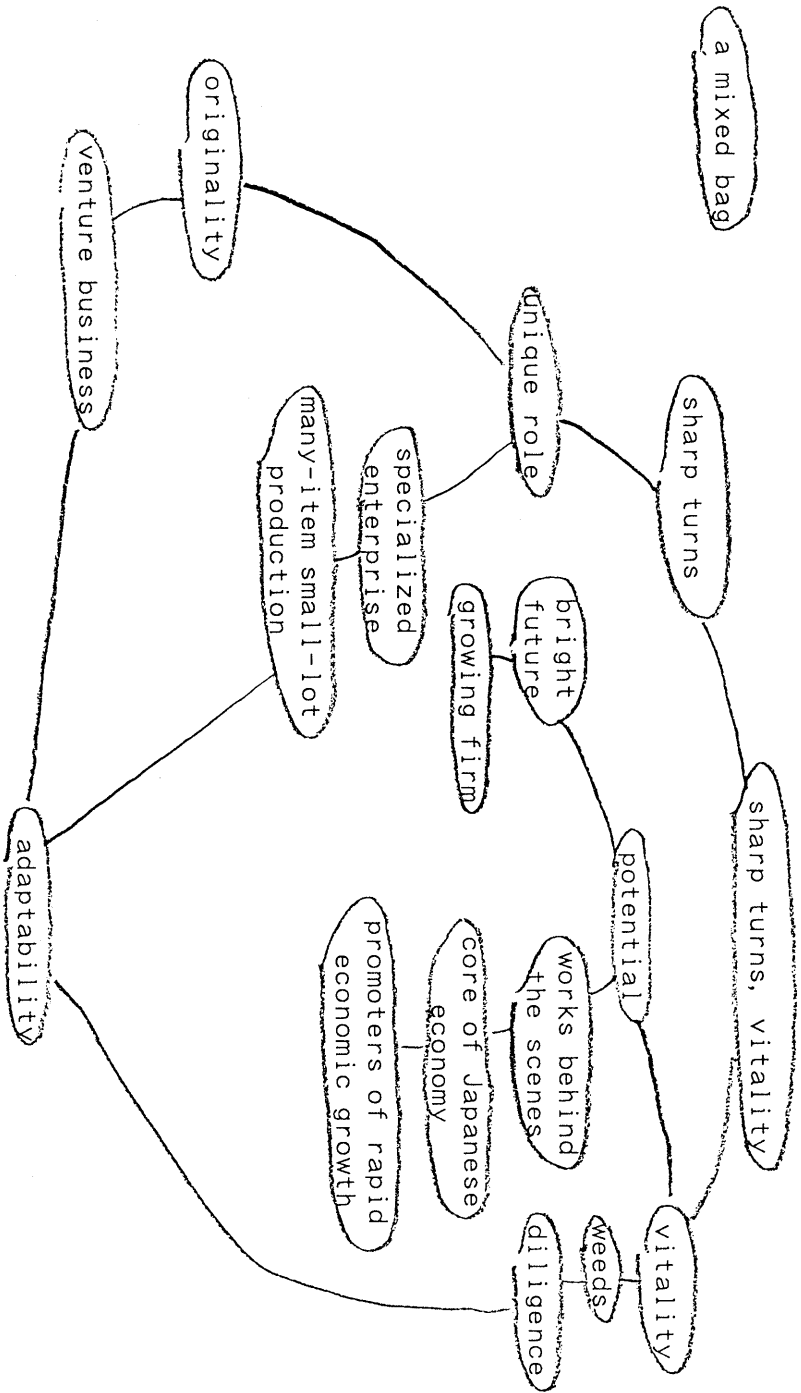


Table 3-1 Number of Establishments by Employee Size (Private, Non-agriculture) (in 1000s)

	1-4	5-9	10-29	30-99	100-299*	300+*	Total
1951	2640	284	202	51	9	1	3,187
1954	2634	369	216	54	10	2	3,285
1957	2715	433	237	60	13	2	3,461
1960	2727	463	271	80	18	3	3,562
1963	2931	515	325	103	23	3	3,900
1966	3083	607	388	122	27	3	4,231
1966	3124	632	421	140	28	8	4,352
1969	3405	713	465	157	31	9	4,780
1972	3717	789	518	175	35	10	5,244
1972	3676	763	482	154	31	8	5,114
1975	3840	834	522	156	30	8	5,389
1978	4105	956	583	167	31	7	5,849
1981	4349	1056	640	183	33	7	6,269

*Note: For 1951-66, 500 instead of 300 is used for classification, therefore, figure in 100-299 is for 100-499, for example. As no data is available for "private" in 1969, the figures for 1969 include non-private establishments. I also adopted for reference the same data for 1966 and 1972.

Source: Management and Coordination Agency, Statistics Bureau, Jigyosho Tokai Chosa (Census of Establishments) (Tokyo). Adopted from Miwa [1990, p.35], Table 2-1.

Table 3-2 Number of Establishments by Employee Size (Private Manufacturing) (in 100s)

	1-9*	10-29	30-99	100-199	200-499	500+	Total*
1951	3,155	569	164	26	16	8	3,938
1954	3,357	698	193	30	18	9	4,304
1957	3,430	866	266	41	24	11	4,637
1960	3,456	974	335	58	31	15	4,871
1963	4,155	960	391	71	38	18	5,633
1966	4,334	1,072	406	77	40	19	5,948
1969	4,751	1,148	418	84	46	23	6,469
1972	5,229	1,200	441	88	47	22	7,026
1975	5,607	1,190	420	81	43	21	7,360
1978	5,698	1,203	405	79	40	18	7,443
1981	2,518	1,293	412	82	42	19	4,365
1984	2,432	1,293	416	88	44	19	4,290

*Note: Data for 1981 and 1984 exclude establishments with 1-3 employees.

Source: Ministry of International Trade and Industry, Kogyo tokei hyo (Census of Manufacturers) (Tokyo: MITI, annual). Adopted from Miwa [1990, p.56], Table 3-1.