- **Japanese Targeting of Steel (1960 to early 1970s)**

Beginning in the 1950s, the Japanese government designated steel as a priority sector. Virtually all the raw materials for steel making had to be imported into resource poor Japan from other countries. Japanese steel production tripled from 1963 to 1970, not only meeting the rapidly growing demands of the domestic economy but also making Japan the world's largest exporter. When a world steel glut developed after the energy crisis in 1973, Japan's industry had the most modern plants with the lowest operating costs. It continued to operate, while the steel industries of other industrial countries were either contracting sharply (as in the United States) or were supported by government subsidy (as in Europe).

This experience raises four major questions. First, was government policy the cause of steel's rapid growth? Possibly yes. The steel industry did grow rapidly. Second, did industrial policy correct some market failure, or did it move the economy in the same direction as market forces would have moved it anyway? Japan would probably have developed a comparative advantage in steel even without state intervention. To begin with, Japan's high savings rate gave it a growing comparative advantage in capital intensive industries like steel. Furthermore, falling transport costs and the emergence of new sources of iron ore and coal made it less necessary for steel industries in general to locate near coalfields or iron deposits. Consequently, Japan might well have had a growing steel industry even without the MITI/MOF intervention. Nonetheless, it is perhaps true that the Japanese government encouraged steel to grow even faster than it would have in a free market economy.

Third, did the policy accelerate economic growth in Japan? This amounts to asking whether the resources used in steel yielded a higher payoff to society than they would have had elsewhere. Japan's steel industry grew rapidly despite a profit rate substantially below the average for Japanese manufacturing. The return directly earned by the resources used in steel was actually not as high as what the same resources were earning elsewhere in the economy. For instance, while the 1971 rate of return in all Japanese manufacturing was 17.5%, the same measure for Japanese steel was 10.7%.[36]

Fourth, was this policy good for Japan's economy? Japan's promotion of steel can be justified only if there were marginal social benefits not included in the market return. However, significant marginal social benefits have not been identified. Capital invested in steel earned a rate of return only a little more than half the average rate of return in Japanese manufacturing even during the prosperous 1960s, and ended up earning an even lower return during the

[36]Paul R. Krugman, in Dominick Salvatore, ed., *op. cit.*,1987, Table 2, pp. 287.