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Chapter 1: Introduction

Research Puzzle

Credit markets dealing with government, corporate and household debts, whose social foundations vary by region and country, are double-edged swords for capitalist states. Whereas periodic credit crises create destructive impacts on these states, credit is a driving force for the economic development of capitalist states. Credit markets are politically important as they are heavily involved in the distribution of wealth within states, and all of the people and institutions under the sun are either directly or indirectly influenced by credit markets. Nevertheless, managing credit markets has proved to be extremely difficult for states. If a state provides excessive autonomy for a credit market, it can make the latter overly volatile and potentially lead to the formation and subsequent bursting of a credit bubble, as the recent global financial crisis indicated. In contrast, if a state heavily regulates a credit market, it hampers market efficiency, resulting in economic stagnation, as the collapse of the Soviet Union showed.

A credit market's levels of autonomy change over time and are strongly affected by influential economic ideologies and international capital mobility. The growing influence of higher international capital mobility has driven the 'financialization' of industrialized countries' political economies. The financial sector's enhanced profitability and enlarged role within the economy and society are included in common themes of financialization, which can change not only the features of firms and financial markets but also the society encompassing them (Clift 2014: 241). Higher international capital mobility is likely to promote a government's regulatory adjustments to attract mobile capital to its financial market, retain capital within its jurisdiction and achieve its policy objectives in competition with other governments seeking similar goals. Furthermore, enhanced capital mobility is also expected to diminish the role of banks as

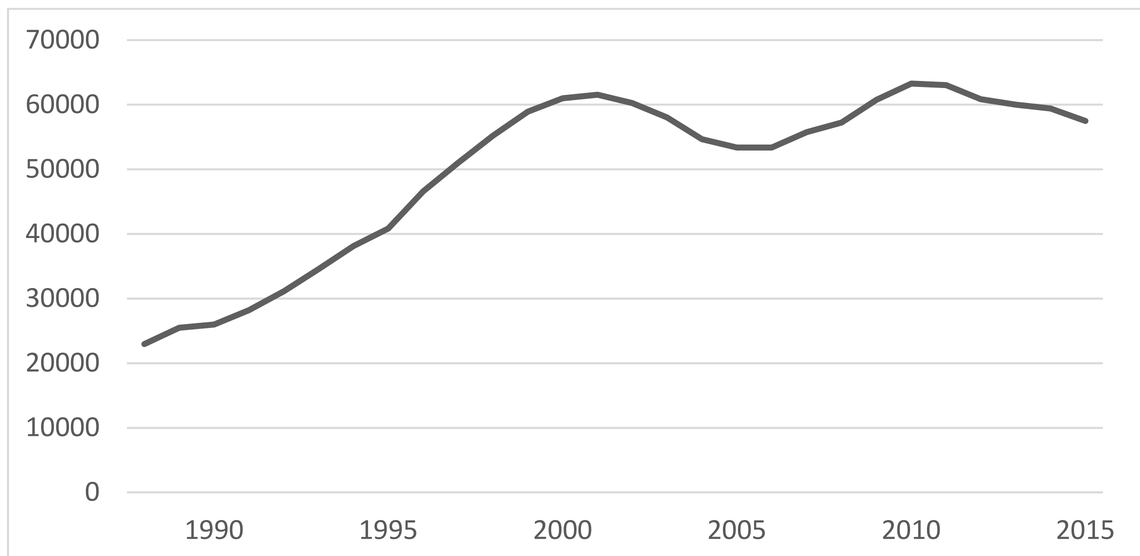
intermediators of debt capital to corporate borrowers because of the increased access of companies to “more efficient and lower cost capital markets,” namely “financial disintermediation” (Rethel and Sinclair 2012: 3).

The research puzzle of this book is why Japan’s financial disintermediation (i.e., shift from a bank-centered to market-based financial system) has stalled since the mid-2000s despite its financial deregulation during the 1980s and 1990s. In the 1980s, Japanese blue-chip firms increasingly tapped the Eurobond market due to its very low-cost funding and the foreign exchange deregulation by the government. The growing Eurobond issuance, the requests from Japanese large firms and securities companies to relax the domestic bond regulation, and the US government pressure to pry open Japanese financial markets encouraged the Japanese government to deregulate its domestic corporate bond market in the 1980s, but the Japanese government itself also needed to deregulate the bond market in order to deal with the expansion of Japanese government bonds (hereafter JGBs). The Japanese government incrementally liberalized the heavily regulated bank-centered financial system during the 1980s and the first half of the 1990s. Furthermore, the enormous bad debt problem, which reflected the malfunctioning of the system, prompted the announcement of Japan’s Big Bang financial deregulation in November 1996. The US and local credit rating agencies have assigned Japanese borrowers credit ratings since the mid-1980s, and the volume of corporate bond issuance in Japan rapidly increased during the mid to late 1990s. However, the growth of the corporate bond market has become stagnant since the mid-2000s, and the market mechanism of Japan’s financial system is still underdeveloped.

Japan’s annual domestic corporate bond issuance amount increased from 2.9 trillion yen in 1990 to 10.7 trillion yen in 1998, but it has been range-bound between 7.1 and 11.9 trillion yen, merely 2% of its GDP, since then. Consequently, the outstanding amount of domestic corporate bonds moderately increased from 55 trillion yen in 1998 to 60 trillion yen (11% of GDP) – still dwarfed by that of

bank loans for companies (roughly 400 trillion yen) – in 2017. The recent trend of the Japanese credit market is different from some European countries. Both France and Germany, the financial systems of which are categorized in the "bank-centered camp" along with that of Japan (Zysman 1983; Allen and Gale 2000), have substantially developed their capital markets. The outstanding amount of German corporate bonds dramatically expanded from 710 billion euro in 1988 to 2,055 billion euro in 2008. Although the outstanding amount of its bank debt securities plunged from 1,876 billion euro in 2008 to 1,164 billion euro (37% of GDP) in 2016 due to the global financial crisis, that issued by non-financial corporates soared from 2 billion euro in 1988 to 276 billion euro (9% of GDP) in 2016.

Figure 1: Historical Outstanding Amount of Japanese Corporate Bonds (billion yne)



Source: Japan Securities Dealers Association

Types of financial systems are closely related to those of corporate governance, which relate to the structure of power and responsibility within firms. Generally, a bank-centered financial system favors long-termist, relationship-oriented

"stakeholder capitalism," whereas a market-centered financial system prioritizes short-termist, profit-prioritizing "shareholder capitalism" (Clift 2014: 230-40).[1] Along with their capital market development, both France and Germany have recently witnessed the "hybridization" of corporate governance combining elements from both stakeholder and shareholder capitalism (ibid.: 231-55). However, such hybridization could be less applicable to the case of Japan. Although Matsuura *et al.* (2003: 1003-13) claim the two roles of the main bank system – providing both corporate finance and corporate governance for companies – have been eroded since the 1980s, this exaggerates the extent of the changes in the Japanese financial system and corporate governance. Although some scholars believe the main banks contributed to corporate governance through monitoring corporate borrowers in the rapid economic growth period (Hoshi, Kashyap and Scharfstein 1990; Aoki, Patrick and Sheard 1994), the effectiveness of the monitoring by the main banks even during that period was questionable – these scholars have failed to provide empirical evidence to support their claims (Scher 1997; Okumura 2005).

There are three hypotheses in this book that may also have implications for other countries. First, the characteristics of the Japanese credit market are co-constituted by the Japanese government and market participants, with the influence of exogenous factors. Second, the exogenous factors that potentially affect features of the credit market as well as domestic social relations and norms include internationally influential ideas, regulatory trends of key global financial centers and levels of international capital mobility. Last, endogenous factors such as domestic social relations and norms also significantly affect the characteristics of both the credit market and corporate governance, which are closely correlated.

The research puzzle – why disintermediation has lost steam despite the Japanese government's deregulation during the 1980s and 1990s – is related to

[1] In addition to shareholders, debt investors and rating agencies affect corporate governance, albeit to a lesser extent, under a market-oriented financial system.

the varieties of capitalism debate, comparing liberal market economies (LMEs) including English-speaking countries, which rely on the market mechanism, with coordinated market economies (CMEs) such as Germany, France and Japan, which rely on mutual cooperation among economic actors connected by a dense network of institutions (Hall and Soskice 2001). The growing convergence of CMEs' financial practices towards those of LMEs is often called financial globalization. Moreover, the puzzle is also linked to the convergence-diversity debate on whether CMEs would converge with LMEs (Yamamura 1997; Laurence 2001; Yamamura and Streeck 2003; Schoppa 2006; Rosenbluth and Thies 2010; Vogel 2018). According to Yamamura (1997), proponents of the convergence view (mainly neoclassical economists) focus on market forces enhancing economic efficiency and believe market forces promote convergence, whilst those of the diversity (non-convergence) view are concerned with both "formal institutions" (e.g. the state, ministries and firms) and "informal institutions' (e.g. norms and ideologies) and think such institutions shape differences in national preferences, for instance, the trade-off between efficiency and equality. Calder (1988: 465-6) and Okimoto (1989: 31-2) have slightly different perspectives from Yamamura and focus on the trade-off between efficiency and stability (or security).

The effectiveness of bank monitoring in Japanese corporate governance deteriorated due to excessive liquidity and a decreased corporate demand for funds in the Japanese economy from the latter half of the 1990s onwards. Batten and Szilagyi (2003: 83-4) point out the Japanese corporate sector's significant excess capacity and excessively high leverage built up during the high economic growth period led to its balance sheet restructuring, and warn of "the adverse selection and moral hazard problems" that could stem from the Japanese financial system being overly dependent on intermediated financing when it faces excessive liquidity and a lack of investment choice. They maintain the banking sector's bad debt problem and the corporate sector's excess capacity questioned the effectiveness of the banks' monitoring of the corporate sector, and emphasize

the necessity to promote “parallel credit channels” through developing the corporate bond market (ibid.: 96). Market-based financial systems priorities “exit” over “voice” in order to influence corporate governance, whilst bank-centered ones prefer “voice” (Hirschman 1970; Zysman 1983: 57). Ikeo (2003: 92-5) claims voice (or a bank-centered financial system) may be more effective than exit (or a market-based financial system) when the economy is at the relatively predictable stage of catching up with more advanced economies, whereas exit may be more efficient when the economy requires a drastic shift from low growth industries to high growth ones.

Despite the above-mentioned rationales for shifting from a bank-centered to a market-based financial system, why has Japan’s disintermediation stalled? Did the Japanese government merely demonstrate mock obedience to the United States (US) since it could not openly resist the US’ liberalization pressure? This explanation might hold some truth, yet it neglects the fact that domestic securities firms and big businesses also urged the government to deregulate, whilst the government recognized the necessity of it. Then, was the government’s deregulation initiative owing to external and internal pressures constrained by its close ties with banks? This account might be more persuasive but it cannot explain why households and companies, the expected beneficiaries of liberalization, have supported the *status quo* – the aggregate outstanding amount of bank loans for the corporate sector remains over six times as large as that of corporate bonds, while households keep immense bank deposits despite extremely low interest rates. Despite the inefficiency of the financial system, Japan has not encountered serious capital flight unlike some European countries. Has Japanese society behaved irrationally? Seemingly, the society has long been accustomed to the “socialization of risk” (Woo-Cummings 1999: 13) through the banking sector, strongly supported by the state, and cannot escape it easily.

Three Major Factors Affecting Features of Financial Systems

There are three major factors that significantly affect the features of financial systems including the relative autonomy of markets vis-à-vis states and interest groups. The first factor is domestic social relations in which both state and non-state actors interact with each other and form or undermine a dominant coalition over the financial system. The second one is a level of international capital mobility, which can constrain a state's autonomy. The third factor is ideas and norms, which greatly influence national political economic systems and world orders. These three aspects are often closely interrelated.

With regard to the first factor, in the case of early post-war Japan, most of the major capitalists were eliminated by the dissolution of the Zaibatsu groups (industrial and financial business conglomerates), the agricultural land reform (which virtually deprived landowners of their property rights) and the heavy wealth tax under the US occupation (1945-52),[2] as well as the wartime economic damage and the post-war hyperinflation. Unlike the US and Britain, where the powerful capitalist class has been influential in economic policymaking, the absence of a major capitalist class in the early post-war period was one key reason for the delayed capital market recovery and it cemented the dominant position of the banks in the Japanese financial system. During the early post-war period, the major banks held relatively strong bargaining power over borrowers due to a scarcity of capital, yet the export expansion and capital accumulation during the rapid economic growth period empowered export-oriented businesses and securities firms, which demanded financial deregulation from the mid-1970s onwards.

In terms of the second factor, Thomas (2001: 115-8) views mobility as a power resource for owners of capital and a potential threat to the state and the working class, arguing "since states and labor are both relatively immobile, this implies

[2] The US occupation forces adopted a pro-labor policy in the early stage of occupation, influenced by the New Deal policy.

the power of capital has risen relative to both the state and labor" (ibid.: 123). Although this argument generally holds true with regard to English-speaking countries from the 1980s onwards, "international capital mobility is not a law of nature or a machine" (Sinclair 2001: 109), and its power and impact on capital's bargaining position vis-à-vis a state and labor are contingent on a state's history and domestic social norms as well as internationally influential ideologies. The relative strength of capital over labor in a certain country may significantly alter depending on the financial market conditions. In a credit boom, when labor enjoys conducive employment conditions and good access to credit, capital has a relatively strong voice and state financial deregulation, which accelerates international capital mobility, is likely to be legitimized. By contrast, in a credit crisis, when labor's employment conditions and credit access deteriorate, financial deregulation loses its legitimacy, and labor tends to demand stricter regulation, which can constrain international capital mobility.

A typical example of the third factor occurred when a liberal economic ideology was permeated globally under British leadership in the 19th and early 20th centuries, while the market failures in the Great Depression beginning in 1929, the wartime experience and Keynesian ideas made state intervention in the economy more acceptable among business leaders (Gill and Law 1988: 96). It was not a mere coincidence that Japan adopted a fairly liberal economic policy from the Meiji restoration until the 1920s, when liberalism was internationally dominant under British leadership. Subsequently, Japan's post-war *dirigiste* policy was internationally tolerated because of the prevalence of Keynesianism and the Cold War.[3] Due to the decline of major capitalists, many Japanese big businesses were run by internally promoted managers, relatively freed from shareholder pressure, with government intervention as well as support from banks, in the early post-war period. As this example demonstrates, an internationally widespread ideology is often intimately related to specific domestic social groups.

[3] During the Cold War, the US considered Japan a bulwark against communism.

Nevertheless, the dissolution of the Bretton Wood system centered on "embedded liberalism" in 1971 and the stagflation during the 1970s discredited Keynesianism, and the 1980s saw the rise of neoliberalism, which promotes a free market and criticizes excessive state intervention. Afterwards, the US became less tolerant of Japan's interventionism and pressured Japan to deregulate its financial market. In addition to influential economic ideologies, norms deeply ingrained in society play a key role in shaping the features of its financial system. Social norms vary across states and change over time. Although the number of proponents of neoliberalism increased in the Japanese dominant groups after the bursting of the bubble economy in the early 1990s, anti-liberal, anti-free market social norms have been persistent and prevented the transformation of the financial system from bank-centered to market-based. This will be discussed later in detail.

The credit market, including bank loans, bonds and various credit derivative instruments, is a key component of the financial system in Japan. Interestingly, while equity markets tend to attract a larger proportion of international investors than credit markets and are fairly standardized globally, credit markets are inclined to retain more local elements such as regulations, practices and high proportions of local participants. One possible reason for this difference is that state regulations and home bias[4] are much stronger in credit markets than in equity markets because of the former's much greater market size, larger market participants (including savers, investors and borrowers) and lower risks and returns (albeit some exceptions). The state is likely to have stronger incentives to regulate the credit market because of its larger potential impact on the national economy. In addition, most states are the largest borrowers in their credit markets.

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[4] Home bias still remains in investment as financial markets are "dependent on information about the intensions of other parties, trust and the power to secure fulfilment of contractual commitments" (Epstein 1996, quoted by Sinclair 2001: 96). The home bias of capital varies across countries, and is strongly affected by domestic social norms. Japan seems to have particularly high home bias of capital.

In these respects, the credit market is a politically sensitive arena. Generally speaking, investors are less likely to be attracted to overseas credit markets unless these markets offer compellingly higher potential returns to overcome home bias.

As Strange (1988: 89-90) argued, "credit is literally the lifeblood of a developed economy" and "the power to create credit is politically important." The major roles of credit markets are not only providing credit for growing and competent borrowers but also forcing less competent borrowers to improve their performance or weeding them out. In capitalist states, who decides on the allocation of capital and who has good access to credit are critically important and reflect the characteristics of the credit market. If a state allows substantial autonomy to its credit market, the market mechanism rather than specific financial institutions will decide on the allocation of credit, which tends to cover a very broad-range of borrowers including subordinate groups [5] though the borrowing conditions of these groups are much stricter than those of privileged groups. This archetype can be seen in the context of the US. The market system excels in terms of efficiency, flexibility, inclusiveness and adaptability to change and innovation; but it is more aggressive in its risk-taking and unstable (ibid.: 90).

Periodic credit crises have destructive impacts on capitalist states. Strange (1986 and 1998) repeatedly warned of the danger of the unstable global financial markets centered on the US, in particular of a credit crisis, and her concern was realized in the 1997 Asian financial crisis and the global financial crisis, which started in 2007. She ascribed such danger to states' weakened control over financial markets (Strange 1998: 179-90).

In contrast, countries with less liberal credit markets, such as Japan, have different financial problems. In these countries, specific financial institutions rather than the market mechanism tend to decide on the allocation of credit, often

[5] Subordinate groups include small and medium-sized enterprises and their employees, subprime consumers, and firms under bankruptcy proceedings.

based on their long-term relationships with borrowers; credit covers a relatively narrow range of borrowers, while the state directly or indirectly intervenes in their decision-making. In Japan, big businesses and their employees generally enjoy better access to credit than subordinate groups despite the latter's significant collective contribution to bank deposits.[6] Big banks are often regarded as *de facto* semi-public entities rather than purely private entities. CMEs are inclined to be more stable but less efficient, inflexible and less inclusive than LMEs, whilst the former provide larger social security, corporate bailouts and other support (e.g. long-term employment and business relations) to sustain their system, potentially leading to excessive public debt burdens and deteriorating economic vigor.

Characteristics of Japan's Financial System and Capitalism

The focus of this book is the resistance towards the transformation of Japan's financial system from bank-centered to capital market-based. However, the features of its wartime and post-war financial system and capitalism, as well as the financial deregulation in the 1980s and 1990s need to be scrutinized in order to tackle this main point.

From the Meiji restoration in 1868 until the early 1930s, although the Japanese government adopted a policy of increasing wealth and military power, its economic policy was fairly liberal, and there was little government regulation in its banking sector (Allen and Gale 2000: 39). The capital market was quite active until the early 1930s,[7] and for instance, 87% of the industrial funds on a

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[6] Although subordinate groups' credit access temporarily improved through non-bank financial institutions (including financiers for small and medium-sized enterprises and subprime consumers during the 1980s and 1990s), many of the non-banks failed or were acquired by banks and their subsidiaries with a stricter credit policy. Chapters 3 and 5 will discuss this point in greater detail.

[7] While Japan could finance the Sino-Japanese War (in 1894-5) mainly through domestic public bond issuance which proved the development of the financial system in the 1880s,

flow basis in 1931 came from the capital markets including both equities and bonds (Noguchi 2010: 34). However, the series of financial crises, including the *Showa* financial crisis in 1927 and the Great Depression beginning in 1929, and the rise of the military after the Manchurian incident in 1931 dramatically transformed the characteristics of the Japanese financial system. After the Showa financial crisis broke out, the Ministry of Finance (MOF) enacted the Banking Law, which significantly strengthened the state's regulation and supervision over the banking industry. Due to the state-led consolidation, the number of banks drastically decreased from 1,402 in 1926, to 61 in 1945 and the corporate bond market was placed under the control of the Japanese government and major banks. Moreover, the Temporary Fund Adjustment Act in 1937 placed the allocation of industrial funds under state control and the National Mobilization Law in 1938 enabled the finance minister to determine which military-related industries and firms the banks should provide with loans.

In Japanese politics and economics, there has been the so-called "continuity-discontinuity debate over pre-war/wartime and post-war Japan" (Muramatsu 1981: 7-11, Noguchi 2010: 13-9). The discontinuity camp, mainly neoclassical economists, claims Japan transformed from controlled economy during the wartime period (1936-45) to liberal economy in the post-war period (Eki 2012, Okita 2010). In contrast, the continuity camp, including Noguchi (2010) and Okazaki (1993), emphasizes the continuity of anti-free market characteristics of the Japanese economic and corporate systems between the wartime and post-war periods. I share the same perspective with the continuity camp. Japan's liberal economic system led by major capitalists from 1868 until the early 1930s was heavily influenced by the liberal world order of *Pax Britannica*. However, anti-liberal norms (exemplified by Confucianism) had long been used by ruling elites (e.g. high-ranking samurai warriors) to dominate subordinates in Japanese

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the financing of the Russo-Japanese War (in 1904-5) had to rely on overseas bond issuance in both London and New York.

society since the feudal period. Dramatically increased class conflicts (e.g. labor and agrarian disputes) in Japan from WWI (1914-8) until the mid-1930s reflected the tension between liberal global norms and anti-liberal Japanese social norms, promoting government intervention into the economy and ultimately leading to controlled economy (Teranishi 2003: 143-7).

Japan's post-war financial system originated from its control economy during WWII. Noguchi (2010) argues anti-liberal, anti-free market norms and institutions of the "1940 system" developed for total war have remained in Japanese society to date, and they can be witnessed in the bureaucratic intervention, the bank-centered financial system, the Japanese-style corporate system, and the prioritization of producer over consumer interests. The bank-centered financial system enabled the government to control the corporate sector through its tight grip on the banks, while the rigid credit control greatly contributed to the formation of keiretsu (interlocking business networks often with cross shareholdings and human relationships)[8] under the wartime economy. Only dominant groups such as big businesses were allowed to obtain good access to credit during wartime and the early post-war period. In fact, there was a nexus of big businesses, finance (MOF and state banks) and the military during wartime.

After WWII, the US occupation forces eliminated not only militarists but also major capitalists, such as landlords and executives of Zaibatsu conglomerates and large firms, accidentally reinforcing the power of "administrators" (anti-free market elites), including bureaucrats, corporate executives, bankers and Liberal Democratic Party (LDP) politicians (van Wolferen 1989:109-11). The US government accepted Japan's state interventionism in order to promote its economic recovery during the Cold War. Furthermore, the US accommodative trade policy and dollar-yen exchange rate (1 US dollar = 360 yen), which were

[8] There are three types of keiretsu in Japan: horizontally diversified business groups (such as Mitsubishi and Sumitomo), vertical manufacturing networks and vertical distribution networks. Unlike Zaibatsu conglomerates, keiretsu networks do not have their headquarters (holding companies).

favorable for Japanese exporters, as well as the US military protection of Japan contributed to Japan's rapid economic growth during the early post-war period, when Japanese companies faced less competition with their rivals in other Asian countries. In this respect, the US support indirectly facilitated the development of the Japanese corporate and financial systems.

The Japanese credit market in the early post-war period had the following three features. First, the credit allocation was decided quite subjectively by banks with heavy state intervention, in contrast to objective credit ratings by the US rating agencies. Second, large firms had good access to credit, while SMEs and households had limited credit access. Last, most financially troubled large firms were bailed out by banks and the state. The empirical part of this book examines the extent to which these features have been changed or retained while exploring the reasons for this.

The restricted international capital mobility under the Bretton Woods System fitted well with Japanese society's anti-liberal, anti-free market norms. The restrictive world financial order (i.e. the constraint of capitalist power) contributed to the continuity of the 1940 system and the dominance of anti-free market elites in Japan. However, since American financial hegemony enhanced international capital mobility after the collapse of the Bretton Woods System and the end of the Cold War, the tension between liberal global norms and anti-liberal Japanese social norms has been re-intensified. Although the power of anti-free market elites was challenged by market liberals from the early 1990s to the mid-2000s, an anti-neoliberal backlash started in 2006, which demonstrated the persistence of anti-liberal, anti-free market Japanese social norms. There are similarities in the tension between liberal global norms and anti-liberal Japanese social norms between the pre-war period (from the mid-1910s to the mid-1930s) and now.

I argue anti-liberal, anti-free market social norms were created and promoted by the administrators of the 1940 system, and consented to by subordinates such

as labor, and small and medium-sized enterprise (SME) owners, contributing to a management-labor alliance against capitalists (mainly international and domestic shareholders) as well as the formation of keiretsu. The economic bureaucracy formed an alliance with the LDP and big businesses during the early post-war period. Unlike their American peers, most Japanese corporate executives and bankers share similar traits with bureaucrats rather than entrepreneurs. Japanese large firms perform public functions such as contributing to stable employment, and banks behave in accordance with political directives rather than as profit-seeking organizations.

Historically, transformations in state-finance relations appear to have been caused by external and/or internal factors. Cox (1987: 4) defines historical structures as "persistent social practices, made by collective human activity and transformed through collective human activity," and maintains the three levels of historical structure – social relations of production (where dominant elites control production and subordinate groups work under the former's control), forms of state and world orders – are interrelated (Cox 1981: 138). In this respect, if contradictions and conflicts in social relations of production (i.e. power relations between social groups within society) and/or world orders exceed coherence and stability (Cox 1987: 269), which has a major impact on forms of state, this will lead to changes in state-finance relationships. Then, how are these contradictions and conflicts intensified? Cox (1981: 136) claims three categories of social forces, namely material capabilities (power), ideas (including norms and ideologies) and institutions, interact within historical structures. For instance, technological development may strengthen the material capabilities of certain social groups, while the major political and/or economic failure of some dominant groups will lead to decreases in their material capabilities. A new powerful ideology or the rise or decline of a hegemon can transform world orders.

Since the 1980s, Japan has encountered a number of profound domestic and international changes. First, towards the end of and after the Cold War,[9] the US economic policy towards Japan became harsh, and the US government tried to curb its trade deficit vis-à-vis Japan and pry open the Japanese financial market through political pressure. After the US-Japan Dollar-Yen Committee in 1983, MOF introduced market-based interest rate products, liberalized Euro-yen bonds issuance, and allowed the establishment of credit rating agencies in Japan. Second, the Japanese economy slowed down, while Japanese companies faced fierce international competition in the midst of the yen's appreciation against the US dollar and other major currencies. Third, higher international capital mobility, which was initiated by the US and the UK, made it difficult for Japanese financial authorities to maintain autonomous financial and macroeconomic policy making. An increasing number of Japanese blue chip companies were attracted to the Eurobond market during the 1980s. Fourth, the influential economic ideology shifted from Keynesianism to neoclassical economics (neoliberalism), which was critical of government interventionism and promoted capitalist power. Fifth, Japan's public debt ballooned as its government tried to boost economic growth through fiscal expansion. Last, the bad debt problem, political and financial scandals and the prolonged economic slump weakened the power of the economic bureaucracy, the banking sector and the LDP.

In the 1990s, a series of political scandals[10] weakened the power of the LDP, while a wave of scandals[11] also hit MOF. According to Toya (2006), Prime Minister Hashimoto, the LDP's Administrative Reform Promotion Headquarters and MOF took the initiative in carrying out the Japanese Financial Big Bang in 1996 – the LDP sought to regain public support in the face of fierce electoral

[9] The end of the Cold War lowered the strategic importance of Japan for the US.

[10] These political scandals included the Recruit Scandal in 1988 and the Sagawa Express scandal in 1992.

[11] These include the Daiwa Bank New York Branch scandal in 1995, the Housing Loan Affair in 1995-6 and MOF officers' wining and dining scandals in 1994-6.

competition, and MOF also chose to win back public support to ensure its survival. However, although the Big Bang itself was an appropriate policy, both MOF and the LDP underestimated the actual size of the bad debts in the banking sector. Japan faced an array of banking crises from 1995 to 1998, [12] which dramatically increased the annual corporate bond issuance in 1998.

During the banking crises and their aftermath from 1995 through to 2003, the Japanese economy suffered from a serious bad debt problem, and the banking sector witnessed major corporate bankruptcies, most of which involved real estate companies, construction firms and non-banks. These sectors were not as politically powerful as manufacturing establishments. [13] In 2001, the yen-denominated bonds issued by Mycal (a major Japanese retailer) and Enron (a US energy trader), with respective amounts of approximately $30bn and $12bn, went into default, and the Japanese corporate bond market experienced major credit events for the first time. However, from 2002 to 2004, the government and major banks provided all-out support to stabilize the financial system due to the public call for stability. The following four measures exemplified such support. First, the government enforced enormous public capital injections into banks and bad debt disposal. Second, banks supported financially troubled major companies. [14] Third, the Industrial Revitalization Corporation of Japan (IRCJ), a governmental institution to support the restructuring of companies through management consulting and provision of public funds, was established. Last, the Bank of Japan (BOJ, Japan's central bank) started quantitative monetary easing. These measures

[12] The banking crises during this period entail the failures of Hyogo Bank, Kizu Credit Cooperative, Hokkaido Takushoku Bank and Yamaichi Securities and the nationalization of the Long Term Credit Bank of Japan and the Nippon Credit Bank.

[13] In real estate, construction and non-bank sectors, there are some notable exceptions such as Mitsubishi Estate and Mitsui Fudosan, which are regarded as establishments.

[14] Banks' support measures for financially troubled companies include interest rate deductions, "forbearance lending," debt forgiveness and debt-for-equity swaps.

made it difficult for credit market participants to perceive credit risk, causing the marketization of the financial system to stall.

Prime Ministers Hashimoto (1996-8) and Koizumi (2001-6) adopted neoliberal policies, including the abolition of the Large-scale Retail Store Law, which had protected small shops, the reduction in public works, the Japanese Financial Big Bang and the privatization of public-sector entities. In addition to the deregulation of industries such as finance, retail, transportation and telecommunications, American-style business and financial practices including corporate restructuring, active use of M&A, structured finance (which creates saleable financial instruments based on cash flows from financial assets), mark-to-market accounting, and pay-for-performance, executive officer and outside director systems were introduced into Japan during the 1990s and the first half of the 2000s.

The domestic financial sector's shareholding rate of all the Japanese listed companies declined from 41% in 1995 to 30% in 2017 due to the financial crisis in the late 1990s and the introduction of mark-to-market accounting, while the foreign shareholding rate sharply rose from 10% to 30% in the same period. This decline shows the rising pressure of international investors to impose shareholder capitalism on Japanese big businesses. The domestic corporate sector's shareholding rate slightly decreased from 27% to 22%, which is still very high and suggests strong resistance towards the convergence with American-style shareholder capitalism.

Another example of Japan's resistance to convergence is the very low proportion of its outstanding inward foreign direct investment (FDI) to GDP (3.8% at the end of 2016), which is much smaller than those of the United States, Britain, China, and South Korea at 35.2, 55.7, 24.5, and 12.4%, respectively. In contrast, FDI in China has significantly contributed to its rapid economic growth. Due partly to US pressure, since the 1980s the Japanese government has campaigned to increase inward FDI, but the increase has been only incremental.

Many scholars (fo instance, Imai 2011; Watanabe 2012; Shibata 2015) claim that deregulation or neoliberal reform of the Japanese labour market have generated a large number of low income non-regular workers. However, others scolars (Keizer 2010; Yun 2015) claim that Japanese corporate management used a low-waged non-regular workforce in order to reduce personnel costs and protect existing regular workers in lifetime employment. According to the 2015 OECD statistics, Japan's relative poverty rate (16.1%) was substantially higher than those of Western European countries (the majority of which was less than 10%). An anti-neoliberal backlash took place in 2006 when the Koizumi administration ended. The global financial crisis intensified the backlash, resulting in strong distrust of American-style capitalism.

Argument in Brief

Why has Japan resisted financial disintermediation despite the deregulation during the 1980s and 1990s as well as the financial crisis associated with the enormous bad debts of the banking sector? I emphasize the concept of "systemic support" as a solution to this puzzle. The original, narrow definition of systemic support, which is a term used in the credit markets, is government and bank support for financially strained financial institutions and companies. However, I contend its broadened definition is dominant elites' support and protection of subordinates in exchange for loyalty and obedience, which is exemplified by broad-ranging domestic social relations in Japan such as the main bank system, lifetime employment, and long-term subcontracting between large firms and SMEs.

The conflict between anti-liberal, anti-free market Japanese social norms (exemplified by systemic support) and American norms promoting market liberalization including financial disintermediation and neoliberal restructuring has been witnessed in Japan since the early 1990s. I argue such Japanese social norms are a form of counter-hegemony that constrain capitalist domination in

Japan, under American financial hegemony, which promotes transnational capitalist power. Systemic support has not only persisted but also generated contradictions and conflicts within Japanese society.

Even if contradictions and conflicts in social relations of production and/or world orders are intensified, the state-finance relationship will not change over a short period of time. Cox (1987: 269) maintains "elements of coherence and stability are matched against contradictions and conflicts," and that coherence and stability here can be viewed as the staying power of the historical structure and attempts by dominant groups to preserve their vested interests. If an old historical structure is losing its hegemonic status, it will take a new historical structure a long period of time to obtain legitimacy in society. Under such circumstances, the new structure will have to compete against the old one until it acquires a hegemonic position.

Despite the financial deregulation during the 1980s and 1990s, the transition from a bank-centered to capital market-based financial system has struggled. The old financial system worked effectively for a long time, and has been firmly embedded in Japan's political economy. Therefore, the question arises, who opposed the shift to a market-based financial system? Many commentators have stated Japanese bureaucrats were the culprits in the delay. In this vein, government and bank support (the narrowly defined systemic support) can be viewed as a major obstacle to the transition. Such support will not fade out easily in Japan, partly because the economic bureaucracy and major banks are unlikely to give up their desire to regulate the market, and partly because both creditors and debtors get accustomed to systemic support and are still reluctant to take large risks without external support. [15] Interestingly, MOF took the initiative in the financial deregulation, and the BOJ promoted the introduction of new financial products such as syndicated loans and credit default swaps. However,

[15] In other words, the risk averse nature has been deeply embedded in the behavior of Japanese creditors and debtors.

MOF's initiatives were constrained by its close ties with the banking sector. Such constraints were evident when MOF allowed the banks to establish securities brokerage subsidiaries in 1993-4 and tacitly assisted the establishment of local credit rating agencies in 1985. It is possible to claim banks and other interest groups may be more strongly opposed to the transition than bureaucrats.

Why have the Japanese government and society endeavored to preserve the old regime despite the increasing malfunctioning of the 1940 system and the relatively weakened power of dominant elites such as the economic bureaucracy, the banking sector and the LDP? While this could be explained partly by the vested interests of some social groups, the more persuasive account stems from deeply ingrained social norms. Clift (2014: 219) maintains "the ideational element – social norms and how market relations are understood in different contexts – has its part to play in explaining ongoing diversity as capitalisms transform."

Typical Japanese social norms can be observed in the government's paternalistic stance towards its people and people's submissive attitude towards dominant elites. In Japan, subordinates receive protection (i.e. systemic support) from dominant elites in exchange for loyalty and submission to the latter. Furthermore, Japanese people are inclined to cooperate closely with other members of social groups, such as local communities, and (subdivisions of) companies and bureaucracies, and exclude outsiders from such social groups in order to pursue stability and minimize uncertainty (Yamagishi 1999:56-88), while their mutual surveillance and regulation make them priorities the collective benefit of their social groups over their own individual benefit (ibid.: 45-9). Subordinates' loyalty and submission to dominant elites have developed not only through the latter's coercion but also through the former's consent to the social norms created by the latter.

Why is the rescue of financially troubled companies justified in Japan? An anti-capitalist coalition between management and labor, which is bolstered by

both systemic support and in-group favoritism, has dominated most large Japanese companies. Frequent corporate bankruptcies would ruin this management-labor alliance, strengthening capitalist power through enhanced capital mobility such as restructuring, overseas investment and M&A. If capitalists were to dominate Japanese corporate society, management (administrators) would no longer be able to maintain their power within their firms, whilst regular workers would lose their employment stability. In this respect, I contend the broadly defined systemic support, together with in-group favoritism, rather than the narrowly defined systemic support, has stalled financial disintermediation, which could sever the long-term social relations sustained by systemic support – for instance, keiretsu, the main bank system, lifetime employment and long-term subcontracting.

I argue the Japanese credit market is a battlefield between the market liberalization and anti-free market camps within the Japanese elite, and that an ideational conflict between the two camps has been observed since the early 1990s. The former camp includes reformist bureaucrats and politicians, Keizai Doyukai (hereafter Doyukai, a neoliberal-oriented industrial association) [16], neoclassical economists, non-Japanese firms and the US credit rating agencies, whereas the latter one consists of interventionist bureaucrats, anti-free market politicians, Nippon Keidanren (hereafter Keidanren, the largest, conservative industrial association) [17], banks, legal elites and the local Japanese rating agencies. Although the market liberalization camp was influential under the Hashimoto and Koizumi administrations, an anti-neoliberal backlash has been driven not only by anti-free market elites but also by subordinates such as regular workers and SME owners.

Excessive systemic support from the government and banks together with the underdevelopment of the corporate bond market has lowered the efficiency of the

[16] Keizai Doyukai's English name is the Japan Association of Corporate Executives.

[17] Keidanren's English name is the Japan Business Federation.

Japanese economy and hampered risk-taking by both creditors and debtors. However, the eradication of systemic support is likely to be extremely painful for a vast number of people due to low mobility in the labor market and weak actual risk-taking in the credit market. Many big businesses and their employees still have incentives to preserve the 1940 system and its bank-centered financial system. Kiyoto Ido, vice chairman of the Institute for International Economic Studies (former head of the International Bureau, MOF), claims "most top managers of Japanese big businesses are just 'top salaried workers' (not professional top management' so that they could take large risk without bank support." [18] In addition, most subordinate groups (including employees of SMEs, farmers and retired people) are heavily dependent on long-term subcontracting, subsidies, public investment and social welfare benefits, which are other forms of systemic support. In these respects, a large proportion of Japanese people are motivated to maintain a high level of systemic support. Having said that, the costs of sustaining the old system are becoming increasingly heavy. The preservation of the old system has aggravated the following contradictions within it: the corporate and household sectors' excessively weakened risk taking, the skyrocketing public debt, and the sharply rising number of working poor.

In summary, there are three key arguments in this book. First, Japanese society's anti-liberal, anti-free market social norms (epitomized by systemic support) have been at odds with financial disintermediation and globalization aligned with American-style capitalism. Second, there has been an ideological contestation of market liberal and anti-free market forces within the Japanese elite since the mid-1990. Last, the strong ties binding social groups and society tend to limit the leadership of dominant elites pursuing change and the mobility of capital, and systemic support has long hampered the transition of the Japanese financial system from bank-centered to market-based.

[18] Interview, October 1, 2014.

Analytical Method

The analytical method of this book is qualitative and empirical – the extensive study of secondary sources and over 50 interviews with current and former bureaucrats (including those at MOF and the Bank of Japan), politicians, academics in economics, sociology, social psychology and business studies, and various professionals (including senior bankers, banking sector analysts, corporate executives, an SME professional and management of both the US and local credit rating agencies) have been conducted. This is because this book does not seek a general theory of the state-finance relationship, but rather specifically analyses the resistance to the transformation of the Japanese financial system since the 1980s. Contradictory causal factors will not be filtered out but instead examined closely within the historicized framework.

The empirical study focuses on the following three aspects of the Japanese credit market: major corporate bailouts and bankruptcies, which reflect the strengths and weaknesses of systemic support and their influence in Japan, differences between the American and local Japanese rating agencies, and change and resistance to change in corporate governance.

Major corporate bankruptcies have strengthened the market mechanism of the credit market, which differentiates the risk premiums of debts according to their creditworthiness (i.e. probability of timely debt repayment), whereas corporate bailouts have constrained the mechanism. Three examples of major corporate bailouts selected in this book illustrate the continuous strength of systemic support. Four examples of major corporate bankruptcies were different from ordinary bankruptcies and did not necessarily indicate weakened systemic support.

There are substantial differentials between the US and local Japanese credit rating agencies in credit ratings for the same Japanese companies, and the gaps

stem mainly from differences in the extent to which rating agencies take systemic support into account when assessing creditworthiness (Morita 2010: 122-33). The US rating agencies were influential in Japan from the early 1990s until the early 2000s when MOF and the banking industry lost power and thereby systemic support weakened, but their influence waned when the banking industry recovered and systemic support resurged.

Analysing change and resistance to change in Japanese corporate governance during the 1990s and 2000s will shed light on three questions. Who promoted market liberalization for what reasons, and who was opposed to it and why? To what extent has Japanese-style corporate governance actually changed? Why has financial disintermediation in Japan lost momentum? Both credit ratings and corporate governance can be viewed as battlegrounds between the market liberalization and anti-free market camps within the elites. An ideational conflict between Doyukai and Keidanren over corporate governance and employment is worth paying particular attention to.

Structure of the Book

Chapter 2 will discuss the analytical framework and methodologies. The main analytical framework is Gramscian, which fits the theme of this book well. Analytic eclecticism, which is adopted in the book in the sense of Sil and Katzenstein (2010), is indispensable to operationalize Gramscian approaches, which are macroscopic and require a supplementary toolkit for meso and micro level analyses. Specifically, the three pairs of contrasting conceptions – "weak and strong ties" (sociology), "promotion and prevention orientations" (psychology) and "guardian and commercial moral syndromes" (moral philosophy) – are effective to elucidate Japanese social norms. This chapter highlights systemic support, which is closely linked with the notions of strong ties, a prevention orientation and guardian morals, is at the center of anti-liberal, anti-free market Japanese social norms. Later in the chapter, major actors'

interests, ideas and alliances in Japanese political economy will be examined in order to clarify how the 1940 system developed and why some of its elements have survived.

Chapter 3 will deliberate over Japan's post-war bank-centered financial system, the financial deregulation during the 1980s and 1990s, and the persistent systemic support. After examining the features of the early post-war financial system and the financial deregulation, the determinants of the major corporate bailouts and failures after 2000, and the political background of the government's establishment of corporate restructuring funds and the SME Financing Facilitation Act will be investigated. Furthermore, this chapter will discuss why systemic support has been justified in Japan, despite its market distortion leading to economic inefficiencies.

Chapter 4 will investigate how the Japanese local credit rating agencies have developed since the mid-1980s and how they are different from the US rating agencies, after examining the growth, power and transformation of the US rating agencies under financial globalization. Focusing on the two contrasting forms of finance – the synchronic form, which focuses on short-term profit making in financial markets, and the diachronic form, which links finance with investment in productive assets for the growth of social wealth (Sinclair 2005: 58-9) – and systemic support, the rise and fall of the US rating agencies' influence in Japan in tandem with the persistence of the local rating agencies will be analyzed.

Chapter 5 will examine the ideational rivalry within the Japanese elite between the market liberalization and anti-free market camps from the early 1990s until the mid-2000s, which coincided with the rise and fall of the US credit rating agencies. The two major industrial associations (business lobbies), i.e. Keidanren and Doyukai, played a role as ideational platforms for Japanese corporate society. The contrast between Keidanren and Doyukai can be described as administrators vs. capitalists and entrepreneurs, stakeholder capitalism vs. shareholder capitalism, and proponents vs. opponents of systemic support. Later

in the chapter, whilst the Livedoor and Murakami Fund incidents of 2006 will be highlighted as blatant examples of anti-neoliberal backlash, persistent systemic support and in-group favoritism in Japanese corporate governance will be the main focus.

Chapter 6 will explore why and how the weakened dominance of administrators has changed the nature of systemic support in Japan from quasi-public goods to virtual subsidies to specific interest groups. The US economic support to and military protection of Japan during the early post-war period can be viewed as systemic support, and the fading out of such support indirectly contributed to the relative power decline of administrators. Furthermore, growing contradictions within the 1940 system generated by systemic support – weakened risk taking of the corporate and household sectors, the rapid expansion of public debt and sharp increases in the number of poor non-regular workers – will be examined.

Chapter 7 will summarize the main arguments of the book, and explore the future prospects of systemic support in Japan.