THE POLITICAL ECONOMY OF THE JAPANESE FINANCIAL BIG BANG: INSTITUTIONAL CHANGE IN FINANCE AND PUBLIC POLICY MAKING

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Abstract

Some claim that "Japan never changes its ways", regarding Japanese politics of the 1990s. However, by examining the Financial Big Bang — the deregulation process of private finance since 1996 — and financial politics in the 1990s, this dissertation argues that Japanese politics has been significantly changing since 1995. There has been institutional change, or a shift in the shared expectations about "how the world works", in two pivotal institutions in financial politics developed over the postwar era: "stability and cooperation" and "continuity" have ceased to prevail in the post-1995 world. The Convoy System in finance — the segmentation of the financial sector protected by the Ministry of Finance (MOF) largely through informal means — has broken down, and the public policy making mechanism of bureaupluralism — the bargaining process of state and societal actors centered around the bureaucracy and the Liberal Democratic Party (LDP), the ruling party for 1955-93— is in decay. This decay is likely to deepen in the whole political economy, as the causal factors of changes in financial politics, "performance failures and scandals" and "possibility of change of government", will probably affect other policy areas as well.

In showing the above, our rational-actor approach achieves three tasks. First, we provide a realistic image of the post-1995 financial politics by improving the behavioral assumptions of actors. The Big Bang can be best understood as an outcome of the strategic interaction of the state actors, i.e. the LDP and MOF, pursuing organizational survival through cooperation, competition, and confrontation. The public now matters in financial politics: the practice of "going around" the "insider" process of bureaupluralism has steadily been on the rise since 1995.

Second, we provide a causal mechanism to developments in financial politics by constructing a framework of institutional change and a typology of financial reforms. "Failures" (financial crisis and scandals) — caused by the gap between the faster pace of environmental changes and the slower pace of institutional adaptation — and "change in the

institutional environment" (the change of government in f993) have brought about the institutional change by altering the players, the formal rules, the informal interaction patterns, and the shared expectations among actors. Within our four-by-two typology, constructed from the diversity in the coalition patterns and the interaction pattern of state and societal actors, the Big Bang is shown to have been "defection" and "public interest politics".

Third, we offer some theoretical insights beyond Japanese financial politics. Entrenched actors may not be as entrenched as they may seem, and the bureaucrats may not be always maximizing tangible tokens of organizational power. The public may be more influential than commonly thought of, because not only politicians but also bureaucrats and interest groups have reasons to pursue public support to enhance their political influence: thus, better organized groups may not always prevail over the unorganized public.

Preface

The basic objective of this dissertation, beyond contribution to knowledge, is to connect economic policy making to researches in political science and social science in general. This concern stems from my working experience at the Ministry of Finance of Japan (MOF): in my view, the under-representation of social science in Japanese economic policy making and the over-representation of macroeconomics in international economic policy making have led to avoidable policy failures in the respective policy areas in the 1990s, and a better understanding of the political interplay of actors would contribute to better economic policy making. This dissertation seeks to demonstrate to those involved in public policy making that political science can be useful.

Seen from the above standpoint, existing works of Japanese politics lead to frustration. Roughly speaking, there are two types of studies. On one hand, institution-oriented works have good empirical research based on detailed historical study, but they tend to focus on the complexity with which the world has evolved up until the present. Such works may offer insightful typologies, but the typologies are often static (understandably, as most of them focus on the apparent stability of postwar Japan): one can hardly see how the world is likely to evolve next, or how the switches occur within typologies. On the other hand, actor-oriented studies make good efforts to develop a theory, or a causal framework, enabling us to formulate strategies and predictions. Yet, their empirical research is, often times, of such unsatisfactory quality that their assertions lack credibility to the eyes of those involved in policy making.

This dissertation aims to connect the gap between the two extremes, in line with the recent *rapprochement* between the two approaches: indeed, both theory and empirical research are important. This research adopts the second strategy, reflecting my belief that the rational-actor approach does not necessary result in poor empirical research. This approach has potential to connect works of political science to public policy making, as it can tell policy makers which factors to look for (and influence), if they are to improve the state of the world. Of course, today's world is complex and mono-causal explanations often turn out to be wrong; nevertheless, in my view, given the salience of *ad hoc* approaches to policy making, the introduction of social science will do no harm, if accompanied by a caution against simplistic explanations.

I would like to thank many individuals whose assistance was indispensable to the completion of this dissertation. I am greatly indebted to my advisers: Daniel Okimoto, Masahiko Aoki, and Barry Weingast. Daniel Okimoto guided me through every stage of the process — choosing the topic, doing empirical research in Japan, and writing up the dissertation, besides coming to Stanford, first of all — by offering inspiring advice, based on his deep knowledge and understanding of Japan. I would have never made it through the program but for him, and I consider myself lucky to have had an advisor with such personal warmth as his. Masahiko Aoki gave me the tools to tackle my problem: I hope that I did justice to his innovative framework of institutional change, built from the Comparative Institutional Analysis (CIA) perspectives, in my attempt to demonstrate its promise in analyzing real world issues. I learned a great deal about "how social science works" by witnessing his devotion to a better explanation of the world through a continuous improvement of his theory. Barry Weingast provided useful comments "from outside Japanese politics" that brought my work closer to the general literature beyond the study of Japanese politics. His incisive feedbacks at various turning points of the research forced me to focus and better organize the main argument of the dissertation.

The devastatingly sharp comments by Stephen Krasner helped me formulate the basic problematique of this research. Walter Powell and he kindly served on the University Oral Examination and provided helpful suggestions for improving the dissertation. The interaction with the following scholars at Stanford contributed to this research project in one way or another : Tom Brady, Judith Goldstein, Torben Iversen, Ronald McKinnon, Roger Noll, Jean Oi, and Michael Thies. I would also like to thank the participants of the meeting of the Stanford Asian Pacific Research Center (A/PARC) research project on Japanese political economy, held on 29 October 1999.

The wisdom of the talented current and former students of Japanese politics at Stanford has facilitated my studies in many ways. Harukata Takenaka helped me survive the whole process by serving as a mentor who pioneered in the challenging task of completing this Ph.D. program while being a government official. Jennifer Amyx shared valuable research data with me and gave me an opportunity to present my topic in her course on Japanese politics at Stanford. Yves Tiberghien provided me with many hints and useful documents; this research topic would not have emerged, had he not proposed to give lectures for the Rise of Industrial Asia course for which we served as teaching assistants. Mariko Yoshihara, with her warm personality, helped me better prepare for the challenges posed by the Ph.D. program and marriage all at once. I would also like to acknowledge the input of Philipp Riekert, Amy Searight, and Masaru Kohno. Friends at the Department of Political Science as well as my Asian Pacific Scholars peers at Stanford helped me through the project by making life in graduate school more pleasant than commonly expected.

The faculty and staff at the Stanford A/PARC and the Asian Pacific Scholars Program have greatly facilitated my research. In particular, my thanks go to Yumi Onoyama, Greet Jaspaert, Claire McCrae, Maria Toyoda, and Romola Breckenridge. I would also like to thank Susan Stevick, who provided an invaluable editorial assistance.

I am grateful for those I interviewed for generously sharing their time to answer my questions. Four exceptional individuals even went further, offering me their wisdom about life in general (career, marriage, etc.), turning the interviews into a memorable educational experience: Shijuro Ogata, Eisuke Sakakibara, Yasuhisa Shiozaki, and Katsuhiro Nakagawa. My thanks also extend to Kazuhito Ikeo, Hideki Kato, Yutaka Kozai, Kiyoshi Mizuno, Yoshimasa Nishimura, and Yukio Noguchi, as well as other individuals (government officials and those in the financial sector) who shall remain anonymous. In particular, friends at MOF and MITI helped me better grasp how government works by sharing their *honne* (true feelings) with me.

Partial research support was provided by the Dissertation Grant on Japanese Studies provided by the Institute of International Studies at Stanford and the Japan Fund. The Stanford Asian Pacific Scholars Program and the Long-Term Study Abroad Fellowship of the National Personnel Authority of Japan supported part of my studies at Stanford. I am immensely grateful for the generosity of the Ministry of Finance of Japan, which sponsored my Ph.D. studies at Stanford. However, the views expressed in this dissertation should not be attributed to any organizations with which I have been affiliated in the past.

Three professors at the University of Tokyo opened my eyes to the excitement of academic works. Hiroshi Watanabe introduced me to the study of politics and first directed my attention to the importance of what people think. Kahei Rokumoto first connected me to works of social science. Shiguehiko Hasumi, the first teacher I had in college and now President of the University, left no choice but to engage in the pursuit of knowledge from day one of my college life.

Finally, I would like to express my gratitude to my family, whose encouragement and feedbacks on the project were invaluable. My parents, Hiromichi and Kiyoko Toya, have given me their uncompromising love and support. My brother, Hiroaki Toya, has always provided me wisdom and protection as the older one. Riina Toya, *née* Tomita, made a significant contribution (including the choice of topic), besides becoming fiancée and then wife over the process. As promised on our engagement day, this dissertation is dedicated to her.

Tetsuro Toya

Stanford, California

May 2000

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Tables

Yen / Dollar Rate (Average)
(Source: Keizai Kikaku Cho 2000, 415)

1985	238.05
1986	168.03
1987	144.52
1988	128.22
1989	138.11
1990	144.88
1991	134.59
1992	126.62
1993	111.06
1994	102.18
1995	93.97
1996	108.81
1997	120.92
1998	131.02

Figures

Abbreviations

ARPH Administrative Reforms Promotion Headquarters, LDP
BOJ Bank of Japan
CLB Cabinet Legislation Bureau
CPJ Communist Party of Japan
DKB Daiichi Kangyo Bank
DPJ Democratic Party of Japan
EPA Economic Planning Agency
FA Financial Agency (to be established in 2001)
FILP Fiscal Investment and Loan Program
FRC Financial Reconstruction Committee (established following the Financial Diet)
FSA Financial Supervisory Agency (established in June 1998)
FSRC Financial System Research Council, MOF
FTC Fair Trade Commission
FY Fiscal Year
IBJ Industrial Bank of Japan
IC Insurance Council, MOF
IFB International Finance Bureau, MOF
LDP Liberal Democratic Party
LTCB Long-Term Credit Bank of Japan
MAFF Ministry of Agriculture, Forestry, and Fisheries
MHW Ministry of Health and Welfare
MITI Ministry of International Trade and Industry
MMD Multiple Member District (electoral system)
MOC Ministry of Construction
MOF Ministry of Finance
NCB Nippon Credit Bank
PARC Policy Affairs Research Council, LDP
PT Project Team (of the ruling coalition)
SEC Securities and Exchange Council, MOF
SESC Securities Exchange Surveillance Commission, MOF
SMD Single-Member District (electoral system)
SPJ [SDPJ] Socialist Party of Japan [Social Democratic Party of Japan]
WG Working Group (Ikeo Report)
WT Working Team (at MOF)

Chapter 1 Introduction

1.1 Problematique

Has Japanese politics changed over the 1990s? There have been many changes in the political economy over the decade. The economy has stopped being the wonder of the world in the 1990s. The Liberal Democratic Party (LDP), the ruling party since 1955, lost power in 1993. The bureaucracy, which was once perceived as a power center of the activist state, has come under heavy fire amidst numerous policy failures and scandals, giving rise to a first major reshuffling of the central government ministries since, at least, the postwar reform of the 1940s. The list of major changes goes on.

Yet, some observers stress the continuity in Japanese politics, pointing to the limitations of reforms, imposed by the institutions developed over the past. Reforms are gradual, if they are ever to be achieved, despite the needs for structural reforms. (Curtis 1999; Vogel 1999) On the other hand, there are those who claim that Japanese politics has changed, mainly due to the electoral reforms of 1994, which introduced the single-member district and changed the electoral incentives of politicians. (Rosenbluth and Thies 1999)

The main empirical goal of this research is to establish whether "continuity" or "change" characterizes Japanese politics of the 1990s by producing a plausible causal explanation. Of course, elements of change and continuity coexist in any phenomenon in politics; however, our analysis may enable us to determine which aspect is more relevant, contributing to a better understanding of Japanese politics of today and the future.

1) Has Japanese politics changed over the 1990s? Which aspect is more important, "continuity" or "change"? How can we explain Japanese politics of the 1990s?

To the above question, we offer the following claim: *Japanese politics has been significantly changing since 1995 (but from other reasons than the electoral reforms of 1994).* To prove our point, we examine the Financial Big Bang and financial politics of the 1990s. Finance has undergone a major change in the latter half of the decade: the deregulation since 1996 has had a significant impact over the financial landscape as seen below. Many observers have stressed the pivotal importance of the financial system to the entire political economy.[1] If finance is important in the political economy, and if finance has drastically changed, would it not follow that the political economy has undergone a significant change? Besides, wouldn't the changes in finance affect the political economy as a whole? Even if there are policy areas such as agriculture and construction where "continuity" seemingly obtains, would such policy areas be left immune from the developments in financial politics?

The Japanese Financial Big Bang is a policy package introduced by the Japanese government in 1996, initiating massive deregulation and liberalization in the financial sector. The affected areas include the banking, securities, and insurance industries, as well as foreign exchange and accounting standards. Prime Minister Ryutaro Hashimoto unveiled the initiative in November 1996, and the Ministry of Finance (MOF) announced the detailed plan in June 1997. The reforms are planned to be carried out in a three-year period, starting in April 1998 with the deregulation of the control on foreign exchange, and to be completed by the year 2001. (Table 1.1 at the end of the section shows a summary.)

The Big Bang has brought about a drastic change in the Japanese financial landscape. The lifting of the regulatory constraints has resulted in a number of new products as well as newcomers to the market.[2] More importantly, financial firms are altering their strategies significantly in anticipation of increased competition. The unthinkable in the 1980s and early 1990s has materialized: inter-*keiretsu* alliances are happening *en masse*, and foreign takeovers of domestic financial institutions are common phenomena these days. While it was understood that financial liberalization would bring such changes at some time in the future, not many would have predicted the changes to occur at this timing, scope, and pace even as late as 1995.

Reflecting its large significance, there are numerous accounts of the Big Bang appearing both in Japan and abroad. However, apart from some journalistic accounts, most of them focus on the economic aspects of the Big Bang, especially its projected outcomes. In contrast, we seek to explain why the Big Bang came about *from the political economy perspective*, focusing on the incentives of the political actors in deciding economic policies that have distributive effects.

In the process of addressing the main question ("Has Japanese politics changed?"), we derive three sets of questions from our case, Japanese financial politics in the 1990s.

Why does financial liberalization take place? Many would point to structural factors in the environment (e.g. aging population, global integration of national economies, and technological innovation) as possible causes for financial liberalization in the long run. While such structural factors have no doubt been in operation behind this drive for financial reforms, they are insufficient in explaining this particular outcome, the Big Bang: actors in the political economy need to alter their behavior to reflect such changes in the environment. In particular, such choices made by the decision makers, regarding the timing (1996-97), the scope (the Big Bang approach — encompassing private finance, yet without public finance), the pace (completion by 2001— a specific deadline), and the sequence (foreign exchange first, then the rest), do not necessarily follow from the structural change in the environment.

The Big Bang initiative was far from reflecting a consensus in the policy world. While few would have contested the need for financial liberalization itself, how to achieve it was by no means obvious. Various concerns were raised by the skeptics: the timing of the Big Bang may hit the financial institutions at the bottom of their financial strength amidst the bad debt problem; its scope and pace may not be far-reaching enough; its sequencing (see above) may result in the massive outflow of Japanese individual financial assets and thus the "hollowing out" of the Japanese financial market, and so on.[3]

Thus, an explanation that focuses on the political question of "Who gains and loses?" becomes necessary to understand why the Big Bang materialized at this timing, scope, pace, and sequence. Some actors may have seen economic gains to be obtained; others may have seen political goals enhanced. Who brought about the Big Bang?

There is an even more fundamental question: what is so significant about the Big Bang? The Big Bang caused a significant change in the financial landscape, but so did the numerous regulatory reforms in the past thirty years (e.g. the liberalization of the capital account, and the introduction of foreign competition).[4]

> *2) What caused the Big Bang? What determined its timing, scope, and pace? Who gains and loses from it? Who brought it about? First of all, what is so significant about the Big Bang?*

The context of the Big Bang, in the political economy as well as within finance, no doubt had a large impact in determining the outcome. Japan has had a successful political economy for thirty years until the 1980s: it consistently had higher economic growth rates than most other industrialized nations and a stable political system. This achievement was based on a set of distinct, basic institutions in the political economy. Such institutions included, in the economy, the main bank system, *keiretsu*, and lifetime employment, and in politics, the one-party dominance of the LDP between 1955-93 and the large presence of the bureaucracy. However, Japan appears to have increasingly been in a state of economic crisis in the 1990s. The economy has stagnated (despite the short recovery of 1995-96), turning into negative growth in 1998; unemployment has steadily been on the rise; and the financial system has experienced a slump, verging on a total collapse in 1997-98.

Within the financial system, there have been many changes prior to and paralleling the Big Bang: let us briefly review the course of events, mainly from the conventional economic viewpoint stressing the need for market discipline. Since the mid-1980s, financial liberalization has been carried out gradually under the careful guidance of MOF whose main concern was to maintain "stability in the financial order", meaning that their primary concern was to prevent bank failure at all costs. The piecemeal liberalization was centered around interest rates and corporate bond markets, eliminating the rent that the banking industry was able to enjoy under the Convoy System in finance, the postwar regulatory system which essentially allowed no financial institutions to fail. Under the Convoy, the compartmentalization of the financial sector (banking, securities, and insurance; segmentation within banking and insurance) was meticulously retained in face of the globalizing pressures: a half-hearted effort to break down the barriers separating the financial businesses came into effect in 1993. (Horiuchi 1998; Ikeo 1995)

The heavily regulated financial industries lost their incentives to innovate, and have become largely inefficient during the 1990s, compared to their counterparts in the United States and the United Kingdom, where deregulation efforts were earlier, faster, and more comprehensive. A "hollowing-out " of financial services, in which financial services would flow out from the Tokyo market to New York, London, Hong Kong, or Singapore, was increasingly becoming a reality. The banking industry failed to quickly come to terms with the bad lending and investing decisions made during the bubble economy of the 1980s: the result is a huge amount of bad debts that are mostly centered around industries that attracted speculation (e.g. real estate, construction). The problem has become even worse with the lack of monitoring of financial firms, as little competition existed and the regulator (MOF) lacked the ability to enforce adequate regulations, such as prudential regulations. (Ueda and Fukao 1996; Horiuchi 1998)

The Japanese financial system has been increasingly unstable since 1995: bank failures, policy failures, and scandals joined to undermine the financial system. In the summer of 1995, the failures of several small financial institutions indicated an instability in the financial system. In the fall of 1995, the Daiwa Bank Scandal occurred: the huge loss incurred by a bond dealer in New York evolved into a cover-up scandal by the bank, involving MOF being accused of failing to promptly notify the U.S. authorities, resulting in the eviction of Daiwa from the U.S. market and heavy public criticism of MOF. In the winter of 1995-96, the Housing Loan (*Jusen*) Affairs became the center of the political debate: the first decision to inject public money into the financial mess created by the housing loan companies[5], the banks, and the agricultural cooperatives stirred up a public uproar against MOF, the LDP, and the banking industry. Meanwhile, the Wining and Dining Scandals of MOF were widely reported in the mass media. The trust in the financial system had become low, and everybody called for structural reforms of finance.

In face of the above, many observers of the Japanese political economy would give us the following story line.[6] (Curtis 1999; Vogel 1999; Gibney 1998; Horiuchi 1998) The basic institutions that supported the past "success" of high growth and political stability have essentially been kept intact with some incremental reforms introduced in hopes of overcoming the slump, deemed to be temporary. However, the economic slump has remained in spite of these gradual reforms, lending credence to the fact that the problems that the political economy has been facing are not temporary, but fundamental. Thus, structural, drastic reforms are needed rather than incremental, gradual reforms. However, the reforms are slow to come because of such structural impediments as institutional inertia and entrenched interests. Largest of all impediments are the bureaucracy and/or the LDP, who are mainly concerned with maintaining the status quo and their privileged status.

We take issue with the above view in two aspects, regarding the interpretation of the developments in finance and the (un)likelihood of drastic reforms in Japan. First, we contest a common interpretation of Japanese finance that characterizes the process of change as one in which Japanese finance curtails its deviation from the prescription of the principles of market economy. We offer an alternative image based on a recently developed approach, comparative institutional analysis (CIA), which delves into the reasons behind the diversity of economic systems around the world and thus departs from the neoclassical view that implicitly assumes the convergence of all economies into the "market economy" model. (Aoki forthcoming) The institutions that compose Japanese finance have had reasons for their existence in their heyday; while they may be indeed changing to a new system, we need a different framework from purely *ex post* accounts that simply blame the actors for failing to bring about the necessary "regime change" (Horiuchi 1998) in finance at an earlier time. As mentioned above, while the overall direction (i.e. promoting liberalization) may have been clear throughout the process, how to proceed was highly problematic, and thus an analysis of the politics of financial reforms is necessary to understand why a particular outcome resulted. We need an alternative causal framework that allows us to situate the Big Bang in the larger picture and to make sense of the causal interaction between the Big Bang and the environment.

3) How can we situate the Big Bang in finance and the Japanese political economy of the 1990s? Any causal framework?

Our second objection is raised against the image of "non-change", widely shared among the observers of Japanese politics, as noted above in the main empirical question. While the regulatory reforms were indeed gradual and the bureaucracy and the LDP had not acted to introduce drastic reforms until the mid-1990s, a large change in financial politics seems to have been taking place since then. Drastic, structural reforms that transform numerous basic institutions have been brought about in the financial sector, and the Big Bang experience suggests that the state actors, i.e. politicians and bureaucrats, may be showing different patterns of behavior from those patterns continuously observed in the postwar era. Instead of seeking the perpetuation of the status quo as expected from their "entrenched" image, the state actors may be actually pushing for drastic reforms. This may have an important implication for future regulatory reforms in other fields of political economy and different countries: what makes them behave in such ways? If institutional inertia and entrenched interests hinder drastic regulatory reforms in general, the Big Bang must be a rare case in which drastic reforms have been implemented: the conditions that enabled the Big Bang deserve attention.

4) Can we draw any theoretical insights that are applicable to regulatory reforms in general, in Japan as well as in other countries?

The remainder of the introduction proceeds as follows. It states the research puzzles that arise from the political actors' behavior observed in the Big Bang. Next, it briefly introduces the methodology as well as specifies the objects of analysis. Then, it summarizes the main argument of the research, responding to the above problematique. A survey of the structure of the dissertation follows.

Table 1.1 Big Bang Initiative: Summary

Fields: *inclusive vis-à-vis private finance, without public finance*
Includes (jurisdiction in parentheses)

- Banking (MOF Banking Bureau)
- Securities (MOF Securities Bureau)
- Insurance (MOF Insurance Department in Banking Bureau)
- Accounting (MOF Securities Bureau)
- Foreign exchange (MOF International Finance Bureau)

but not

- FILP (MOF Financial Bureau)
- Postal Savings (Ministry of Post and Telecommunications)
- Pension Fund (Ministry of Health and Welfare)

Chronology: *a five-year plan, launched in 1996*

- November 1996 Hashimoto announces the Initiative (scope and deadline)
- June 1997 MOF announces the detailed plan for banking, securities, and insurance
- April 1998 The first phase begins with the liberalization of foreign exchange control
- 2001 The reforms are planned to be completed

Summary of the Measures: *free, fair, and global*
1) Enhanced Competition and Reduced Government Control

- Liberalization of the international capital transactions
- Product liberalization (securities, investment trust, derivatives, loan securitization)
- Deregulation of cross-entry among banking, trust banking, securities, and insurance
- Removal of the ban on the financial holding companies
- Liberalization of fixed brokerage commissions

2) Market Development, Fairness, and Transparency

- Harmonization of accounting standards with international practice
- Stricter disclosure rules for banks and securities
- Creation of safety net for securities and insurance

Paralleling Reforms in Finance:

- Creation of the Financial Supervisory Agency (FSA) (MOF break-up)
- Full revision of the Bank of Japan (BOJ) Law (increased central bank independence)
- Change in the style of financial administration (towards a rule-based system)

1.2 Research Puzzles

The Big Bang poses an anomaly to the conventional understanding of the Japanese political economy that sees gradualism in reforms. The gradualism widely observed until the mid-1990s does not seem to hold in two aspects. First, while the Big Bang initiative has been carried out largely under the control of MOF as in past financial reforms, it is wider in scope (five financial areas) and deeper in degree (including measures that drastically hurt the prospect of survival for some financial firms[7]) than past "fundamental" reforms (such as the 1991-93 reforms, which were centered around banking and securities and resulted in an incomplete, gradual cross-entry). Second, more importantly, the initiative did not evolve from the informal bargaining process among actors which characterized public policy making in postwar Japan, a steady pattern that observers conceptualized as "bureaupluralism" (Aoki 1988), "patterned pluralism" (Muramatsu and Krauss 1987), "compartmentalized pluralism" (Sato and Matsuzaki 1986), and "bureaucratic - inclusive pluralism" (Inoguchi 1983). The Big Bang initiative first came to be known publicly when Prime Minister Hashimoto announced it within two weeks of the LDP victory in the Lower House elections of October 1996, taking many by surprise. Thus, the initiative did not originate from what we call the institution of "bureaupluralism", where public policies are produced from a consensus-making process organized by the bureaucrats, involving the regulated industries and the affiliated LDP politicians ("tribesmen"), centering around such policy making bodies as the deliberative councils in the government and the LDP Policy Affairs Research Council (PARC) apparatus.

These observations lead us to ask what made the Big Bang different from past attempts to reform the financial system. This can be developed into four questions, regarding the main actors of financial politics: the bureaucracy, financial industries, politicians, and consumers of financial services.

First, evidence suggests that MOF was more than willing to launch this initiative (see Chapter 5). MOF had been discreetly preparing for it since early 1996, and proposed its plan to Hashimoto, who adopted it as his Initiative. However, this initiative is expected to bring about negative consequences for this bureaucratic agency in two aspects. It strips away many regulatory tools (including important ones such as those regarding foreign exchange control and entry control in the securities business) from the agency. It is also expected to sever MOF's close ties with the financial sector, which have provided information, cooperation to public administration, as well as retirement positions in the past, by bringing fierce competition in finance and undermining many financial institutions' prospect for survival.

If we follow conventional accounts of bureaucratic behavior, which focus on the bureaucrats' maximization of tokens of power — such as budget, regulatory power, or discretionary power — (Niskanen 1971; Kato 1994; Vogel 1996; Amyx 1998), we would expect MOF to resist, or at least forestall such reforms which diminish its regulatory and jurisdictional power. What has made MOF willing to launch the initiative instead?

Alternately, the Big Bang may have been a plot by the Ministry of International Trade and Industry (MITI) that some, including the developmental state literature (Johnson 1982), describe as the most powerful strategist in the Japanese political economy. MITI, with its jurisdiction over non-financial industries, has been pressing for an all-out deregulation of the Japanese economy as a whole since the early 1990s. Then, is the Big Bang a process of MITI trying to pry into MOF's jurisdiction over finance?

a) Why was MOF willing to propose and carry out the Big Bang? More generally, what makes a bureaucracy willing to abandon tokens of organizational power such as regulatory power and beneficial networks? Or, was the Big Bang MITI's plot and basically a bureaucratic turf war?

Second, many point out the great influence of the financial industries in the Japanese financial politics.(Rosenbluth 1989; Calder 1993) Indeed, it appears that the "weaker" (as opposed to the powerful, large city banks) financial institutions, especially the securities firms and the long-term credit and trust banks, have successfully forestalled past attempts by MOF to launch financial reforms (e.g. the 1979-82 banking reforms, the 1991-93 financial reforms). Because increased competition negatively affects these weaker financial firms which were the beneficiaries of the heavy segmentation of finance, their positions regarding financial reforms can be expected to remain constant. What made the Big Bang different from financial reforms in the past?

b) Why were the financial industries unable to forestall the Big Bang as they did in the past?

Third, there appears to have been a steady alliance between the ruling LDP and the permanent bureaucracy during the one-party dominance period between 1955 and 1993.(Aoki 1988; Okimoto 1989) While the Big Bang was launched by the LDP Prime Minister and received the full support of the LDP and MOF, paralleling developments in finance — such as the breakup of MOF and the creation of the Financial Supervisory Agency (FSA) in June 1998, as well as the revision of the Bank of Japan (BOJ) Law in 1997 giving greater independence from MOF to the central bank — suggest that the once steady alliance between the LDP and MOF has undergone a major change. In the past, the LDP had been known to endorse a wildly unpopular proposal by MOF even at the risks of electoral defeat, as the twenty-year process that led to the introduction of indirect taxation in 1989 attests (Kato 1994). This time, however, when MOF suffered a bad reputation among the general public as a result of various scandals (Housing Loan, Daiwa Bank, and Wining and Dining) and the economic mismanagement of the mid- to late-1990s, the LDP seems to have decided to part ways with MOF.

c) How can we explain the LDP's behavior, supporting the Big Bang while making decisions that drastically undermine MOF's presence in finance? What happened to the seemingly stable LDP-MOF alliance of the postwar era?

Fourth, the Big Bang may represent a pivotal change in Japanese public administration in that it explicitly targets the consumers over the producers, or specifically, the users over the providers of financial services. The Japanese political system has often been seen as one in which the interests of the providers are over-represented at the expense of those of the consumers or the general public. (Okimoto 1989; Vogel 1999) Here, the "users" who may benefit from more efficient financial services can be either non-financial firms or the general public. There may be a possibility that the non-financial firms saw their interests effectively represented by MITI, forming a counter-coalition against the financial sector and MOF. Or, it may be that the general public found ways to effectively represent their interests through a mechanism that overrides, substitutes, or supplements the "bureaupluralism" model of interest representation. Is it through elections, based on the newly introduced single-member district, that some proponents of electoral rational choice (Rosenbluth and Thies 1999) would claim?

d) How can we understand this new, "user-friendly" orientation of the Big Bang vis-à-vis "bureaupluralism", or the provider-friendly model of the past? Is the Big Bang a victory of a counter-coalition of the corporate sector and MITI over the financial sector and MOF? Or, is this a victory for the consumers that the electoral reforms of 1994 brought about? Do we have a better explanation?

1.3 Methodology and Theoretical Framework

Our methodology has three pillars: it is a "rational-actor approach", which focuses on "change" through a framework of institutional change and other derivative frameworks, and which seeks to improve the link between theory and evidence.

First, our research adopts a "rational-actor approach", which considers the (boundedly) rational calculations of actors as the main explanatory factor of the political outcomes resulting from the strategic interaction of actors. It starts from a simple assumption: organizations seek survival, or self-continuation. This assumption, which is not uncommon in other fields — e.g. the assumption of states seeking survival in the study of international relations —, is particularly well-suited for the analysis of the Japanese political economy of the 1990s, as we will show through a discussion of actors (political parties, bureaucratic agencies, and firms and interest groups as organizational actors; and the general public). Our analysis operates at the level of organizations and sub-organizational groups. To explain organizational behavior, we will introduce the distinction between organizational survival as the "ultimate" goal, and the other goals or the "ceteris paribus" goals (e.g. maximization of tokens of organizational power). Our focus is on the interaction of actors rather than on a fixed pattern of domination (e.g. bureaucratic dominance): we will introduce a model of strategic interaction that distinguishes the state actors (politicians and bureaucrats) and the societal actors (firms and interest groups, and the public) according to the form of access to governmental power (direct / indirect). We will propose that both politicians and bureaucrats seek the support of the two sets of societal actors, challenging the assumptions of conventional theories of bureaucracy (see above) and regulation[8] (e.g. "politics is driven through organized groups").

Second, unlike many past works that focused on the apparent "stability" of Japanese politics, we will focus on "change" by developing a framework of institutional change (see Chapter 3). Institutions will be defined in terms of collective perceptions about "how the world works": institutional change will be characterized as the shift in shared perceptions through an evolutionary process. We will link this framework to politics, or distributional conflicts among actors: we will examine what drives institutional change ("failures"), what leads the actors to change their perceptions ("forecast" and "distributional calculation"), as well as how a status quo coalition can be displaced ("defection" from inside and "counter-coalition" from outside).

From this basic framework, we will develop several theoretical frameworks. We will introduce the logic of organizational survival, in which sub-organizational groups with different views and interests about institutional change compete for the control of their organization, which will be used to explain the behavior of the LDP and MOF in Chapter 5. Moreover, we will construct a typology of how financial reforms can take place: this will guide the empirical analysis in Part II (Chapters 5-7) which will situate the Big Bang along these patterns. A new look at the role of the public in politics will be proposed, where "public support", rather than objective "public interest", plays a larger role in not only influencing politicians through elections but also bureaucrats and interest groups.

Third, we seek to improve the link between theory and empirical data through three means: comparison, analytic narrative, and alternative explanations. We will present a "longitudinal comparison" of financial reforms: three cases from before the Big Bang and another case taking place after the Big Bang will enable us to construct an image of change among cases sharing many similarities (e.g. actors, institutional settings). We will build an analytic narrative, emulating the recently developed "analytic narrative" approach (Bates et al. 1998), by offering a preliminary theoretical account, then revising it through a dialog between theory and data. We will contrast our account against alternative explanations, which we derive from the existing literature, in an effort to increase the plausibility of our explanation.

1.4 Objects of the Analysis

While we will adopt a rational actor approach, which primarily advances deductively, our empirical analysis in Part II will proceed inductively to secure as much empirical accuracy as possible. Our empirical analysis primarily aims to explain why the Big Bang came about. Thus, its time frame centers around the November 1996 initiative announced by Prime Minister Hashimoto and the June 1997 detailed plan announced by MOF. We will start from the analysis of the emergence of the Big Bang initiative (Chapter 5). Then, the implementation process that followed will be analyzed, while introducing three cases of financial reforms in the 1980s and 1990s to show how the two worlds (i.e. before and after 1995) differ from one another. (Chapter 6)

After obtaining a general observation about what happened to the politics of financial reforms (or, the reforms of the regulatory system of private finance), we will contrast that observation against another case in an adjacent field in financial politics that took place afterwards (as the Big Bang is the most recent case for financial reforms): the Financial Diet of 1998 was a case in which a large step towards the resolution of the bad debt problem in banking was made in the forms of nationalization and forced re-capitalization schemes for troubled banks. This case will enable us to confirm the assertion that the public policy making process in Japanese finance has been drastically altered since 1995. (Chapter 7)

We would like to note what this analysis is not about: what we basically attempt here is to answer the question "Why has it occurred?" and derive the implications. Our analysis is not about the economic projection of what the Big Bang will bring about to the Japanese economy; its focus is not on providing a detailed account of each measure of the Big Bang. Because of our primary interest in financial politics, or the distributional conflicts in finance, we will focus on the three industries of banking, securities, and insurance, around which the political struggle on deregulation has centered since the 1980s.[9] Also note that we will not delve into public finance (e.g. the Fiscal and Investment Loan Program [FILP], the postal savings system, public financial corporations, and pension funds), which is closely linked to private finance in many ways.[10] This reflects the fact that we have the benefit of knowing what was and was not included in the Big Bang: we omit the issue of public finance, as it was largely outside the political process of the Big Bang. However, the question of "What to reform?" is an interesting one, and we will address it briefly in Chapter 5, as it will give us clues to such pivotal questions as "Who brought about the Big Bang?" and "How much change has taken place?"

1.5 Summary of The Main Argument

As seen above, we have a main question ("Has Japanese politics changed over the 1990s?"), and three sets of questions that we address in course of answering it. In response, we provide the main answer (1) and three sets of answers (2-4) that support it.

1) Main Contention: Japanese Politics Has Changed Since 1995

Japanese politics has changed since 1995. The evidence is that there has been institutional change, or a shift in the shared expectations about "how the world works", in two pivotal institutions in financial politics developed over the postwar era: "stability and cooperation" and "continuity" have ceased to prevail in the post-1995 world. The Convoy System in finance has broken down, and the public policy making mechanism of bureaupluralism is in decay. We offer a prediction for the latter, which is an ongoing process: this decay is likely to deepen in the whole political economy, as the causal factors of changes in financial politics, "performance failures and scandals" and "possibility of change of government", will probably affect other policy areas as well.

2) A Realistic Image of the Big Bang and Financial Politics since 1995: the Outcome of the Strategic Interaction of the LDP and MOF and an Increased Role for the Public

The Big Bang initiative was not:

a) A pre-designed and coordinated initiative by a single bureaucratic agency;
b) The result of financial institutions' domination of financial politics;
c) The result of the politicians overcoming or subduing the bureaucrats;
d) The result of the non-financial firms (and MITI) gaining the upper hand of MOF and financial industries; or
e) An achievement by the LDP backbenchers promoting consumerism as a result of the electoral reform of 1994, introducing the single-member district.

Rather, the Big Bang was brought about by political winners, the LDP and MOF, which saw political gains in obtaining public support independently from the exchange of goods and services with their constituents. Their strategic interaction through the logic of organizational survival explains the process of financial politics in 1995-96. As the loss of public trust amidst performance failures and scandals (e.g. the Housing Loan Affairs) was what brought the threat to their survival, the LDP and MOF sought to re-coup public trust by enhancing public interest over constituents' interest. The views held by the sub-organizational groups that won in the policy contest within the LDP and MOF were those rewarded by the environment (continued public criticism due to recurrent failures; and increased probability of change of government): as long as "survival" was the ultimate goal for all members, what appeared to increase the prospect of survival eventually became the policy of the organization. Our framework stressing the strategic interaction of actors enables us to understand the complexity of the relationship between the LDP and MOF in 1995-96: cooperation (the Housing Loan Affairs), competition (the Big Bang), and conflict (the MOF reforms). The timing of the Big Bang reflected Hashimoto's reform agenda at the beginning of his second Cabinet, the pace and the scope reflected the fact that MOF planned the content, and the sequence reflected which field in financial policy making the "reformers" within MOF and the "mavericks" within the LDP controlled.

The domestic financial institutions were, on the whole, unable to effectively oppose the reforms, which threatened their survival through increased competition: this becomes clear from the comparison with the financial reforms of the past. While the financial industries affected the "pace" of the reforms, the "timing" (i.e. immediately, and until 2001) and the "scope" (e.g. including insurance) were largely unaffected. Because the regulated industries were by-passed by those who conceived the Big Bang in the planning phase, they were forced to face the already public Initiative; political leadership by Hashimoto made it hard for the industries to campaign through the LDP; public support of reforms markedly raised the cost for assembling a counter-coalition. The financial scandals drastically hurt the political influence of the financial industries to forestall the reforms; the subsequent scandals propelled the Big Bang further, as the initiative became part of the process of the departure from the Convoy System, vilified by the scandals and discredited by the financial crisis.

Our empirical analysis in Part II, based on the analysis of various financial reforms in the 1980s and 1990s, finds that the essence of the new developments in financial politics since 1995 (including the Big Bang) is that "the public now matters" as a determinant of financial politics in a world in financial crisis where changes of government can occur. We find that the most significant change in financial politics since 1995 is not so much the altered financial landscape itself (which may have happened in various occasions in the past) as the change in the public policy making process towards larger inclusiveness. The public policy making mechanism of the "insiders" has been increasingly allowing the "outsiders" to wield a significant influence through the practice of "going around" the mechanism of bureaupluralism by relying on public support.

3) The Mechanism of How the Big Bang and Other Changes in Finance Proceed: "Institutional Change" in Finance and Public Policy Making, and Patterns of Financial Reforms

We show that our framework of institutional change can help us make sense of the new trend in financial politics that "the public matters". In financial politics, there were two institutions in place before 1995: the Convoy System in finance (the Convoy) and bureaupluralism in public policy making. The Convoy was a financial system in which all financial institutions would proceed at the same speed as the "slowest" institution as in a naval convoy: this was secured by regulatory rules setting up segmentation walls between financial businesses as well as restricting entry and exit, a reliance on informal policy tools for governmental regulation, and essentially, the shared expectations of "stability" (i.e., continuity of the current arrangement) and "cooperation" (i.e. cooperation among such insiders as MOF, the LDP, and the domestic financial industries). Bureaupluralism was a steady bargaining process involving the bureaucracy, the industries, and the LDP: it was a stable interaction pattern of these three sets of actors, based on the informal interaction of the same actors over time, guaranteed and reinforced by formal rules, sustained by the shared expectations of "continuity" (e.g. "the policy making process will always be the same").

There has been institutional change in financial politics since 1995: the breakdown of the Convoy and the decay of bureaupluralism. Our inquiry into the collapse of the Convoy is two-fold. First, we show how exogenous developments (technological innovation; globalization of finance) and change in institutional environment led to institutional change. The following states our causal mechanism of institutional change: *"performance failures and scandals" in finance, caused by the gap between the faster exogenous developments and the slower institutional response, as well as the "change of government" of 1993 in politics, have brought about a new development in financial politics (as observed in Part II), or "the increased importance of the public in politics", triggering institutional change in finance and public policy making.* Second, through an analysis of the evolution of the Convoy at the levels of players, formal rules, informal interaction patterns, and shared expectations, we identify a shift in the organizing principles, or the fundamental principles recognized by all actors as objective characteristics as well as normative values of the institution: from "cooperation and stability" to "competition and transparency". The Big Bang was triggering and triggered by, reinforcing and reinforced by, other shifts in the same direction, towards the breakdown of the Convoy System in finance.

As for public policy making, bureaupluralism has been decaying. Reflecting the collapse of the shared expectations of "continuity", actors have started to question the worth of the institution; nevertheless, it remains to be seen whether this will lead to a full-scale institutional change or not. We offer a prediction based on our causal framework: institutional change is likely to happen on two grounds. The experiment of "going around" in the policy making process has been on the rise; the conditions that make the public important in politics, such as "failures" and "change of government", are likely to continuously remain salient in the political economy in general. Thus, as the shared expectations of "continuity" collapse, bureaupluralism will erode over time.

We also develop a four-by-two typology of financial reforms, focusing on the evolution of coalitions and the way state actors interact with societal actors. The evolution of coalitions yields four categories (status quo, inclusion, defection, and replacement) along a continuum, regarding who can participate in public policy making. In "status quo", "insiders" remain in charge; in "inclusion", some "outsiders" see their interests incorporated while the policy making process itself remains intact; in "defection", some "insiders" switch strategies and "go around" the established policy making process; and in "replacement", "outsiders" take over, eliminating the status quo policy making mechanism. How state actors interact with societal actors has two patterns: "interest group politics", in which state actors act based on the exchange of goods and services with interest groups, and "public interest politics", in which state actors act independently of interest group pressure (see Figure 1.1 at the end of the chapter).

4) Insights into Regulatory Reforms in Other Contexts: Entrenched Actors, the Role of the Public in Politics, and Generation of Hypotheses

Our empirical analysis in Part II establishes that within our four-by-two typology of financial reforms, the Big Bang fits the one that combines "defection" ("insiders" such as MOF and the LDP in charge) and "public interest politics" (as opposed to "interest group politics"). This enables us to offer insights with relevance to other cases of regulatory reforms.

First, entrenched actors may not be as entrenched as they may seem. Our analysis shows that such seemingly "entrenched actors" as the LDP and MOF can willingly engage in efforts of deregulation if given a set of incentive structures (loss of public support and threat to organizational survival). The image of the past may be misleading: the past does not necessarily prohibit future shifts in strategy.

We contend that our theoretical devices are useful in establishing the above. The introduction of the hierarchy of goals (survival on top of the others) leads to a more realistic behavioral assumption for the bureaucracy. Of course, we may expect an internal struggle within the organization prior to such a policy shift: the "logic of organizational survival" sheds light on the mechanism of the formation of a single organizational policy, enabling us to account for the seemingly puzzling behavior by MOF, which planned the give-away of its regulatory power, or by the LDP, which engaged in a complex relationship with MOF in the financial politics of 1995-97.

Second, the public's control over the politicians through elections may not be the only way the public influences politics. Elections certainly matter to political parties: the Big Bang experience confirms this generally accepted view, as can be seen in the LDP's strategy facing tough competition from its rivals in the 1996 elections. However, we stress that not only the politicians, but also the bureaucrats and the regulated industries have the incentives to cater to the general public's interest in order to boost public support, besides taking care of their own immediate concerns. "Failures" lessen public support for the organization at the level of competence ("performance failures") and ethics ("scandals"). It is when "failures" occur and organizations become "public enemies" (e.g. polluting firms; corrupt bureaucrats and politicians) that such incentives to promote the public interest become salient. When organizational survival is in danger, actors would seek to pursue this ultimate goal. The public does not need to engage in direct action (e.g. boycott, mass protest) to wield political influence, as politicians, bureaucrats, and industries would risk losing political influence regarding matters of their interest by becoming "public enemies".

Our model of strategic interaction among actors gives us an improved characterization for the role of the public in politics. It questions the conventional assumption that societal interests can only have significant political influence through organized groups; it sheds light on the public's influence other than through the principal-agent relationship between the voters and the legislators.

Admittedly, it is not that the public always matter in politics: thus, we look beyond financial politics towards other issue-areas in the Japanese political economy to generate hypotheses. *Third, such factors of domestic politics as "failures", "public visibility", and* *"electoral vitality", along with such economic factors as "technological innovation", "global integration", and "institutional environment", may help us determine the likelihood of economic reforms in other issue areas.* We face a problem of comparability, and thus our findings may be more relevant to areas of economic regulatory reforms (e.g. telecommunications and transportation) rather than those of budgetary politics (e.g. agriculture and construction). Despite this limitation, to the extent that our contention — that public support is a determinant of economic reforms — holds, we point to some candidates of determinants of economic reforms in general by constructing a rudimentary two-level model of domestic politics and economic environment.

1.6 Structure of the Dissertation

Part I (Chapters 2-4) provides the conceptual tools and the background information in preparation for our later analysis. In Chapter 2, we offer a survey of the existing literature on Japanese politics, financial politics, and the Big Bang, from which we derive our approach and the concerns to be addressed. We outline our methodology in response and build alternative explanations concerning the question of "Who brought the Big Bang?", for later use in Part II.

In Chapter 3, we have two tasks. First, we introduce our theoretical frameworks of institutional change and organizational survival which will be utilized in later chapters to make sense of the development in financial politics. Second, we construct an image of the possible scenarios regarding financial reforms, by identifying the actors and deriving their preferences based on observed behavioral regularities. We will see how our starting assumption — that organizations seek survival — applies to the actors in the political economy in general such as political parties, bureaucratic agencies, and firms and interest groups. Through this process, we identify the prevailing institutions in finance (the Convoy) and public policy making (bureaupluralism) in Japan, that were constantly reproduced in the past until the first half of the 1990s.

In Chapter 4, we provide an image of the economic realities of the Big Bang. What the initiative includes and what it implies to the actors in the financial market will be discussed. This leads us to grasp the distributive effects of the reforms, or who the "winners" and the "losers" are. We will see that the Big Bang was expected to bring negative results to almost all firms among the domestic financial industries, an important "insider" component of the policy making process of bureaupluralism.

Part II (Chapters 5-7) provides our empirical analysis of financial politics. Chapter 5 will analyze the political process of the emergence of the Big Bang, up to November 1996, when the initiative was first launched. The question of "Who brought it about, and why?" will be the focus of our inquiry. We will show how the logic of organizational survival worked to bring about this outcome. That MOF and the LDP, in cooperation, competition, and confrontation with one another in financial politics, saw political benefits to be reaped from the reforms and thus acted to bring about the initiative will be demonstrated.

In Chapter 6, which analyzes the process in which the initiative of November 1996 was embodied and implemented, the Big Bang will be contrasted with three cases of past financial reforms (1991-93, 1992-1994, and 1979-82) to assess the extent of change the Big Bang has brought about. The influence of the regulated industries, or the economic "losers", on public policymaking will be the focus, as we wish to assess how much influence they had on the outcome as well as explain their inability to reverse the reforms in the Big Bang, in contrast to their large political influence in the past.

In Chapter 7, we proceed from financial reforms to financial politics in general, to find out what can be said about the new development in financial politics since 1995. To achieve this goal, we refer to the Financial Diet of 1998 dealing with the bad debt problem in banking, an adjacent field in financial politics, to confirm the new development observed in the Big Bang as a general trend in financial politics since 1995. We derive our main observation in financial politics after 1995 — the public now matters as a determinant of politics.

Part III (Chapters 8 and 9), our concluding section, seeks to make sense of the developments analyzed in Part II by making use of the frameworks provided in Part I. Chapter 8 situates the Big Bang in finance and the political economy in general. We utilize the framework of "institutional change", introduced in Chapter 3, to understand the large change taking place in finance. We show the causal mechanism in which the observed changes in financial politics occurred, while demonstrating how the components of the Financial Convoy are related to one another, triggering the breakdown of the Convoy. In the end, we observe the breakdown of the Convoy and the decay of bureaupluralism, offering a prediction on the future of the latter.

Chapter 9 provides the conclusion. It probes the applicability of our findings to other cases in the political economy, generating hypotheses about the determinants of regulatory reforms in general. It also discusses the policy implications of the analysis and identifies further issues as well.

Fig. 1.1 Typology of Financial Reforms

Interaction of State and Societal Actors?

Evolution of Coalition Patterns?	Interest group politics (I)	Public interest politics (P)
Status Quo (S)	**Past Financial Reforms** *(Domestic Financial Firms)*	
Inclusion (C)	**Postwar LDP Politics** *(Non-banks and Foreign Firms)*	
Defection (D)	*(Some Financial Firms)*	***The Big Bang*** *(LDP and MOF)*
Replacement (R)	*(Corporate Sector)*	*(LDP Thrown Out)*

In Parentheses: "Who Brought About the Big Bang?"
Shaded: Institutional Change (Departure from Bureaupluralism)

I: state actors act as a result of interest group pressure
P: state actors act independently of interest group pressure

S: same policy making process, insiders only (e.g. domestic financial firms)
C: same policy making process, inclusion of outsiders (e.g. non-banks)
D: different process, led by insiders switching strategies (e.g. LDP and MOF)
R: different process, outsiders displacing insiders (e.g. change of government)

Part I Preparing the Analysis (Chapters 2-4)

Before engaging in the political analysis of the Financial Big Bang, we need to prepare ourselves by developing our conceptual tools, familiarizing ourselves with the actors in financial politics and their strategies, and understanding what materialized by the Big Bang and its implications to the actors in the financial market.

What has been said about Japanese politics enables us to offer our methodology in response to the shortcomings of the literature as well as obtain an idea of how others would tackle our case of interest, the financial politics of the 1990s. This leads us to offer our own methodology, a rational-actor approach with focus on "institutional change". (Chapter 2) After introducing our theoretical framework of institutional change, we identify the actors and their strategies regarding financial politics. We obtain a typology of financial reforms, which yields possible scenarios regarding timing, pace, depth, and scope. (Chapter 3)

Our analytical focus is on the political interplay of actors that led to the introduction of the Financial Big Bang, and not on the economic projection of what the deregulation package will bring about. However, it is important to know what the Big Bang package includes and what it would mean to the actors in the financial market, as it would give us an idea of "who wins and loses", and thus the incentives of the societal actors (firms and interest groups, and the public) vis-à-vis financial deregulation. (Chapter 4)

Chapter 2 Existing Approaches, Methodology, and Alternative Explanations

2.1 Introduction

In this chapter, we will provide an overview of the existing literature on Japanese politics, with our case of interest — Japanese financial politics in the 1990s — in mind. We will identify three issues of contention in the various approaches to Japanese politics: we will explain our position in these issues. We will then analyze works on Japanese financial politics and the Big Bang financial reforms, which will give rise to five sets of concerns that need to be addressed. Based upon the above, we will offer a discussion of our methodology. As our methodology includes the use of alternative plausible explanations for increasing the plausibility of our claims, we will close by constructing five alternative explanations against which we will contrast our explanation in the later chapters.

2.2 Three Issues of Contention in the Studies of Japanese Politics

It is difficult to group the diverse literature on Japanese politics according to one criterion. We find that there are three issues of contention in the various approaches to the study of Japanese politics in terms of theoretical focus.

1) Actor-oriented v. Institution-oriented
2) Change v. Stability
3) Dominance v. Interaction

The discussion of the literature will lead us to offer our position in each issue.

1) Actor-oriented v. Institution-oriented

There may be two salient ways to approach institutions in social science.[1] One may start the analysis from the individual actors (actor-oriented approaches); alternately, the institutional structures may be where one begins (institution-oriented approaches). In actor-oriented approaches, one keeps the actors and their preferences exogenous (e.g. they are beyond the scope of explanation), and seeks to explain institutions that shape human behavior. This methodological orientation, dominant in the study of economics, can be seen in the rational choice analysis of political institutions: the emphasis is on how the institutions reflect the actors' interests and structure their incentives and strategies, while the preference of actors is taken as given.[2] In institution-oriented approaches, on the other hand, the institutional structures are what explain the actors and their behavior. Historical institutionalism in political science adopts this position, often shared in sociological studies: the emphasis is on how institutional structures shape the actors' preferences and constrain their behavior.[3]

In the study of Japanese politics, the latter approach has been traditionally dominant. Historically developed institutional structures have been placed at the center of the explanatory frameworks by many theorists (Johnson 1982; Samuels 1987; Calder 1988).[4] Typically, the central analytical concept that summarizes the essence of the complex set of institutional structures (e.g. "developmental state" [Johnson]; "reciprocal consent" [Samuels]) as well as a typology of possible arrangements (e.g. "plan rational and market rational" [Johnson]) would be offered, and a detailed process-tracing of the historical development of one or a few cases would establish the validity of such conceptualization. The emphasis is rather on causal complexity than on mono-causal explanation, and thus the orientation is more inductive than deductive.[5]

The principal strength of this approach lies in its empirical accuracy: the methodology dictates that the researcher grasps his/her cases very thoroughly in making theoretical assertions. This attention to historical, social, cultural, and other contexts reduces the risk of making erroneous assertions based on false empirical data: the reliance on extensive archival research and interviews prevent such occurrences. However, this approach has several weaknesses. First, because of the emphasis on detailed case studies and its inductive nature, the theoretical findings often tend to be case-specific and thus have little potential for generalization. Second, while the theoretical findings may indeed show a realistic image of "how things have evolved up to the present", the causal mechanism and the micro-level incentive structures are often left unclear because of the very emphasis on causal complexity. The inductive nature of the theory may lead the theorist not to specify the causal mechanism, making it less amenable to verification by others. The behavioral assumptions about the actors (i.e., what they pursue) and their incentive structures under strategic settings are often ill-defined, making them vulnerable to the trap of *post hoc* explanation. Third, a corollary of the vagueness of the causal mechanism is that it leads to little prediction potential. Prediction is indeed a difficult task for all works of social science; however, as we will argue later, it may be what increases the importance of the academic works in the policy world.

Actor-oriented approaches in the study of Japanese politics have been of recent development: rational choice analysis of Japanese politics has only appeared in the 1990s.[6] (Rosenbluth and Ramseyer 1993; Cowhey and McCubbins 1995; Kohno 1997) Applying the principal-agent framework developed in transaction cost economics and the rational choice analysis of American politics, theorists would seek to explain such topics as electoral politics, postwar party politics (Kohno), and the legislative control over the bureaucracy and/or the judiciary in public policy making (Rosenbluth and Ramseyer; Cowhey and McCubbins). The theoretical emphasis is on the individual actors' incentive structures, which are derived from such behavioral assumptions as "politicians pursue reelections" in strategic settings (e.g. lawmakers as principals and bureaucrats as agents), which are set forth by the formal and informal institutions (defined as "rules of the game") such as laws, constitutions, and seniority rule.[7] The orientation is deductive: the behavioral assumptions and the constraints set by the institutions would lead the theorist to deduce a set of hypotheses, which would be confirmed by a narrative of empirical cases. In this approach, such causal factors as electoral rules (e.g. single member district), regime types (presidential / parliamentary), or the veto power of the legislators over the bureaucrats would explain the political outcomes: such "rules of the game", which the actors seek to manipulate to pursue their own goals, would set the incentive structures of the actors, thus determining the outcomes of their strategic interaction.

The strengths and weaknesses of the rational choice approach lie in the opposite of that of historical institutionalism. The first strength of this approach is that its theoretical frameworks are better suited to generalization across cases. The universalistic behavioral assumptions and micro-level analysis of individual incentives (e.g. politicians pursue reelections, which can be expected to hold across democracies), with little emphasis on country-specific historical, social, or cultural context, make the findings from the analysis easier to connect to cases in other countries (but this can be a weakness as well: see below). For example, if the behavioral assumptions do not vary much across cases, then, the variations in political outcomes could be attributed to those in political institutions. Second, rational choice analysis excels in theoretical rigor and clarity. The assumptions, as well as the process of deriving the hypotheses through deductive logic, are well delineated: this makes it easier for others to check the theory's validity. The causal mechanism is often made clear: for example, one can easily see that "electoral rules" and "regime type" are the two explanatory factors of various outcomes in Cowhey and McCubbins (1995). Third, because the causal mechanism is made clear, this approach is well suited to offer predictions: for example, if "electoral rules" are shown to matter, then the change of electoral rules would likely alter the outcomes.

There are shortcomings to rational choice analysis, too. First, the behavioral assumptions of actors are often problematic. In rational choice, "the trick is in defining the preferences in general, ex ante to a particular application". (Levi 1997, 24) However, without knowing what the actors are pursuing for sure, one cannot offer a plausible explanation of the strategic interaction. How accurate is the assumption that politicians seek reelections? This problem becomes all the more acute for the bureaucrats, as their behavioral goals are much less clear: what do they pursue?[8]

Second, this ambiguity of the veracity of the assumptions, coupled with the minimal attention to historical, social, and cultural contexts as well as the emphasis of deductive logic, increases the risk for the theorists of making inaccurate claims.[9] Because the role of empirical cases tend to be "confirming" rather than being an indispensable part of "theory-building", one does not need to carry out empirical research as extensive as in historical institutionalism nor provide detailed empirical evidence to support one's argument. This aspect leads to a greater risk of making inaccurate (or misleading) statements, which more extensive empirical research (e.g. additional interviews) would prevent. For example, such assertions as "the government deliberative councils function to provide the LDP with information" or "the Supreme Court only includes recent LDP appointees" are less likely to emerge from other approaches with more emphasis on detailed case studies and less emphasis on application of theories developed elsewhere.[10]

We have given an overview of the two different approaches to institutions in Japanese politics. This difference in focus need not be a dichotomy, and the two approaches can be complementary rather than substituting one another: both theorists of rational choice analysis and historical institutionalism in general seem to be increasingly aware of this fact.[11] The weaknesses mentioned above may not be inherent in the approach itself, and could be avoided if the researcher proceeds with caution. For example, in historical institutionalism, generalizability and theoretical clarity can be further pursued, making the assumptions, the incentive structures, and the causal mechanism more explicit, while rational choice analysis can aim for greater empirical accuracy with more attention to contexts other than the formal "rules of the game" such as constitutions and electoral laws.

Keeping the strengths and weaknesses of the two approaches in mind, we adopt the actor-oriented approach in this dissertation. This deliberate choice reflects our belief that works of political science on current issues ought to aim for greater policy relevance, if they are to be of greater use to the society that supports such endeavor.[12] Unfortunately, the presence of political scientists in the policy debates on issues of political economy is minimal, especially in the Japanese context.[13] In our view, this state in part reflects the way academic works of political science are presented to the policy makers. If, as in studies of economics (which invariably adopt an actor-oriented approach), it is presented that "causal factor A leads to result B" and that changing the status of A (e.g. increasing/ decreasing; creating/ eliminating) would improve matters, policy debates are likely to be seriously affected by such recommendations. On the other hand, if, as in numerous past studies of Japanese politics, the academic shows that the Japanese system is complex with interacting causal factors and that the historical (or sociocultural) development of the basic institutions make things hard to change, what are the policy makers to do? While analyses telling us "how complex the world has been up until the present" contribute to our understanding of politics, we aim for more by adopting a rational-actor approach, constructing a framework that enables us to identify the causal factors that give us better clues to prediction and policy recommendations.

The above discussion on the weaknesses of rational choice analysis points us to the way to proceed. Greater attention to empirical accuracy can be pursued within the rational choice perspectives: better attention to historical and other contexts other than formal "rules of games" and more realistic assumptions can achieve this goal, as we will see in Section 2.4, which delineates our methodology.

2) Stability v. Change

The second issue of contention in the study of Japanese politics is one between analytical frameworks of "stability" and "change". Reflecting the apparent stability of the postwar political economy, many works of Japanese politics, particularly those which have appeared up until the 1980s, have sought to explain the "stability" of such prominent observations as bureaucratic dominance, LDP one-party dominance, or the arrangements between the public and private sectors, and so on. (Johnson 1982; Sato and Matsuzaki 1986; Muramatsu and Krauss 1987; Samuels 1987; Okimoto 1989) One common strategy for the theorists may have been to characterize the Japanese state (or, the arrangement that governs the interplay of politics, economics, and society) by a single phrase, such as "developmental state" (Johnson), "societal state" (Okimoto), and "patterned pluralism" (Muramatsu and Krauss).

This attention to stability was warranted up until the early 1990s: however, we saw that the LDP rule collapsed in 1993. How are the theorists to proceed? In face of the seemingly unstable political reality of the 1990s, there are those who stress the continuity from the past and thus the "stability" of the political system, and those who argue that a significant "change" has been taking place. On one hand, there are those who argue that little has changed in Japanese politics in the 1990s. (Curtis 1999; Vogel 1999) According to this view, there is a large gap between the reform rhetoric of the Japanese political leaders and the reform policies of the Japanese government: in the decade, little have been achieved by the numerous attempts to reform the political system and the public policy making process. If change is to occur, incremental, rather than radical, policy change is likely to happen.[14]

On the other hand, there are those who see changes happening. As Kohno (1997) suggests, the "stability" of the postwar era such as the LDP one-party dominance could have turned to "change" at any moment (as it did in 1993): the image of "stability" may be misleading in that it gives the false image that things were pre-destined to be stable from the start. Pempel (1998) argues from an institution-oriented approach that a significant public policy redirection and coalitional adjustment occurred in Japan in the 1990s (compared to that of the 1960s), just short of a complete "regime shift".[15] As we will see below, some works on Japanese finance (Amyx 2000; Rosenbluth and Thies 1999) suggest that there was a significant departure from the traditional financial system.[16]

On this issue, we find that the single-phrase characterization of the Japanese political system, common in the past (as mentioned above), has a shortcoming in the sense that such strategies adopted by the theorists seem to be based on the assumptions of "stability", or "continuity" and "non-change". Wouldn't such strategies of focusing on one stable system at work make it hard to identify signs of change until well after that change takes place? Of course, whether things change or not is a relative matter, and one can easily find evidence for both. This essentially boils down to a contest of plausibility between two views in face of the reality.

While realizing the tendency to emphasize equilibria as noted by such critics as Green and Shapiro (1994), we nevertheless adopt the actor-oriented perspectives, as this framework enables us to question the appearance of "stability" (as shown by Kohno [1997]). Actor-oriented approaches need not be addressing "stability" alone: it is merely one outcome of the many possible outcomes of the strategic interaction of actors. While an equilibrium may give little incentive to any actors to shift their strategies, environmental changes may induce the actors to adopt different strategies, thus disturbing the appearance of "stability". Relying on the framework of "institutional change" that we develop in Chapter 3, we challenge those who see "non-change" and show that "change" is what characterizes the development in Japanese political economy since 1995. Japanese politics may be departing from its past pattern of gradualism and non-change: we will show this in the areas of finance and public policy making.

3) Dominance v. Interaction

The third issue of contention in the literature on Japanese politics may be whether one focuses on the dominance of one set of actors (e.g. bureaucrats, politicians, or interest groups) over others or, instead, on the interaction patterns among actors.[17] First, some focus on the domination of the bureaucrats over other actors.[18](Johnson 1982) This line of framework incorporates in its theorization the primacy of the "pilot agency" (be it MITI or MOF) over the politicians and the interest groups. Second, others see the domination of interest groups in the political economy. From the actor-oriented point-of-view, Japanese finance, as the theory of interest-group regulation predicts, may be dominated by financial institutions (Rosenbluth 1989); or from the institution-oriented standpoint, long-term credit banks and *keiretsu* may be key to Japan's "strategic capitalism" strategy to economic development. (Calder 1993) Third, there are some who stress the dominance of the politicians over the bureaucracy by adopting the rational choice approach (Ramseyer and Rosenbluth 1993; McCubbins and Noble 1995), or by adopting a framework of pluralism, adding such adjectives as "patterned" (Muramatsu and Krauss 1987) and "compartmentalized" (Sato and Matsuzaki 1986).[19]

Alternately, there are those who focus on the interaction between the actors. Okimoto (1989) and Amyx (1998) focused on the relational networks linking the actors by delving into their informal interaction patterns: they showed how such networks enabled or constrained the state's ability to pursue economic goals. Samuels (1987) found that "reciprocal consent" was the dominant interaction pattern between the state and the private sector in the transformation of the industrial structure in the energy sector.

Needless to say, the focus of a theory is largely determined by the state of the academic discourse when the research is done. Given the large impact of the bureaucratic dominance view (largely to the credit of Chalmers Johnson) many works that appeared in the 1980s naturally focused on the question of dominance. However, in the end, as Curtis (1999, 60) notes, there has been an increasing convergence regarding the state-society relationship among theorists, towards an image of "an activist state interacting with strong social institutions".[20] We endorse this view, given our actor-oriented approach seeking to address changes. The pattern of dominance may or may not be stable over time, and thus it may be more fruitful to search for a trend in which the pattern of domination evolves than to try to identify the permanently dominant actor.

From this standpoint, some theories among those stressing dominance must be said to have weaknesses, as the ways some models are set up determine the pattern of dominance even before the process of contrasting the theory with the reality.[21] The developmental state literature (Johnson) demonstrates this weakness: for example, if one *a priori* defines the model to incorporate the preeminence of a "pilot agency" in the political system, how can one account for the loss of bureaucratic dominance?

Similarly, in some works of the rational choice approach, we can detect an assumption of *a priori* domination of politicians over bureaucrats. The mechanism of political control may be a veto power "over anything bureaucrats do" or a control over their promotion. (Ramseyer and Rosenbluth 1993) Alternately, such a mechanism could be shown through the theory of "fire-alarm" (i.e., the interest groups reporting to the politicians about the bureaucrats' ills) or the rebuttal of the "abdication" (i.e., that politicians abdicate power to bureaucrats) hypothesis. (Noble and McCubbins 1995) However, two factors undermine the validity of such theories as explanation of Japanese politics. First, some assertions are unfounded by empirical evidence. (e.g. the "fire-alarm" claim: deliberative councils serving the information needs of the LDP![22]) Second, the excessive attention to (mostly formal) "rules of the game" lead the theorists to confound theory with practice. Take the "veto power" argument: true, the Japanese Constitution guarantees the primacy of the legislative branch, the Cabinet Ministers are assured of their leadership position by the legal statutes, and the ruling party can always veto the bureaucrats' proposals, that is, in theory. Then, why would we see so much frustration by the politicians as to how hard it is to overcome the bureaucrats' resistance? [23] Why wouldn't the "veto points" by the LDP work as predicted by the theory? One can skirt the issue by choosing to define abdication as "the agent has complete discretion over the policy choices and that the principal has no control", asserting that "relative amounts of abdication imply that the principal is able to influence the agent's choices to at least some extent". (McCubbins and Noble 1995, 74) However, the creation of such an irrelevant dichotomy between "abdication = zero control" and "control = non-zero control" completely obfuscates the following, crucial point: that politicians have some control over the issues is not the subject of contention, but how much substantive control they have is in question here.[24] Attention beyond formal "rules of the game", which set the outer limits of bureaucratic behavior, towards the informal interaction patterns, digging into the substance of the politician-bureaucrat relationship, would help bridge this gap between theory and reality.

In sum, we adopt a position that focuses upon the interaction of actors over one that stresses the dominance of one set of actors. While we do not dismiss the relevance of the search of "dominance" *per se*, we reject theories with built-in dominance. While adopting a rational actor approach, we seek to go beyond the formal "rules of the game", reaching towards the informal interaction patterns among actors, to grasp a truer image of the relationship between actors.

Our position emerges from the examination of the three issues of contention in the current literature on Japanese politics: we adopt an "actor-oriented" approach to institutions which seeks to account for as well as establish that "changes" have occurred in the Japanese political economy since 1995, focusing on the "interaction patterns" between the actors rather than the dominance of one particular set of actors, and reaching beyond formal "rules of the game" towards informal interaction patterns.

2.3 Works on Japanese Financial Politics and the Big Bang

We now turn to the works on the specific field of our interest within the Japanese political economy, financial politics (or the political process of the public policy making concerning private finance) and the Big Bang. In the study of financial politics, many analysts have emphasized the gradual nature in which reforms take place. (Rosenbluth 1989; Vogel 1996; Amyx 1998) Thus, such works would have difficulties coping with the Big Bang, where the planning was much quicker, the content was much more far-reaching (i.e., creating the obvious losers), and the schedule of the implementation was largely pre-fixed by the reform initiative (instead of being left to later negotiations), compared to the 1991-93 financial reforms, the most recent, similar attempt in the past (see Chapter 6). What happened to the gradualism of the past? Is it still there? What accounts for such differences between 1991-93 and 1996?

There are works by economists on the financial reforms as well, but they tend to focus on the gap between the desirable policies to be pursued from the economic standpoint and the reality, while offering little insight on the political interaction of actors out of which such a gap materializes. More often than not, MOF or the LDP, whichever is assumed to be in charge of financial policy making, is simply blamed for this failure. (Ikeo 1995; Horiuchi 1999; Hoshi and Kashyap 1999) If there are optimal economic policies, what hinders them from being adopted?

This question leads us to a common view among analysts of Japanese politics that characterizes the bureaucracy, MOF, and/or the ruling party, LDP, as actors that hinder or forestall the much needed economic deregulation for their own causes.[25] (Vogel 1996; Keehn 1998; Pempel 1998; Curtis 1999) If so, who brought about the Big Bang? Is it that some other actors who benefit from the financial reforms (e.g. domestic or foreign financial institutions) pushed for it, overriding MOF and/or the LDP? Or, is it that MOF and/or the LDP somehow decided to change their mind and actively push for the reforms? Are the "entrenched actors" (the LDP/ MOF) as "entrenched" as they are often believed to be?

On the Big Bang, there are numerous accounts that tell us what it contains and what the expected economic consequences are, in addition to some valuable narratives of the interplay of the actors (Tahara 1998; Otake 1999).[26] However, this being a recent development, few works systematically treat the political process of the Big Bang and the accompanying changes in financial politics altogether (or why things came out as they did), while some address the developments in finance paralleling the Big Bang. How can we understand such diverse developments in finance as the breakup of MOF (Mabuchi 1997), the Housing Loan affairs in the bad debt problem in banking (Rosenbluth and Thies 1999), and the Financial Diet of 1998 which finally showed a resolution to the above problem (Amyx 2000), *and* the Big Bang financial reforms? What are the relationships between these developments? Is there a framework that gives us a sense of the causal mechanism at work?

As for the relationship between the actors in financial politics, theorists may stress either the dominance of MOF (Vogel 1996; Keehn 1998), the dominance of the financial institutions (Rosenbluth 1989), or the paralysis of MOF bound by its relational networks with the banking sector.(Amyx 1998) In the financial politics of 1995-96, as we will see in Chapter 5, MOF and the LDP cooperated in the Housing Loan Affairs (the bad debt problem), competed in the planning of the Big Bang, and confronted each other in the MOF break-up. How can we possibly grasp such a complex situation by a framework of dominance? If we are to focus on interaction, what type of explanatory framework would satisfactorily explain the fact that the resolution of the bad debt problem was not forthcoming as Amyx suggests, while the financial reforms, hurting many financial institutions, were introduced suddenly in 1996? If the relational ties are to prevent the state actors from taking actions, why only in the banking reforms, but not in the Big Bang?

Lastly, we may note that the role of the public is unclear in many works on financial politics (and Japanese politics in general), despite the fact that Japan is a liberal democracy, where the public is supposed to be "ultimately" in charge. Works tend to focus on the interplay of such elite actors as politicians, bureaucrats, and interest groups, and not much on the role of the public, with the exception of rational choice theories which incorporate the voting public as the ultimate principal of their principal-agent chains leading to the politicians and then to the bureaucrats.[27] However, empirical studies such as Kabashima

(1986) suggest that not only politicians but also other elite actors (bureaucrats and interest groups) are influenced by public opinion (largely through the mass media).[28] What is the public's role in Japanese politics? Wouldn't the change of government in 1993 give a greater role to the voting public? Granted that voting gives the public an influence over the politicians, wouldn't there be other means of influence? What about the public's influence on bureaucrats and interest groups?

2.4 Our Methodology

We delineate our methodology below with the discussion in the previous sections in mind. At the end of the section, we will show that it addresses the concerns raised above. (Fig. 2.1)

1) Rational Actor Approach Focusing on Interaction: Level-of-Analysis, Rationality, Goals of Actors, and Model of Strategic Interaction among Actors

We adopt a rational actor approach, starting our analysis from the assumption that actors are rational in the pursuit of their goals: we discuss the level-of-analysis, the notion of rationality, the goals of actors, and the interaction among actors below.

First, our level-of analysis is at the level of organizations and sub-organizational groups. The actors are political parties, bureaucratic agencies, and firms and interest groups, as well as the public treated as a whole, while we sometimes denote the actors as "politicians" or "bureaucrats". Obviously, how the incentive structures within the organizational actors work vis-à-vis its individual members also needs to be taken into account. Organizations can utilize reward and punishment, both formal and informal, to ensure compliance to organizational policy, as decided by its internal decision-making bodies.[29] Thus, we do not offer an extensive scrutiny at the individual level, assuming that organizations such as political parties and firms have incentive structures that make it rational for individuals to go along with the organizational policy observable from outside.[30] However, we allow for possibilities that some groups of individuals within the organization compete for control over the organizational policy, thus operating at the sub-organizational level.

Second, on the notion of rationality, we organize our analysis from the rational choice perspectives, assuming the actors to be rational (means-end efficient) in the pursuit of their goals, however defined. Our view is that the actors are boundedly rational in that they face a constraint regarding their reasoning ability and the available information, but intendedly rational, which we call "subjective rationality".[31] In the discussion of institutional change in Chapter 3, we will see that the institutions in fact help the actors understand "how the world works", conveying information in compressed forms to the subjectively rational actors. While we base our analysis on the *ex ante* rational choices made by the actors, we do not contend that this solely determines the outcomes of institutional change: the existence of multiple equilibria makes the analysis of the historical information necessary, as we recognize that random events, mistakes, and unintentional fits, as well as *ex post* rationality (or revisions after the events) count along the *ex ante* rational choice.[32]

Third, on the goals of the actors, we start from a simple assumption that *organizations seek survival* or self-continuation. There may be many other goals for actors. However, we assert that this is the ultimate goal, or the goal that overrides other goals: we introduce a rank-ordering of goals between the ultimate goal, the pursuit of survival, and other goals, *ceteris paribus* goals, which tend to be factors with such characteristics as "the more (less) the better" (e.g. budget for bureaucratic agencies; profit for firms).[33] This assumption of survival as the ultimate goal, not uncommon in other fields — for example, the assumption of nation-states seeking survival as their ultimate goal is widely accepted in the study of international relations[34] —, is particularly well-suited in the analysis of the Japanese political economy of the 1990s, as will be shown in Chapter 3. To avoid tautology, we will refer to the Japanese political economy in general, rather than Japanese financial politics, in the process of deriving our behavioral assumptions: we will see how this assumption of survival fits the observed empirical regularities concerning the goals pursued by political parties, bureaucratic agencies, and firms, rather than such specific actors in financial politics as the LDP, MOF, and the financial industries.

Fourth, on the interaction of actors, we adopt a stance that the strategic interaction among actors does not necessarily result in the dominance of one actor over the others. However, we recognize that there is a distinction between the state actors, or the political parties and the bureaucratic agencies, and the other actors (firms and interest groups; the public): the former have direct access to governmental power, while the latter can only have indirect access through influencing the former. Put simply, politicians can make laws, bureaucrats can make administrative decisions, but firms, interest groups, and the public cannot wield the governmental power by themselves: they have to influence the state actors through inducement, coercion, and other means. Thus, in our world of politics, there are two state actors {politicians; bureaucrats}and two societal actors {firms and interest groups; the public}.[35] The state actors have two set of societal actors who provide support: constituencies (firms and interest groups) and the public. In order for them to pursue their goals of survival, they have to rely on the resources provided by these actors.

It is commonly assumed that interest groups drive politics: in the context of the politics of deregulation, the interest-group theory of regulation (e.g. Peltzman) provides one such prominent example.[36] However, we question its underlying assumption that organized groups determine the politics of deregulation: what if, state actors vie for the support of the unorganized public, independently of the inducement from *any* organized groups? We will pursue this topic in Chapter 3, where we will derive the patterns of financial reforms, and in Part II, where we will assess the role of the organized interest groups in the Big Bang.

2) Approach Focusing on Change: Institutional Change, Logic of Organizational Survival, Patterns of Reforms and Public Support

We focus on the interaction of actors rather than the dominance of one set of actors, and on change rather than stability. To this goal, in Chapter 3, we will introduce our theoretical framework of institutional change and organizational survival.

Dissatisfied with the existing rational actor literature on Japanese politics, which focuses too much on "rules of the game" (especially formal ones such as the constitution, electoral rules, and veto points) as seen earlier, we seek to adopt the views on institutions as developed from the comparative institutional analysis (CIA) perspectives.[37] We reach beyond the emphasis on "the rules of the games" to adopt a view of institutions as "equilibria" with a view to explaining its formation. Moving beyond the exclusive attention on formal rules, and learning from other approaches with more attention to context, we reach towards the informal interaction patterns. We recognize that both informal interaction patterns as well as formal rules matter, but we ask: what causal factor determines them? Here, we find that institutions are best represented in terms of shared expectations, as the fact that actors collectively believe such institutions are in place is what fundamentally supports the existence of the institutions.[38]

Thus, we define institutions in terms of shared expectations, following Aoki (forthcoming). Institutions will be defined as *shared, stable, summarized expectations about how the world works, which may not be unique*, based on a feedback mechanism between the shared expectations and the validation of such expectations by the objective reality. Institutions will be analyzed at four levels, players, formal rules, and informal interaction patterns, as well as the shared expectations that reinforce, and are reinforced by, the other three levels.

We will build our framework of institutional change, linking Aoki's framework to politics, or the distributional conflicts among actors, of the economic reforms. In our framework, institutional change is essentially a shift in shared perceptions about "how the world works" through a collective learning process based on the evolutionary selection mechanism of strategies. It is caused by the gap between the faster pace of environmental changes and the slower pace of adaptation in domestic political and economic institutions. This gap appears in the form of "failures", or "performance failures" and "scandals", which lead the actors to question the "taken for granted" aspect of the institutions. "Nature" — environmental changes in technology or institutional environment— eventually determines the outcome of the competition of the institutions by rewarding the actors' strategies: the successful strategies will increase their share in the population. Yet, the political struggle takes place between those actors who see the process as "resilience" of the institutions and/or have stakes in preserving the status quo on one hand, and those actors who see that "change" is taking place and/or see enhanced interests in the new institutions. This political struggle is facilitated by symbols derived from such sources as history, foreign practice, ideology, and leadership. In the process, how the "conservatives" are displaced by "reformers" may be either "counter-coalition" (from outside) or "defection" (from within). When a critical mass of the agents shift their views about "how the world works" and the new institutions become "taken for granted", we call it "institutional change".

From this, we will derive the logic of organizational survival. While all individuals in the organization may start from the same goals (survival), their views about the future and/or the stakes they have in the status quo may differ. This may lead to a split within the organization: a competition for the control of the organization may result. Eventually, "nature" rewards one group over the others: observing this, the "losing" groups revise their strategies. As long as all the individuals share the ultimate goal of survival, eventually, the group that calls for an organizational strategy that seems the most promising for organizational survival will control the organizational policy.

After deriving the actors and their behavioral assumptions from observed regularities, we will construct a typology of the financial reforms, from our framework of institutional change. We obtain a four-by-two typology, based on the patterns of the evolution of coalitions and on the interaction patterns between state and societal actors, that will guide the later empirical analysis in Part II.

Throughout the discussion of organizational survival and patterns of financial reforms presented in our empirical analysis in Part II, we will emphasize the role of the public. We will see that in both dimensions, public support is a critical factor that constrains not only the politicians who face elections, but also the bureaucrats and the financial industries in terms of the political influence they command. In a liberal democracy, no single actor can sustain becoming a "public enemy" through a massive loss of public support. If such a thing happens to an actor as a result of "failures", that actor would have strong incentives to recover the lost support in order to pursue survival.

3) Improving the Link between Theory and Empirical Validation: Longitudinal Comparison, Analytic Narratives, and Alternative Explanations

We seek to cure the shortcomings of rational actor approaches by adopting the following three strategies that improve the link between theory and empirical validity in Part II: longitudinal comparison, and analytic narratives, and the use of alternative explanations.

As we saw in Chapter 1, our first empirical objective is to show a realistic picture of the Big Bang, including what and who brought it about. In order to strengthen our approach, we rely on a comparison with the past cases of financial reforms. While a thorough comparison by John Stuart Mill's Method of Difference is impossible in this complex world, we are seeking to assimilate this method by trying to select the cases with the most commonalities, essentially sharing the set of actors involved, the political and economic settings, and the fields of reforms: it is a longitudinal comparison.[39] Our analysis is about the politics of the regulatory reforms in finance with particular focus on their distributional effects. Thus, we are interested in the past cases of financial reforms, which had many similarities with the Big Bang, yet with different results. By contrasting our case against such past cases, we may increase the plausibility of our thesis that stresses "change".

Second, we seek to improve our rational actor analysis by learning from the "analytic narrative" approach, as recently developed by rational choice theorists. (Bates et al. 1997) This approach advocates an iterative process between theory and empirical data in theory-building, recognizing that theories are being shaped by case materials, departing from a conventional notion of hypothesis testing of deductive theories and blurring the line between deduction and induction.[40] We find this approach attractive, as it helps us cure the conventional ill of actor-oriented approaches, namely the inattention to context, that we discussed above. Thus, we seek to build an analytic narrative, based on an understanding of "the actors' preferences, their perceptions, their evaluation of alternatives, the information they possess, the expectations they form, the strategies they adopt, and the constraints that limit their actions."(Bates et al. 1997, 11)

Yet, by adopting this approach, an empirical validation of one's theory (or analytical narrative) becomes problematic: another means of confirmation is needed. Thus, third, we make use of alternative explanations to increase the plausibility of our account, as in the analytic narrative approach.[41] While there may be many explanations to one phenomenon, one may assess their relative plausibility by contrasting one against another.(Kohno 1997) For example, through this process, one may find that one's theory may explain cases that other explanations fail to explain.

Figure 2.1 summarizes how our methodology responds to the five concerns as identified from the existing literature in the previous section.

Fig. 2.1
Five Concerns Identified from the Existing Works on Japanese Financial Politics and the Big Bang: Our Response

a) What happened to the gradualism in the financial reforms of the past? Is it still there? Why did the pattern of financial reforms change between 1991-93 and 1996?

→

- Framework of "change"
- Comparison among cases of financial reforms

b) Who brought about the reforms? The financial institutions? MOF and/or the LDP?

→

- Actor-oriented approach
- Better behavioral assumptions
- Logic of organizational survival
- Pattern of financial reforms

c) How can we establish the link between the Big Bang and other paralleling developments in finance? Is there any framework that tells us how the causal mechanism works?

→

- Framework of institutional change

d) Is it dominance or interaction that adequately captures the relationship among actors? If it is interaction, what is the framework?

→

- Model of interaction among actors
- Rational actor approach
- Logic of organizational survival

e) What is the public's role in Japanese politics? Wouldn't the change of government in 1993 give a greater role to the voting public? Granted that voting gives the public an influence over the politicians, wouldn't there be other means of influence? What about the public's influence on bureaucrats and interest groups?

→

- Role of the unorganized public in politics (in the model of interaction among actors)
- Patterns of financial reforms
- Role of public support in the analysis of organizational survival and financial reforms

2.5 Constructing the Alternative Explanations

We close this chapter by constructing alternative explanations, which will be contrasted against our analysis of financial politics in Part II. We derive them from the existing literature that we surveyed in this chapter.[42] How would the existing theories explain the Big Bang and the surrounding developments in financial politics? While the diversity of the existing literature cannot be captured in its entirety, we organize the alternative explanations along the lines of "dominance", as our main concern regarding the Big Bang (as identified in Chapter 1) is to ask the essentially political question of "Who brought about the Big Bang?". We obtain five different views: we begin by positing three simple explanations based on common "dominance" views, and then add two more complex views.[43]

First, it may be that a single bureaucratic agency, be it MITI or MOF, was the mastermind of the Big Bang, as the literature of bureaucratic dominance would posit. In this scheme, MITI as the pilot agency of the economy (Johnson 1982) or MOF as the regulator of finance (Vogel 1996) would plan and coordinate the process, while pursuing the enhancement of their own goals, or the maximization of regulatory power over the financial industries. MOF, building on their organizational consensus as seen in tax politics (Kato 1994), may have effectively dominated the political process on financial politics. If MITI or MOF, acting as a single unitary actor, can be shown to have gotten their way in the interaction involving the politicians and the private sector, not just in the Big Bang, but across financial politics, this explanation would hold.

Second, in line with those seeing a dominance of financial institutions in financial politics (Rosenbluth 1989; Calder 1993), we may find that the domestic financial institutions have driven the reforms by influencing the politicians or the bureaucrats. Such firms could be banks: city banks around which *keiretsu* are centered, or long-term credit banks which played a key role in postwar industrial finance. Alternately, it could be securities firms which could gain from the acceleration of the shift from indirect to direct finance that would result from financial deregulation. Or, it may be the insurance industry, especially the life insurance firms, that bought up assets all over the world with their financial might in the 1980s. In either case, these domestic financial institutions may have wanted deregulation, but for some reasons, some (or all of them) have switched sides and would have pushed for deregulation. Alternately, we may add the political source of deregulation that the interest-group theory of regulation suggests (Peltzman 1998): the rise of other interest groups, such as new entrants in the financial market (such as foreign financial firms and Japanese firms starting financial business). Perhaps, the "financial outsiders" have displaced the "financial insiders", thus controlling the political process. The formation of a coalition involving the financial institutions ("insiders" or "outsiders") on one hand and the state actors on the other hand, inducing the latter to work for the benefit of the former, would confirm this line of explanation.

Third, as those who see the dominance of politicians over bureaucrats in Japanese politics (Sato and Matsuzaki 1986; Muramatsu and Krauss 1987), we may find that the Big Bang is the politicians' victory over the bureaucrats. The Big Bang is basically an initiative to deregulate, announced by Prime Minister Hashimoto, who was also the President of the LDP. We may find that the politicians, pursuing deregulation for some reasons, have gotten their way over the bureaucrats, who are naturally expected to resist any reforms that threaten their bureaucratic power. Or, we may adopt the rational choice perspectives (Rosenbluth and Ramseyer 1993) and stipulate that the bureaucrats would anticipate the political masters' wishes: then, we would not see much political conflict between the politicians and the bureaucrats across issues in financial politics.

We may add two other patterns on the "Who brought about?" question, combining the above. Fourth, it may be that a counter-coalition was formed outside finance as can be expected from the theory of regulation. (Noll 1989) The non-financial firms, seeking better financial services, may have pushed for the drive for deregulation in alliance with MITI, which would be happy to encroach into MOF's jurisdiction over finance in their pursuit of bureaucratic power. Was the Big Bang essentially an interest-group dominance story coupled with bureaucratic turf war? The formation of the counter-coalition and the struggle between the two coalitions would confirm this explanation.

Fifth and last, we may question the assumption of the continuation of the "producer economy", where producer groups see their interests better represented than consumers, who tend to be less well-organized, that is common to all of the above explanations. Rational choice explanations focusing on formal electoral rules (which we will call "electoral rational choice" to distinguish our rational actor explanation from theirs) would see the Big Bang as a victory of the consumers, brought about by the introduction of the single-member district in 1994.[44] (Ramseyer and Rosenbluth 1993; Rosenbluth and Thies 1999) The LDP may have shifted from their bank-coddling practice to a pursuit of the consumers' victory in the resolution of the Housing Loan Affairs of 1995 (Rosenbluth and Thies): similarly, the Big Bang initiative, announced weeks after the first election after the electoral reform of 1994, could be attributed to the electoral reform. This line of explanation would argue that the principal-agent relationship linking the consumers, the LDP backbenchers, and the LDP leadership has finally resulted in a rise in consumerism.

Table 2.2 shows the five alternative explanations. Note that they basically correspond to the empirical puzzles introduced in Chapter 1. Regarding the question of "change" versus "stability", note that the "dominance" view may lead to either way, regarding how one evaluates the significance of the Big Bang. Our account on the emergence of the Big Bang (Chapter 5) as well as our general observation about financial politics since 1995 (Chapter 7) will be contrasted against these alternative explanations.

Table 2.1
Five Alternative Explanations on the Big Bang and the Surrounding Developments in Financial Politics

a) A pre-designed and coordinated initiative by a single bureaucracy (MOF or MITI)

- Bureaucratic dominance (Johnson 1982; Vogel 1996)

b) The result of the domination of financial institutions ("insiders" or "outsiders")

- Interest group dominance (Rosenbluth 1989; Calder 1993; theory of regulation)

c) The result of politicians overriding bureaucrats

- Political dominance (Muramatsu and Krauss 1987; Ramseyer and Rosenbluth 1993)

d) The result of the non-financial firms and MITI gaining the upper hand of financial industries and MOF

- A variant of interest group dominance (theory of regulation)

e) An achievement by LDP backbenchers promoting consumerism as a result of electoral reforms of 1994, introducing the single-member district

- Electoral rational choice (Ramseyer and Rosenbluth 1993; Rosenbluth and Thies 1999)

2.6 Conclusion

In this chapter, we provided an overview of the existing literature on Japanese politics, financial politics, and the Big Bang. Based on this survey, we arrived at our methodology as well as alternative explanations for the purpose of contrasting our analytical story in Part II. We first identified our theoretical position, along three issues of contention in the literature on Japanese politics: we adopt an "actor-oriented" approach to institutions which seeks to account for as well as establish that "changes" have occurred in the Japanese political economy since 1995, focusing on the "interaction patterns" between the actors rather than the dominance of one particular set of actors, and reaching beyond formal "rules of the game" towards informal interaction patterns. Then, we analyzed works on Japanese financial politics and the Big Bang financial reforms, which gave rise to five sets of concerns that need to be addressed, to which our methodology was designed to respond. (Fig. 2.1)

Based upon the above, we outlined our methodology. Our approach has three pillars: it is a "rational-actor approach", which focuses on "change" through a framework of institutional change and other derivative frameworks, as well as seeks to improve the link between theory and evidence. First, it is a "rational actor" approach, at the level of organizations and sub-organizational groups, based on a "subjective rational" view of rationality, introducing a distinction between "survival" as the ultimate goal and other goals as ceteris paribus goals. The focus is on "interaction": it introduces a model of strategic interaction that distinguishes the state actors (politicians and bureaucrats) and the societal actors (firms and interest groups, and the public), while proposing that both politicians and bureaucrats seek the support of the two sets of societal actors, challenging the assumptions of conventional theories of bureaucracy and regulation.

Second, we focus on "change" by developing a framework on institutional change, building on the comparative institutional analysis perspectives (see Chapter 3). Institutions will be defined in terms of collective perceptions about "how the world works": institutional change would be characterized as the shift in collective perceptions through an evolutionary process. We will link this framework to politics, or distributional conflicts among actors. We will derive the logic of organizational survival, in which sub-organizational groups with different views and interests about institutional change compete for the control of their organization. This framework will be utilized in Chapter 5 to explain the behavior of the LDP and MOF. We will also construct a typology of the way financial reforms take place. We will introduce a new look on the role of the public, where public support, but not the objective public interest, plays a large role in not only influencing the politicians through elections but also the bureaucrats and the interest groups. This will help us situate the Big Bang in relationship with other possible scenarios, including the patterns observed in the past, which we will discuss throughout Part II.

Third, we seek to improve the link between theory and empirical validation by relying on longitudinal comparison, analytic narrative, and alternative explanations. In Part II, we will compare the Big Bang financial reforms to three cases of financial reforms in the past (Chapter 6) as well as to the resolution of the bad debt problem in banking, an adjacent field, which took place after the Big Bang initiative was launched (Chapter 7). In Chapter 5, we will build our analytic narrative of the emergence of the Big Bang, emulating the recently developed "analytic narrative" approach, by offering a preliminary theoretical account, then revising it through a dialog between theory and data. Then, we will contrast our story against alternative explanations, which we derive from the existing literature. In Chapter 7, after we arrive at a general observation about the change in financial politics since 1995 through the analysis of the Big Bang and other cases, we will similarly contrast our explanation against alternative explanations.

In closing, we constructed five alternative explanations by focusing on the question of "Who brought about the Big Bang?", following the problematique outlined in Chapter 1. (Table 2.1)

Chapter 3 Actors, Preferences, Strategies, and Institutions in Financial Politics: Our Theoretical Framework

3.1 Introduction

This chapter seeks to achieve two tasks in preparation for our analysis of Japanese financial politics. First, we introduce our theoretical frameworks which will be utilized in later chapters to make sense of the development in financial politics. Second, we will construct an image of the strategies and possible scenarios regarding financial reforms, by identifying the actors and deriving their preferences based on observed behavioral regularities. We begin from how our starting assumption, that organizations seek survival, applies to the political parties, bureaucratic agencies, and firms. Through this process, we will identify the prevailing institutions in finance and public policy making in Japan, that were constantly reproduced in the past until the first half of the 1990s.

With the above in mind, we start from an introduction of our theoretical concept of "institutions" as equilibria of strategies, as developed by Aoki (forthcoming). Upon this framework, we build our theoretical frameworks of institutional change and organizational survival. Then, we will turn to identifying the actors in the Japanese political economy in general: political parties, bureaucratic agencies, firms and industries, and the public. We show how our assumption of organizational survival matches the observed regularities, better than other conventional assumptions. Two prevailing institutions in financial politics will be identified: bureaupluralism in public policy making and the Convoy System in finance (hereafter the Convoy). We then discuss the actors and their preferences regarding the politics of financial reforms, which will lead us to provide an image of the possible scenarios for financial reforms.

3.2 Institution, Institutional Complementarity, and Institutional Change

This section introduces our conceptual tools on the institutions, as developed by Aoki (forthcoming). In the next section, we introduce our own framework of institutional change, placing more emphasis on the "power and interests" of actors.

1) Institution

What is an "institution"? There may be roughly three different views of "institutions" among actor-oriented approaches, depending on how the theorist sees its fundamental nature.[1] First, institutions may be the "players of the game", or organizations which group individuals (e.g. firms, political parties, bureaucratic agencies).[2] Second, they may be defined as "rules of the game" a la North, or informal and formal rules that constrain and shape human behavior by reducing uncertainty.(North 1990) In this way of theorization, the rules are determined exogenously: for example, in North's framework of economic analysis, the "rules of the game" that regulate economic behavior are decided in the polity (and thus exogenously).[3] While this type of theorization often provides a powerful explanation of the stability of an existing institution, the evolutionary process of the rules themselves ought to be incorporated in the theoretical framework, if the evolution of institutions are to be fully accounted for. Third, thus, institutions may be defined as "equilibrium strategies of the players in the game". An institution is an equilibrium of actors' strategies that arises out of the strategic interaction among actors in the analytical scope, the equilibrium being a Nash equilibrium where no actors have the incentives to change strategies. (Aoki forthcoming; Calvert 1995; Greif, Milgrom, and Weingast 1994)

As we are interested in how institutions change, we adhere to the third view, the "equilibrium" approach: this provides a better way to conceptualize the formation of "rules of the game" within the analysis, than the "rules-of-the-game" approach that leaves out the formation of the rules. Among the "equilibrium" approaches, there have been studies which relax the assumptions (complete information / perfect rationality) associated with classic game theory through such theoretical frameworks as sub-game perfect and evolutionary game theory.[4] As seen in Chapter 2, we find the existing rational choice analysis of Japanese politics wanting, in their excessive emphasis of formal "rules-of-the-game" such as constitutions and electoral laws: we need to move beyond, to incorporate the informal interaction patterns of actors in the analysis and the collective perceptions about how formal rules and informal interaction patterns are governed. Thus, our research adopts the definition of institutions from the comparative institutional analysis (CIA) perspectives developed by Aoki (forthcoming), which conceptualizes institutions in terms of shared expectations.[5] Institutions can be seen as *"shared, stable, summarized expectations about how the world works, which may not be unique"*.[6] Institutions are "shared expectations" about the state of the world, coming to be taken for granted due to the "stable" reproduction over time. Institutions convey "summarized", or compressed, information to subjectively rational actors engaging in strategic behavior.[7] "How the world works" represents the rules that inform the actors about the consequences of one's action under the strategic interaction of actors. "Which may not be unique" signifies the possibility of multiple equilibria, where there may be two or more possible equilibria, which may or may not be Pareto-rankable.[8]

In this definition, an institution is based on a feedback between the objective and subjective worlds. An institution is a) an equilibrium that arises from the repeated, strategic interaction of actors in the objective world, as well as b) a summary representation of such an equilibrium that is collectively shared by actors as subjective beliefs: a feedback mechanism between the two makes institutions self-sustaining. Actors observe the equilibrium in the objective world, and being subjectively rational, compress it into some expectations about "how the world works" (e.g. "If actor A takes action X, then actor B will take action Y"). Such rules come to be collectively shared by all actors as the representation of the objective world, as they are repeatedly validated by the stable equilibrium, which is, in fact, the same strategic interaction being reproduced over and over.

This definition of institutions gives rise to four observations. First, under our definition, codified forms of "rule of the games" (e.g. contract, routine, operational procedure) are representations of the existing shared beliefs about "how the world works". Thus, such representations (e.g. law, routine, operating procedure) are institutions only if actors believe them to be effective representations about "how the world works". Second, uncodified practices can be institutions if such practices are consistently reproduced over time and come to be perceived as such. In Aoki's terms, such practices remain institutions "as long as the agents believe in them as relevant representations" of how the world works.[9]

Third, once the existence of an institution is conceptualized and the actors become aware of it, then the new concept itself acts as a symbol (or a "focal point") to facilitate the reinforcement of the actors' shared beliefs in the institution as a representation of "how the world works". Examples include ideology (e.g. militant nationalism in Japan of the 1930s) and historical tradition (e.g. social systems in pre-modern Japan invoked in reference to the "Japanese Economic Model" of the 1980s).

Fourth and last, the shared expectations, at the bottom of the institution, may be characterized as the expectations of actors based on the stable reproduction of the observable feature of the institution ("what will happen"); they may also be seen as the normative values (or priority) that actors come to hold, based on these expectations ("what should happen"). That a set of shared expectations formed through what started as purely an economic practice acquires a normative character after a stable reproduction over time may not be seen in other cases such as lifetime employment in Japan. Though the practice may be of recent origin (i.e. the 1930s), it heavily constrains the employer's ability to fire employees as stipulated in labor contracts, as the shared expectations give rise to widespread social condemnations.[10]

2) Institutional Complementarity

An institution has an institutional environment in the sense that the strategic interaction of actors out of which the institution arises (hereafter referred as "institutional field") takes place within different institutional fields that surround the process: there are institutions that surround the particular institution in question.[11] Institutional complementarity arises in cases where actors see their institutional environments as "parameters" beyond their control.[12] At the objective level, actors in one institutional field affect the institutional environments as well as being constrained by them: however, actors only identify the latter, due to bounded rationality in face of the complex world, and conceive them to be "parameters" affecting the institutional field in question. This may give rise to an interdependence among institutions: an institution may become viable, given the existence of other institutions in other institutional fields, and vice versa.

When does this kind of situation arise? This has to do with the multiplicity of institutions: as defined earlier, there may be many possible institutions (as Nash equilibria). Such possible institutions may be either Pareto-rankable (superior or inferior: all actors may be better or worse off in one or another) or not (some actors prefer one, while others prefer another). Likewise, among institutions, there may be multiple viable (possible) institutional arrangements: some may be Pareto-rankable, and others may be not.

Aoki (forthcoming) shows that institutional complementarity gives rise to such multiple, viable institutional arrangements. Institutional complementarity is a situation that occurs in two (or more) institutions, in which a specific condition ("super modularity") — which obtains regarding the relative preferences of actors in one particular field given the existence of an institution in other fields (and vice versa) — gives rise to multiple possible institutional arrangements.[13] Such multiple institutional arrangements may or may not be Pareto- rankable. Even if there may be a Pareto-superior (i.e. every actor would be better off) institutional arrangement, a development of one particular institution in a field for historical reasons and its adoption as an institutional environment by actors in other fields may explain the stability of Pareto sub-optimal institutional arrangements over time. Or, the institutional arrangements may not be Pareto-rankable in that some actors may prefer the status quo while others would prefer the new institution.

The presence of institutional complementarity, or the links among institutions that make Pareto sub-optimal institutional arrangements viable, gives rise to the following observations regarding stability and change in institutions. On one hand, this concept sheds light on the stable reproduction of such Pareto sub-optimal institutional arrangements. Because there are other institutions that exist given the existence of one institution, that particular institution becomes less likely to change, and vice versa: institutional arrangements tend to be "sticky" over time. On the other hand, once the environment (including the institutional environment) drastically changes to bring changes in one institution, overcoming such bias towards stability, then, the altered state of one institution should start a chain reaction to other institutions, possibly leading to an emergence of a new institutional arrangement.

3) Institutional Change[14]

In our definition, an institution is an equilibrium and an effective representation of it only if the actors believe it to be as such. Thus, regardless of whether institutional change takes place by conscious design (e.g. by the legislature or other rule-making actors at the core of the institutions) or by decentralized experiments (e.g. by policy entrepreneurs operating at the margins of the institutions), our study focuses on the shift of collective beliefs at a critical mass, the fundamental trait shared by both patterns of institutional change.

Institutions show robustness to minor deviants, as long as the current strategies bring about satisfactory results and such deviations do not result in markedly better outcomes: adjustments can be made at the margins to incorporate any minor, yet successful deviant strategies. However, if some kinds of environmental changes drastically alter the objective world, this may undermine the effectiveness of the "institution as a summary representation of how the world works" (in Aoki's terms, resulting in a "perceptual crisis"). For example, technological innovation may make new actions feasible or alter the consequences of the same action. A crisis due to such causes as war, famine, foreign competition, or demographic change may threaten the survival of a nation, in which all actors come to realize the need for drastically improving their performance (creating a "window of opportunity"). Or, the accumulation of the interaction among actors may bring about a crisis (e.g. drastic distributional differences). The institutional environment may undergo a shift due to external shocks, triggering institutional change.

As misalignment between the objective reality and the subjective representation of "how the world works" emerges due to environmental changes, more actors begin to doubt the effectiveness of the "institution-as-summary-representation". This doubt — the institution is not "taken for granted" any more — encourages the experimentation of alternative strategies that diverge from what is prescribed by the institution. Once such strategies are rewarded by success, such practice becomes emulated by other actors, increasing the prominence of such strategies. A new institution emerges when a critical mass of agents shift their views on "how the world works" to a new one, which comes to be collectively shared, taken for granted, and perceived to yield expected results.

In this process, as was the case in the sustenance of the institution, symbols (or "focal point") facilitate the convergence of the actors' beliefs as the optimal alternatives. Examples include ideology (e.g. the role of communism in the Russian Revolution; the role of democratic ideals in bringing down the socialist regimes of Eastern Europe), historical tradition (e.g. the images of Czarist Russia or eighteenth - century Poland invoked in the demise of the respective socialist regimes), and foreign practice (e.g. the "third wave of democratization" [Huntington 1991] since the 1970s).

3.3 Our Theoretical Framework of Institutional Change

The above framework addresses this oft-asked question of how institutional change happens despite the "stickiness" of political and economic institutions. After all, political and economic institutions are known to be "sticky", partly because of stable reproduction over time (as in above), but also because the powerful actors who benefit from the status quo are often positioned in privileged positions to prevent unwanted changes to happen (e.g. "entrenched state actors"). Yet, in institutional change, such stickiness, including this political bias towards the status quo, is overcome by the arrival of new collective perceptions about how the world works. This takes place through the "evolutionary selection mechanism" which rewards successful strategies (with respect to the objective world) and results in reproduction at the population level. However, our analytical focus on the strategic interaction of actors in the domestic political economy leads us to ask another question: how does this evolutionary mechanism work in the political economy? As mentioned above, privileged actors preferring the status quo could interfere in the process, hindering the evolutionary mechanism. The "victory" of the alternative strategies is not guaranteed beforehand (we may observe it *ex post*, but not *ex ante*). We can easily see that a political conflict would take place between those preferring the status quo and those experimenting with alternative strategies. How does this process translate into our analytical focus, the politics of — or the distributional conflicts that arise around — institutional change? What are the conditions for the "victory" of the alternative strategies over the old ones and the concomitant rise of the new institution?

Thus, how institutional change materializes, especially its evolutionary selection process, needs to be further specified: it ought to be linked to the discussion of power and interest of the actors. To this goal, we develop our own theoretical framework of institutional change in political economy, building on the concepts provided in the last section. Although the framework is developed in the efforts to explain the institutional change in Japan of the 1990s, the following is an effort to set up a general framework, potentially applicable to other cases of institutional change in general.[15]

By projecting our interest in the political conflicts among actors onto this process of evolutionary selection, we ask two questions: 1) What makes actors re-examine their strategies, and where does that come from? 2) How does the process of competition of the "institutions" work, and what decides which side "wins"? A summary of our framework follows.

1) Sources That Make Actors' Re-examine Their Strategies

In the above framework, it is the misalignment between the objective reality and the subjective perceptions that make actors re-examine their strategies. How does such a misalignment happen? The above framework suggests that it is through exogenous shocks (e.g. technological innovation), accumulation of endogenous interaction (e.g. a huge distributional inequality), or change in the institutional environment. However, if such shocks were quickly accommodated by changes in institutions, then, such misalignment would not happen: we would be looking at the stickiness of institutions. As mentioned earlier, institutions are sticky for various reasons (e.g. "entrenched actors", "inertia", and "sunk cost"). Thus, we may expect a gap to be formed between the speed of environmental changes and the pace of adaptation of institutions. This gap can be characterized as "failures": the institutions do not prescribe the strategies that yield expected results given the objective (i.e., exogenously determined) constraint. Failures can appear in the form of "performance failures", where actors cannot yield expected results: in the political economy, we may think of such criteria as economic growth, production volume, profit, and political stability. Alternately, failures may emerge as "scandals", or incidents in which actors' real behavior is exposed to be divergent from what is expected of by the institution.

Laws, by being infringed upon, provide an important source of scandals: however, it may be that such a breach occurs because there are large gaps between what is prescribed by the laws and what is taking place in the real world (e.g. the recurrent scandals of political financing in Japan, Italy, or Germany), the latter being the real "institution" in our definition. An even more important source of scandals may be social standards: what the public collectively thinks is right or wrong. For example, in the Loss Compensation scandals of Japan in the early 1990s where securities firms implicitly offered the guarantee of loss compensation to some of their clients, the top management of many firms which had been compensated for their losses were forced to resign: the reason was not so much the breach of law (as it was not, at that time) than the social resentment against the favorable treatment of some influential actors over the public. (See Chapter 6.)

Performance failures and scandals often appear hand-in-hand. Performance failures lead the actors to question the "taken for granted" aspect of the institutions. Scandals can accelerate this erosion in the collective beliefs in the institutions by providing the symbols (focal points) for alternative strategies. When things are going well (e.g. the Japanese economy of the late 1980s; the Asian economies of the early 1990s, the U.S. economy of the late 1990s), scandals tend not to surface; even if they do, they are not seen to express the pathology of the institutional arrangements of the economy (e.g. "first-rate economics and third-rate politics", a cliché representing the collective beliefs of the 1980s that the trouble only lies in politics[16]). However, once things start to "fall apart" (e.g. the Japanese economy of the 1990s; the Asian economies after 1997) in terms of economic growth, inflation, unemployment, political stability and other measures of performance, such scandals increasingly become salient in that they provide the symbols (or focal points) for views that question the "taken for granted" aspect of the institutions. Unless such structural factors ("performance failures") exist, such scandals by themselves can hardly be expected to be of material importance (e.g. East Asia before and after the crash of 1997-98): scandals by themselves are hardly sufficient to cause the shift in collective beliefs about institutions.

However, with the existence of such "performance failures", we may expect the recurrence of such scandals, which accelerate the process of the erosion of the collective beliefs in the institutions: actors are increasingly led to believe that "something is wrong" in the institutions by the combination of performance failures and scandals. In this way, failures — or performance failures and scandals— shake up the actors' beliefs in the institution as an effective representation of "how the world works" and as a device that tells actors which strategies to choose.

2) The Mechanism of Evolutionary Selection

In the above framework, the dynamics of evolutionary selection rewards the "best response" strategy, and the share of that strategy in the population increases as its success leads other actors to emulate it. However, this characterization bears an "auto-pilot" flavor: how the process relates to the political struggle of actors needs to be further specified, if we are to identify any signs of "institutional change" *ex ante*, in the hopes of offering clues for prediction.

Let us start from the "performance failures and scandals", which lead some actors to re-think about "how the world works" and adopt alternative strategies. A competition between two (or more) sets of strategies arises: the one is prescribed by the "institution", dominantly observed in the population, and the rest are "alternative" strategies, adopted by a very few "mavericks". At this point, "institutional change" cannot be said to have taken place: institutions are resilient to minor deviation. There may be attempts to change: however, if they fail, institutional change cannot be observed *ex post*, and institutions persist. On the other hand, if the alternative strategies of the first "mavericks" succeed, the share of such strategies in the population increases. Once a critical mass of the actors adopt the strategies and accept the new views about "how the world works", we call it "institutional change".[17] What decides which strategy wins? In the failed attempts, what makes them fail? How does the experimentation (or mutation or mistake) become a minority, and then dominant, and thus part of the new shared perceptions about "how the world works"?

Here is where the political struggle comes in. Exogenous conditions (e.g. technological innovation, crisis, change in institutional environment) may dictate which side ultimately wins or loses by determining how successful each strategy becomes. Yet, we may be better able to know how this process works by looking at the following two concerns: a) what differentiates actors' strategies; and b) the pattern of coalition formation. Below, let us, for the sake of simplicity, suppose that there are two sets of institutions, the status quo (α) and the alternative (β),and that the population is composed of two sets of actors, the insiders (I), or actors with privileged positions in the institution (e.g. entry point in the political process), and the outsiders (O), or actors without resources in the institution. At the starting point, the equilibrium is α: every actor prefers this institution (by definition, an institution is a Nash equilibrium). We call those who prefer α "conservatives", and those who prefer β "reformers". Thus, all actors start as "conservatives".

a) What Differentiates Actors' Strategies?

We may posit two possibly divergent concerns that drive the change of strategy for actors: first, the interpretation of the development can be either "resilience" (i.e. return to the status quo) or "change" (i.e. this is an institutional change), and second, the distributional effect of the institutional change may lead the actors to prefer either α (status quo) or β (alternative), depending on whether the institutional change is Pareto-rankable. Note that the first concern affects the second: if one thinks that "change" is happening due to exogenous developments and/or adaptation of other actors, one is more likely to shift preferences from α to β. Institutional change (the shift from α to β) may or may not have distributional effects: if α and β are not Pareto-rankable, then α may be beneficial to some, while β may be beneficial to others, however, if they are Pareto-rankable (e.g. the shift from α to β is beneficial to both A and B), the shift is not constrained by the political struggles between A and B.

Suppose nature "moves", and some environmental changes identified in the framework in the previous section happen to shake the "taken for granted" aspect of the institution. Now, α holds dominantly with some scattered observation of β in the population: some "mavericks" start to experiment with alternative strategies, joining the ranks of "reformers". Such developments are likely to be suppressed by the "conservatives": the political struggle between the two groups is part of the process of institutional change. If such efforts to suppress succeed, we are seeing "institutional resilience", another possibility in the process.

In this process, symbols (focal points) invoked by actors often enhance the legitimacy of their views about "how the world works", both for continuity and change. History, or common historical experience, can be both a source for conservatism and reforms (e.g. patriotic wars, imperial past). Successful foreign practice may call for emulation at home or justify the preservation of the existing practice (e.g. a well-functioning capitalist democracy today; a socialist system with five-year plans in the 1930s). Ideology may furnish another focal point to "show the way" to actors (e.g. communism, democracy). Leadership or personal charisma may come to provide symbols for both continuity and change (e.g. Mao in post-1949 China for continuity; Mao in pre-WWII China for change).

b) Pattern of Coalition Formation

Thus, we may see a struggle between two or more coalitions in the process of institutional change. How does this process work? The distinction between "outsiders" and "insiders" may be helpful here: in the above, "outsiders" are more likely to become "reformers" than "insiders" all else being equal, as the former have fewer stakes in preserving the status quo. There are two patterns in which the "conservatives" may be displaced: "counter-coalition" or "defection". "Counter-coalition" is a scenario in which the outsiders turned into "reformers" form a coalition among themselves against the insiders or "conservatives", while "defection" is one in which some among the insiders defect to become "reformers" and band together against the remaining insiders or "conservatives".

To relate these concepts to real world examples in political economy, we may think of revolutions and regime changes "from outside" and "from within". Counter-coalition can be found in the Russian Revolution, which may be marked by the emergence of "outsiders" with different strategies, or the Bolsheviks. On the other hand, defection may be found in many instances of democratization in Latin America and Southern Europe since the 1970s. In the latter, due to some exogenous changes (e.g. democratization in other countries; lost war; economic depression), a "split between the hard liners and the soft liners" within the ruling elites appeared in authoritarian regimes at the start of the democratization. (O'Donnell and Schmitter 1986) Or, in our language, some among the "insiders" started to adopt different strategies. (Later on, we will come back to these concepts, using them to project possible scenarios of financial reforms.)

3) Summary: Our Theoretical Framework of Institutional Change

Institutional change is essentially a shift in shared perceptions about "how the world works" through a collective learning process based on an evolutionary selection mechanism of strategies derived from the actors' subjective beliefs about "how the world works". It is caused by the gap between the faster pace of environmental changes (including the institutional environment) and the slower pace of adaptation in domestic political and economic institutions. This gap appears in the form of "failures", or "performance failures" and "scandals", which lead actors to question the "taken for granted" aspect of the institutions. "Nature" — environmental changes in technology or institutional environment— eventually determines the outcome of the competition of the institutions by rewarding various strategies of actors: the successful strategies will increase in the population. Yet, political struggle takes place between those actors who see the process as "resilience" of the institutions and/or have stakes in preserving the status quo on one hand, and those actors who see that "change" is taking place and/or see enhanced interests in the new institutions: the distributional concerns of the institutional change comes in only when the old and new institutions are not Pareto-rankable. This political struggle is facilitated by symbols derived from such sources as history, foreign practice, ideology, and leadership. In the process, how the "conservatives" are displaced by "reformers" may be either "counter-coalition" (from outside) or "defection" (from within). When a critical mass of the agents shift their views about "how the world works" and the new institutions become "taken for granted", we call it "institutional change". Institutional complementarity often makes institutional change in one institutional field difficult; however, once such change happens in one institution, it is likely that the institutions in its environment will be forced to be re-assessed by the actors, thus starting a chain reaction of change.

Fig. 3.1 summarizes the theoretical framework of institutional change as presented in this section. Note that the whole process of institutional change can be reversed at any point in the process. Once "failures" appear, the shared expectations about "how the world works" come to be increasingly questioned by "mavericks": we may refer to this situation as the "decay" of the institution, where more and more actors conclude that "something is not right". However, if "nature" signals the return to the status quo or if the "conservatives" crush the few "mavericks", this "decay" may be halted: this would be another instance of "institutional resilience", where the institution shows its robustness against minor deviations.

Fig. 3.1
Theoretical Framework of Institutional Change in the Political Economy

Environmental changes (e.g. technological innovation, global integration)
Change in institutional environment (e.g. international political situation)
Crisis (e.g. war, famine, demographic crisis)
Faster pace of exogenous developments

→

Slower pace of institutional adaptation
Sticky domestic political and economic institutions
(because of inertia, distributional reasons)

→

Gap = "Failures" = "Performance failures and scandals"
(e.g. slump in economic, financial, and political performance, reinforced by the recurrence of scandals)

→

Decay: "Something is not right"
The rise of "mavericks" doubting the "institution" and experimenting with alternative strategies (through centralized legislation or decentralized experimentation)

→

Struggle between the "conservatives" and "reformers"
1) perception ("resilience" or "change"?)
2) distributional preferences ("status quo" or "alternative"?)

→

Nature (environmental changes, change in institutional environment) rewards the various strategies, determining which institutions win the competition. The actors repeatedly revise their strategies according to their observation through a feedback mechanism between the objective reality (how these strategies work) and the subjective perceptions about "how the world works"

→

Institutional Change (scenario 1)
Enough objective reality supports the alternative strategies derived from the new subjective notion about "how the world works". A shift in the actors' collective notion of "how the world works" takes place. A new institution "taken for granted" is in place.

Two patterns of displacement of "conservatives"
1) counter-coalition (from outside: "outsiders" displace "insiders")
2) defection (from within: defecting "insiders" displace the remaining "insiders")

Note:
At any stage before institutional change materializes, there is a possibility for
Institutional Resilience (scenario 2)
to take place, demonstrating the robustness of institutions to deviation once again.

3.4 Organizational Survival

By further examining how "defection" works in our framework of institutional change, we may capture the dynamics at work concerning the "entrenched actors" (the "insiders" in our terminology) and "organizational survival". The entrenched actors (e.g. the LDP in Japan) are conventionally expected to be the jealous guardians of their secured interests under the status quo, and thus are often assumed to be inimical to institutional change. However, they may not be as "entrenched" as they often appear to be: some among them may adopt alternative strategies as a result of re-evaluation based on the altered situation (e.g. changing environment and shift in the distribution of the strategies adopted by the population), and become "reformers". In other words, a stable reproduction of strategies by some actors with privileged positions in one institutional arrangement does not prohibit such actors from becoming the "reformers" later on: the only thing that makes them likely to be "entrenched" is that they have "more things to lose", with their privileged positions in the status quo. Thus, we may expect "entrenched" actors to be slower in joining the camp of the "reformers", *ceteris paribus*. However, this does not preclude the possibility that some among the actors who used to be the guardian of the old institutional arrangements become strong proponents of institutional change.

Taking the process of institutional change into the sub-organizational level, or within organizational actors (e.g. political party, bureaucracy), we may project a framework of evolutionary selection mechanism of organizational strategy for survival. At the starting point, under a stable institution, all the actors (i.e., individual members of the organization) are "conservatives". However, "nature" moves: environmental changes happen to give rise to alternative strategies, which increase in the population. At this point, a "split" appears within the organization: a conflict takes place between two sets of sub-organizational actors, each side seeking to maximize the prospect for organizational survival according to its own views about "how the world works" and/or according to its own interests.

On one hand, the "conservatives" would see the process as one in which the institution in question shows resilience, and may also have their own stakes in the preservation of the institution: thus, their prescription for the organization would be to adopt the same strategy as in the past. The "conservatives" would tend to group those who have large stakes to lose: the "insiders" within the organization, or with more power resources within the organization, are expected to be on this side on the whole. The "reformers", on the other hand, see the process as one in which the institution is changing due to environmental changes: thus, they recommend the organization to change strategies to adapt to the new institution, or even participate in creating one. The "reformers" may have gains to be made in the new institutions: thus, this group would tend to comprise those more on the margin rather than the center of the power structure of the organization.

Both sides would recommend the strategy that they think increases the prospect for organizational survival, the "ultimate" goal shared by all actors. "Nature" (technological constraints and changes in institutional environment) moves and rewards either one of the strategy: all actors, observing which strategy works better to the goal of survival, revise their views accordingly. Through this reiterated process, either "conservatives" or "reformers" emerge as winner of the selection mechanism, having command over the organizational strategy.

The above framework will be utilized in Chapter 5. Based on our discussion on the preferences of actors, we will start from a framework of political actors (political parties and bureaucratic agencies) pursuing organizational survival through maximization of "constituencies interest" and "public interest". We will see how the loss of public support drove the politicians and the bureaucrats to engage in a complex strategic interaction, involving competition, cooperation, and conflict with each other.

3.5 State Actors (1) — Political Parties

We now turn to a discussion of actors in Japanese politics. Four sets of actors emerge: political parties, followed by bureaucratic agencies, firms and interest groups, and the public. We distinguish state actors, politicians and bureaucrats, equipped with direct access to public policy tools (laws and administrative tools) to influence the private sector, from societal actors, firms and interest groups as well as the public, who influence state actors to obtain preferred policies. As for state actors, we start from a Downsian assumption that "every government seeks to maximize political support." (Downs 1957, 11) However, we see two sets of state actors instead of Downs' focus on political parties as "government": politicians and bureaucrats. Expanding the framework of "bureaupluralism" of Aoki (1988) to incorporate both politicians and bureaucrats, in our framework, state actors seek to maximize political support from two sources, the constituencies and the general public. In the following four sections, the goals of each set of actors will be derived from a discussion of their behavioral regularities in the context of Japanese political economy. For the state actors (politicians and bureaucrats), the sources of political support will be discussed as well.

Politics in postwar Japan has been characterized by the dominance of one party, the Liberal Democratic Party (LDP), a conservative party which has been continuously in power since its formation in 1955. This lasted until 1993, when a defection of some of its lawmakers concerning the issue of electoral reforms over the introduction of a single-member district (SMD) prior to the Lower House elections, led to an eight-party non-LDP coalition government.[18] However, the coalition broke down in 1994 with the defection of the Socialist Party of Japan (the Social Democratic Party of Japan after January 1996 [SPJ; SDPJ]) and the Sakigake Party. A coalition government centering around the LDP has ruled Japan since 1994. The Socialists and the Sakigake Party were the members of the LDP-led coalition government between 1994 and 1998. The first Socialist Prime Minister since 1947, Tomiichi Murayama was in office from 1994 to January 1996, as the policy package dealing with the Housing Loan Affairs was about to reach the Diet and our account of the Japanese Financial Big Bang began. Ryutaro Hashimoto from the LDP succeeded him, and presided over the passing of the Housing Loan Affairs bills and the Big Bang initiative (see Chapter 5).[19]

To cope with the above political process of the 1990s, we start from the assumption that organizations seek survival. When applied to the political parties, this translates to the following: "political parties pursue maximization of electoral seats".[20] Political parties in a liberal democracy are basically competing against each other to maximize their political influence, which is exercised through their presence in the Diet, the Japanese bicameral parliament.[21] While early observations on Japanese politics may have questioned whether a true inter-party competition existed in Japan under the dominance of the LDP, we have the benefit of being able to observe the development of the 1990s, where party alignment has constantly shifted as noted above, and are thus confident that "competition" holds for Japanese politics of at least the 1990s, if not for the whole postwar era.[22]

Political parties can maximize their chance of organizational survival by winning elections.[23] A withering political party with fewer electoral seats cannot be expected to wield power; at its worst, it must fear extinction.[24] Our assumption of organizational survival through electoral seats maximization is based upon the behavioral goals of the individual politicians, who are assumed to pursue their own reelections.

Our analysis mostly focuses on the LDP for the following reasons. First, the LDP has been the largest and most influential party throughout the 1990s, whether in power or in opposition, as in the past. Reflecting its long dominance, the interaction between the government and the private sector in the Japanese political economy has largely come to be structured around this party. Second, the LDP has been in power throughout our analytical time frame (1995-1998); it can be said that it has been in power for more than forty years in the past except for a short interval of less than a year. This is not to say that the LDP saw its chance of electoral survival unaffected by party competition: we will see that the LDP was threatened by its rival parties in the period of our analysis of the 1990s.

The non-LDP parties, those in coalition and in opposition, will be discussed as they come in the political process. The coalition parties are obviously important in influencing policy outcomes, as they are incorporated in the policy making process (or the process in which a legislative proposal passes through the public policy making bodies of the bureaucracy and the ruling parties before it reaches the Diet: see below). The opposition parties are basically excluded from the policy making process, and can participate in the decision making only after the bills reach the Diet; under a parliamentary democracy with strong party discipline as in Japan, the opposition can hardly affect the bills through votes, unless they resort to some kind of boycott (e.g. refusal to attend the Diet deliberation, refusal to move to vote, and delaying tactics).[25] However, opposition parties can have a significant role in the policy making process if the LDP loses its majority in the Upper House. When the control of the Lower House and the Upper House belong to a different party (or coalition), the one which controls the Lower House will be in power, by electing the Prime Minister; however, the opposition will have increased access to political decision-making, as those in power need to compromise if they wish to pass their proposals.[26]

What do parties need to maximize their goal of organizational survival through electoral victory? There are two kinds of resources: votes and money. Who provide these essential resources? There are two sources: the constituencies and the public. The constituencies, or the interest groups, provide blocks of votes (e.g. agriculture; labor unions) and/or campaign contribution (e.g. labor unions; large firms grouped into pro-business groups and industrial associations). To those in power, the constituencies may request particularistic favors (e.g. budget measures; regulatory protection) in exchange. Alternately, their support may be untied to a specific policy but to a more general platform (e.g. pro-business as opposed to pro-labor). The public vote in the elections, not so much in anticipation of a special policy favor, but more on general policy concerns (e.g. overall economic health; pollution): their support can be characterized as "generalized voter support".[27]

3.6 State Actors (2) — Bureaucratic Agencies

The Japanese bureaucracy has had an important political role in postwar Japan. Especially since 1955, under the LDP one-party dominance, such bureaucratic agencies as the Ministry of International Trade and Industry (MITI) or the Ministry of Finance (MOF) wielded considerable influence over economic policy decisions, as observed by many theorists.[28] As mentioned in Chapter 2, we are interested not so much in whether the politicians or the bureaucrats dominate the policy making process than in the pattern of their interaction. As dominance fails to capture an important aspect of political interaction, both actors matter in our theoretical framework, as the two actors, or the state actors, are the only ones with direct access to the exercise of governmental power through legislation and its administrative execution.

What do bureaucratic agencies pursue? There may be many ways to characterize their behavioral goals, according to the theorist's taste and cases of interest. For example, some say budget maximization (Niskanen 1971) and others say revenue maximization (Brennan and Buchanan 1980). In works on Japanese politics, Ramseyer and Rosenbluth (1993, 99-120) argue that the bureaucrats seek to please their political masters, who have veto power, alternative sources of information, and control over their individual career (promotion and retirement). Kato (1994) starts from a maximization of discretionary power in her study of tax politics in Japan.[29] Vogel (1996) sees a "regime orientation" toward maximization of regulatory control to be prevalent among Japanese bureaucrats.[30]

However, the empirical validity of such behavioral assumptions needs to be justified against the reality they seek to explain. In this regard, the above assumptions leave much to be desired, when contrasted to the reality of Japanese politics and our case of the politics of financial reforms. First, the assumptions of "pleasing their political masters" assume away the potential conflicts which may arise between the bureaucrats and the politicians: that politicians have the ultimate veto power does not necessarily guarantee that they can use it at their will because of many constraints (social, political, etc.). When one thinks of many past instances in which political initiatives were successfully stymied, if not frustrated (e.g. administrative reforms of the past), it becomes clear that such an approach leaves out a large number of important instances.[31] Second, as for the rest, or the assumptions of maximization of tokens of organizational power — such as budget, revenue, discretionary power, or regulatory control — may be leaving out the cases in which the bureaucrats see it in their interest to oppose the increase of such tokens (e.g. bureaucrats opposing a military budget increase decided by the legislature) or to actively reduce them (e.g. bureaucrats willingly taking regulatory barriers off). Such instances cannot happen in the world recreated by the theorists adopting such assumptions: regarding regulatory reforms, when regulatory control or discretionary power is reduced, this would mean that either the politicians or the interest groups got the upper hand over the resisting (or acquiescing) bureaucrats.

Indeed, the above considerations are plausible goals for bureaucratic agencies to pursue.[32] However, it may well be that actors have priorities: there are ones that are more important than others. In this sense, the above theorists may be missing the more fundamental goal. We introduce, again, the assumption of organizational survival: *the Japanese bureaucrats pursue the organizational survival, or maximization of organizational prestige, of their agencies more than anything, given their incentive structures set forth by the institutional settings in which they operate.* Let us see how this can be derived below. We contrast our approach against those stressing the bureaucratic maximization of tokens of organizational power: in the context of regulatory reforms, we call such act a maximization of "regulatory power" (as measured by jurisdiction and discretion).

It is well understood that the individual incentives for bureaucrats may consist of many things: promotion, job security, political influence, social status, and material gains may be some of the considerations. As Amyx (1998) has shown in her study of MOF's internal organization, the personnel system is structured in such a way that the job promotion serves as a proxy for all these individual incentives into one. The personnel system is based on continued employment from right after university graduation until the *de facto* forced retirement around thirty years later: the officials basically stay under the control of one ministry, while they may be temporarily assigned to positions in other agencies throughout their career. It is a combination of seniority rule and meritocratic competition: those who joined the Ministry in the same year ("peers") get promoted basically at the same speed; however, whether one reaches a higher rank in the bureaucracy usually depends on how well one does in the earlier competition among peers.[33] While the rank and salary of each job does not differ from one another among peers, the status and power attached to each assignment differs based on one's reputation within the organization. In the second stage in their career, the bureaucrats would go on to assume positions in the private sector or public corporations, related to the agency: this practice has been referred as *amakudari*, or "descent from heaven". Again, it is known that the position in the second stage depends on how far one reaches the bureaucratic ladder: the higher in the bureaucracy, the higher in retirement.[34] Given the personnel structure, competition among peers for promotion is very fierce. Through this process, "loyalty to one's agency is inculcated and takes priority". (Pempel and Muramatsu 1995, 49) Thus, the personnel system serves to ensure that those who seek to enhance the organizational interests are selected for higher positions, occupying the mainstream of the agency.

Thus, promotion works to integrate individual incentives to organizational goals: how does this work to make organizational survival the top priority? Again, there may be many possible goals for the organization. On one hand, officials may wish to keep their regulatory power. As long as one's continued employment is incorporated in the expectations of the individual bureaucrats, they have reasons to wish that *amakudari* will be maintained, as they consider their second career. One of the reasons that firms receive retired officials is that they may expect a favorable treatment (e.g. better access to information) from the regulators. Thus, officials are likely to see their stakes in protecting the regulatory control or discretionary power over the industries, which basically generate the demands for retirement positions.

On the other hand, social status as well as political influence of the agency at the levels of shared expectations among all actors (i.e. in the nation) may also be important goals to pursue, given the uncertain future of their individual promotion: the pursuit of such intangible resources, or "prestige", may be an important goal as well. Those with lower stakes in the retirement market (e.g. due to future uncertainty), may care little about regulatory control. The maintenance or enhancement of the agency's prestige, a function of how all actors in the nation perceive the agency, may matter more than such quantifiable or tangible measures as budget, jurisdiction, or regulatory power, especially as uncertainty about the future increases (e.g. What happens if there is less possibility of internal promotion or *amakudari* in the future?).

While these goals often go hand-in-hand, there may be situations in which "maximization of regulatory power" and "maximization of prestige" do not coincide with each other. That such instances may occur can be easily seen by imagining a situation in which regulation comes to be seen by all actors as hampering the "public interest" due to changes in trends in economic thoughts. Which one is the overriding goal? We may see that the latter is, as this goal is crucial even for those who are concerned about regulatory power. The agency's ability to influence the private sector is not solely determined by the regulatory power the former possesses: that the agency commands high prestige, enjoying influence over other actors is also important. Otherwise, the industries will see that having access to a weakened agency may not be worth the financial costs of receiving a retired official, and the power (including of material benefit) that the retired officials enjoy are likely to be negatively affected.[35]

Thus, we take the latter to be the goals that bureaucrats pursue, defining them to be "organizational survival". Organizational survival of a bureaucratic agency is the maintenance or enhancement of the agency's presence in politics, economics, and society, not necessarily measured by tangible tokens of organizational power, but in terms of its prestige, or the social status and political influence that the agency enjoys vis-à-vis other actors (e.g. political parties, firms, and the public) in the nation.

This distinction of "prestige" from "power" corresponds to our emphasis upon "shared expectations" over "formal rules" in our theoretical framework of institutional change, presented later in this chapter.[36] In line with the above, organizational survival, or the maximization of prestige (shared expectations), matters more than the preservation/ maximization of the organizational integrity, or the organizational form of the bureaucracy and its jurisdiction as defined by the legal statutes (formal rules).

The concern for organizational survival centers around the prestige that the agency commands: whether an agency remains one, is split into two, or is consolidated with other agencies may or may not matter in this regard. Given the institutional settings of the Japanese bureaucracy, in which continued employment of officials under one agency's personnel management obtains, the bureaucrats are likely to resist a downward pressure on the organizational form, such as the split into two (or more) of their agency: however, we may reinterpret this resistance not so much in the loss of organizational integrity but more for the attempt on the agency's prestige (as in MOF's case in Chapter 5). There may be cases in which bureaucrats see gains to be obtained by sacrificing organizational integrity: for example, an agency may be willing to sacrifice its organizational integrity to capture a more strategic position (and thus prestige) in the government. An increase in jurisdiction may be welcome in general for bureaucrats; however, a consolidation of multiple agencies into one may mean that the officials have to compete against an increased pool of candidates for higher positions. On the other hand, if those in an agency are confident of capturing a strategic position and of taking the initiative in the new consolidated agency, they may be willing to shed the organizational integrity of their agency.[37]

There are many possible ways to criticize empirical assumptions: no doubt, our assumptions may not be able to capture moments in which the bureaucrats sacrifice organizational survival for other goals identified by others. As mentioned above, all such goals are plausible, based on observed regularities. However, the point here is to ask when goals conflict with each other, which one the bureaucrats are likely to choose. Would "budget", "revenue", "regulatory control", "satisfaction of political masters" or "discretionary power" be chosen over "organizational survival (or maximization of organizational prestige)"? The above discussion as well as the empirical narratives provided in the later chapters strongly suggest that our position can be successfully defended against rival positions.

Lastly, what do bureaucratic agencies pursue in order to secure the survival of their organization? Although the bureaucrats do not pursue votes and money as political parties do, we may be able to identify the same two sets of interests, following the framework of "bureaupluralism" as developed by Aoki (1988): the constituencies and the public.[38] One set would be that of the jurisdictional constituents which provide goods and services to the bureaucracy. The regulated industries provide valuable information, cooperation to administrative measures, and retirement positions to the bureaucratic agencies (see below). The other set of interests that the political actors need to satisfy is that of the general public: the reputation among the general public is also a determinant of the chance of the actors' survival. By demonstrating their positive contribution to the nation, the bureaucratic agencies can expect better acceptance for their policy measures, maximize the status they enjoy in the society, and hence secure the prospect of continued existence.

3.7 Societal Actors (1) — Firms and Interest Groups

The conventional economic characterization of firms' behavioral regularity is the maximization of profit. This reflects a corporate governance structure that emphasizes the control of the shareholders, or the "owners" of the firms, over corporate management. This textbook picture of "shareholder capitalism", which tells us how firms are supposed to operate, may well capture the dynamics of such economic systems as the one in the United States. However, the Japanese economy in the postwar era has rather developed a "stakeholder capitalism" in which stakeholders, such as management, employees, and creditors other than shareholders, have exercised a large control besides shareholders.[39] In the Japanese economy, such inter-related practices have developed as lifetime employment in the labor market, cross-shareholding in the capital market, and the main bank system as the corporate governance system, largely undermining the assumption of "shareholder capitalism".[40] Within this economic system, as in other capitalist systems, the firms certainly do pursue profit. However, as was the case for the bureaucracy, we may see that there are other goals: especially, given the prevailing practices in the firms (e.g. lifetime employment; seniority wage; management recruited from within the corporation), the management may also be interested in the continued employment of core workers, which can be best provided by the continuous prosperity of the organization, or the survival of the organization.

Most of the time, firms both pursue profit and continued employment of core workers (i.e. not the part-timers). However, the question is, again, "What are the priorities?" The answer to this question can be obtained by asking which concern, "profit maximization" or "continued employment of core workers", are given priorities by the corporations, in times when the two conflict with each other, such as a downturn in corporate performance. If, on one hand, the former concern is to be given priority, the management would choose "lay-off". If, on the other, the latter is the priority, the management would sacrifice profit while retaining a potentially redundant labor force.

It has been widely observed that the Japanese firms, especially the large firms, have operated with the latter, continued employment of core workers, as its priority over profit maximization. According to Fukao (1999), the shareholders for large public firms have less control over residual rights than core employees. Clearly, corporate profit acts as a parameter that determines whether a firm can continue to exist: if a firm approaches failure, it would fire its employees. However, in the Japanese context, such practice can only be observed well after other attempts (e.g. cut in salary of board members and employees) would fail: firms would not fire their employees even when the profit for the term becomes negative as long as it has some internal savings. (Fukao 1999, 175-82)

Given the existence of an inflexible labor market, such concerns for continued employment of core workers translate to the pursuit of organizational survival, in line with our starting assumption. Firms in pursuit of organizational survival engage in segmented competition. More often than not, they pursue maximization of market share or sales volume, so as to maintain the need for its core employees' services.[41] The participants in the sectoral competition stay the same over time, given the rare entry and exit into the market, especially for those sectors heavily protected by regulation (e.g. broadcasting, finance). In such settings, stability or "order in the industry" may come to be valued over competition that may result in a failure ("exit") of a firm, and thus a loss of jobs for the employees. Therefore, while the competition for market shares may indeed be intense, if the restriction on entry and exit exists, what may follow is a stable distribution of market shares for some large firms which dominate one sector.

Firms wield their political influence by the exchange of goods and services with politicians and bureaucrats: this could be done by individual firms, but usually firms organize themselves into interest groups for this purpose.[42] Organized interest groups offer political contributions as well as blocks of votes to politicians as is the case all around the world. In the Japanese context, as observed by Okimoto (1989), the Japanese firms are organized into industrial associations, which aggregate individual company interests, build intra-industry consensus, and serve as a vehicle of communication between industry and government. The formation of sector-specific industrial associations may be attributed to the need for individual firms to increase bargaining power against the government or other interest groups, according to Aoki (forthcoming). Compared to sector-specific industrial associations, the national business associations (such as Keidanren) do not wield much power: as a rule, they refrain from taking stands on industry-specific issues, rather concentrating on macroeconomic and societal issues. Especially, regarding regulatory reforms, such comprehensive associations have trouble adopting a policy position, as they include both competitive and protected sectors and consensus would be unlikely.[43]

3.8 Societal Actors (2) — The Public

Finally, we add the public to our list of actors in the Japanese political economy. Given the framework of liberal democracy, which guarantees personal freedom over political, economic, and social actions as well as free electoral representation, the public has the ultimate power to decide the political outcomes. One powerful way for the public to exercise that power is through the elections of political leaders: this channel of influence has been one of the centers of attention, naturally, from political scientists as well as economists in the study of politics. However, there are also other means (e.g. mass protest, boycott, civil disobedience), short of the use of physical force (e.g. uprising, revolt, assassination), by which the public can influence political parties, bureaucratic agencies, and firms in an industrialized democracy. Of course, nevertheless, for numerous reasons, the public does not wield political influence as can be expected in a naive view of liberal democracy. For example, the public may not be well-organized vis-à-vis other small groups (such as interest groups); the public may not care to know what the issues are because it is too costly to do so, and so on.[44]

The above general observation about the public's political role in a liberal democracy certainly obtains for Japan as well. The Japanese public can freely vote and elect politicians of their liking; the public is guaranteed free economic choices (e.g. purchase and sale of goods and services) as well as freedom of expression, free press, and so on. The same reservations on the public's influence on politics apply in Japan as well: frustration regarding the lack of political response to the public's needs has been a recurrent topic in the political debate.

In our framework, the public has two ways to influence the political outcomes. First, the public may be "actors" who engage in direct action to translate their preferences. Examples of such actions include elections directed at politicians as well as mass protest and boycott against all other actors. However, elections only take place once in a while, and as is well known, whether the public's preference translates into policy results is highly questionable. Mass protests or boycotts may be influential, provided that they occur: however, they may be rarities. Second, more importantly, the public may be "parameters" that determine the behavior of the other political actors such as political parties, bureaucratic agencies, as well as firms and interest groups. For the politicians, this link may be obvious: they face the elections, thus they constantly care about what the public thinks. However, the public may be important for bureaucrats or firms as well. For the bureaucrats, they need the support of the public in addition to that of their jurisdictional constituencies, as their ability to act as the delineator of the national interest vis-à-vis other actors will be largely affected by public support. (Aoki 1988) As for the firms, becoming a "public enemy" may have dreadful consequences: mass protests or boycott may result, and their political activities (e.g. lobbying for their cause) may be largely constrained by such developments. For example, polluting companies (e.g. Chisso Corporation in the Minamata Pollution) have paid hefty prices for becoming public foes in the past; the banking and securities industries in the post-bubble years have approached this category.

Thus, while we do not neglect the first pattern of "direct action" (e.g. elections, mass protest, and boycott), we rather focus on the second pattern, or the public as a "parameter" of actors' strategies. The political actors observe the public, and decide their strategies in order to maximize "public support" or at least avoid losing "public support": this framework not only applies to "parameter", but also to "direct action", as "public support" is an important determinant of elections, mass protest, and boycott.

In efforts to incorporate this oft-underemphasized actor in the Japanese politics literature into our analysis, we raise two concerns. First, the public may matter in some instances (e.g. in a social revolution) but not always: to assert that "the public matters", the conditions in which such an assertion holds need to be specified. (This will be one of our central concerns in our inquiry presented in the later chapters.) Second, due to limitations on reasoning capacities and available information, the public is unlikely to know what is "objectively" good for them. Public interest is not necessarily equal to public support. In the remainder of this section, we will discuss this second concern.

What is "public interest"? Where does the public interest lie regarding an economic policy? One answer may be to add up all actors' utility functions: a common way to do that is to add the welfare of producers (firms) and that of the consumers and decide that the maximization of the aggregate welfare, or the most efficient outcome, must be where the public interest lies. Along this line of thought, the above tendency of producers' interest to be over-represented needs to be remedied towards the increase of consumers' benefits, if one is to increase economic efficiency. Or, the inefficiency of the existing institutions of political economy may be explained through the process of interest-group capture of the regulation process, or alternately, from the transaction cost perspectives with emphasis on the institutional structures in which the strategic interaction of actors take place.[45] Another way may be to look at the aggregate output (e.g. economic growth) of the national economy: then, policies that are likely to result in more economic growth are in the interest of the public. Alternately, noting that these positions have implicit biases towards efficiency concerns, we may introduce non-economic goals such as distributive justice (equality), social stability, and so on.

More often than not, such goals as economic efficiency, economic growth, equality, and social stability go hand-in-hand, as seen in the development process of the Asian countries (World Bank 1993). However, the issue becomes problematic when the goals conflict with each other. For example, as in postwar Japan, economic growth may be achieved in a "producer-led economy" with an under-representation of consumer interests, resulting in an efficiency loss. As long as the Japanese nation as a whole had a consensus towards the pursuit of a higher GNP, where did the public interest lie, even if some economists could argue that more efficiency could have resulted by dismantling such inefficient sectors as agriculture? Alternately, we may think of a case in which maximizing economic efficiency and growth result in a widening gap in the distribution of wealth, leading to a rise in social turmoil, and a case in which efficiency and growth are sacrificed for such concerns as social stability: imagine the different approaches to employment in the United States and continental Europe. In either case, where does the public interest lie?

In this regard, we agree with Vogel (1996, 15) that "there is no single public interest: disputes over the definition of the public interest lie at the heart of political debate". Actors often manipulate the definition of public interest towards their economic goals. For example, regarding the financial reforms, Chapter 4 will show that the domestic financial institutions see "the preservation of financial order and the avoidance of confusion among the public" to be the public interest, while the foreign financial firms see "increased efficiency in the financial market and more choices for the customers" instead. It is not surprising that their image of public interest matches what their economic interests tell them regarding the financial reforms.

Based on the above discussion, we adopt the following approach to public interest. According to our definition of institutions that projects a feedback mechanism between the objective and subjective worlds, we see a similar mechanism between "public interest" (or objective aggregate of social and economic welfare of the public) and "public support" (or subjective support from the public). In our definition, "public interest" is distinguished from "constituencies interest". What the public interest includes are concerns for the unorganized consumers and the general nation (e.g. aggregate economic output); the constituencies interest represent the interests of firms and industries as represented by the interest groups. (See Chapter 5.)

The definition of public interest operates at the level of "shared expectations" of the institutions: what consists the "organizing principle" of an institution, often developed over stable reproduction in the past, may acquire a normative value for actors in the institution (e.g. lifetime employment in Japan). The definition of organizing principle or public interest may shift over time: what the actors collectively perceive to be the organizing principle may be where the public interest resides. Obviously, this depends on the initial conditions across time and space: take Japan for example. Starting from poverty after war destruction, "high growth" and "catch up with the West" became top priorities for the nation: (potential) distributional conflicts between producers and consumers were of lesser concern. However, as the economic performance nears the West, "quality of life" increases as the priority of the Japanese: now, the desire of consumers for cheaper prices becomes more important, and thus the public interest may be expected to shift accordingly.

Admitting that the definition of public interest involves a value judgment of the analyst, regarding the Big Bang and the related changes, we will start from an economic definition of "public interest", expanding and questioning it as the analysis progresses. As will be seen in Chapter 4, the Big Bang produces "losers" such as most domestic financial firms: everybody cannot become winners. Thus, we equate "public interest" with the improvement of the welfare of the unorganized consumer public as well as the national economy. Whether the reforms are good or bad is a function of the situation that Japan faces today. Judging from the challenges to Japan of the 1990s, the Big Bang is a beneficial development for the Japanese public, at least economically: the consumers would be better able to benefit from more efficient financial services, in the face of the inevitable aging society of the 2020s, and the financial sector will be invigorated, increasing the chances for higher economic growth for the national economy.

We start from the assumption that "public interest" is closely related to "public support" in Chapter 4, as we heavily rely on the economists' forecasts to construct an image of the distributional effects and the impact to the national economy that the Big Bang is expected to have. This stance will be maintained in Chapters 5 and 6, which will discuss how the actors reacted to the loss of public support (Chapter 5) and how economic reforms shifted from "interest group politics" to "public interest politics" (Chapter 6).

How the public interest relates to public support will be explored in Chapter 8, where we provide an explanation for the rise of the public in financial politics, as identified in Chapters 5-7. Only with the result of our analysis, and thus with a more concrete image of what has been taking place since 1995 in Japanese financial politics, can we offer our view on the relationship between public interest and public support with confidence.

3.9 Prevailing Institutions in Japanese Financial Politics (1)— Bureaupluralism in Public Policy Making

Now that we have our theoretical frameworks as well as a basic image of the actors, we turn to the task of identifying the prevailing institutions (or "status quo") in Japanese financial politics. There are two institutions of interest: *bureaupluralism in public policy making, and the Convoy System in finance.*

These two institutions have been continuously reproduced in the postwar era. While these institutions have evolved over time, their basic characteristics as described below remained the same.[46] Although the institutions were only partially supported by formal rules, actors nevertheless acted according to the strategies prescribed by these institutions, forming the shared expectations about "how the world works" among actors. Our goal is to obtain an image of financial politics before 1995, from which we start our analysis in Part II. Who are the actors in financial politics? What are the formal rules that constrain them? What are their interaction patterns? What are the shared expectations underlying all of the above? In this section, we will deal with bureaupluralism, turning to the Financial Convoy in the next section.

Bureaupluralism, as developed by Aoki (1988), is a concept aimed to capture the pluralistic bargaining that takes place within the LDP- bureaucratic alliance of postwar Japan.[47] Based on the arbitration of labor and business interests taking place at the firm level under enterprise unionism (or "micro-corporatism" according to Aoki [forthcoming]), the bargaining within an industry is mediated by a "bureau" (which can be bureaus or agencies) with almost exclusive jurisdiction over that industry; the bureaus engage themselves in bargaining within the ministry or among ministries, competing to promote the interests of the industries under their jurisdiction. The tribesmen (or *zokugiin*) within the LDP, with special expertise on a specific policy, would intervene on behalf of the industry vis-à-vis the bureau, and would promote the interests of that particular bureau-industry coalition against other bureau-industry coalitions.

Bureaupluralism is an institution in public policy making in which policies are produced through the inter- and intra- industrial bargaining presided over by the ministerial bureaus in charge, which engage in intra- and inter- ministerial bargaining within the government, with the occasional intervention by the LDP lawmakers on behalf of the industries. The bargaining of bureaupluralism is carried out through arenas such as deliberative councils and the LDP PARC, as well as through negotiations behind closed doors, involving the bureaucrats, the industries (through their industrial associations), and often times the LDP politicians.

In this section, first, we look at the policy tools available for the government to influence the private sector. There are two types of policy tools: laws, involving the legislature and most of the time, the bureaucracy; administrative tools (such as administrative order, administrative legislation, authorization, and administrative guidance), mostly involving the bureaucracy. Below we will see how each type of tool is enacted and executed in bureaupluralism, through which we will discuss two important policy-making bodies that emerged (the deliberative councils and the LDP PARC). Second, relying on the above discussion of actors, we establish how the interaction among them can be understood, given the tools used by the government to influence the private sector.

1) Policy Tools (Laws; Administrative Policy Tools)

Laws are legislated by lawmakers in the Diet, as stipulated in the Japanese Constitution. In the Japanese parliamentary democracy, the following two observations hold. First, the ruling party (including the ruling coalition, hereafter in this section) dominating both Houses of the Diet can enact their proposals into laws, given the strong party discipline as in the United Kingdom (at least, theoretically). Second, the government (the executive branch), under the control of the ruling party, can propose legislation along with the legislators. Third, the bureaucratic agencies are led by politicians from the ruling party, although the number of parliamentary leaders in one agency is limited to two or three (including the Minister), under the legal statutes.[48] In postwar Japan, a one-party dominance held between 1955 and 1993, where the LDP controlled both Houses for most of the time; the government proposes roughly 90% of the bills submitted to the Diet, which is a lower percentage than many European states, including the United Kingdom.[49]

Under the shared expectations of continued LDP rule, and given the dominant role of government-proposed legislation, the following policy making process emerged. First, a need for legislation would emerge. Second, the issue would be deliberated upon within the government: the bureaus would organize the discussion, with the involvement of the affected industries, the LDP tribesmen, and experts, around the deliberative councils, obtaining a final report, which, though not legally binding, almost always becomes the outline for the policy proposal. Third, the proposal would be made into legislation, which goes through the LDP decision-making body and is then submitted to the Diet. Fourth, the opposition may, in some politicized issues, successfully oppose or force the legislation into revision, despite their minority status by condemning the "brutality of the majority" through such strategies as boycott of the Diet deliberation. For most bills, however, the ruling party would not yield at all, and the opposition would satisfy themselves by attaching a morally-binding resolution to the enacted laws.[50]

Through this process, two policy making bodies emerged, one within the government, and the other within the LDP. During the second stage in the above, the issue would be discussed within the deliberative councils, or advisory panels reporting to the Minister (or Prime Minister). The deliberative councils would include representatives from the industries within and outside the jurisdiction of the bureau in charge, and outside experts such as academics, think tank analysts, and so on. Their potential functions included "increasing fairness of policy decisions", "coordination of various interests", "absorbing expertise and new ideas", and "giving authority to administrative decisions".[51] Because the appointment of the members as well as the final report is heavily influenced by the bureau which acts as the council's secretariat, the conclusion of the final report would often reflect the bureaus' own conclusions.[52] (Muramatsu 1981; Vogel 1996)

The second important policy making body under bureaupluralism, operating at the third stage, was the LDP's internal decision-making body (to which we refer as the LDP PARC hereafter). At the bottom were the sub-divisions of the LDP Policy Affairs Research Council (PARC), which were organized into policy areas, often over-lapping with each ministry (e.g. commerce and industry sub-division and MITI; transportation sub-division and the Ministry of Transport). The sub-divisions were staffed with many lawmakers who, by experience, would come to be equipped with expertise that often superseded that of the bureaucrats: such lawmakers would come to be called tribesmen (*zokugiin*), who cluster around policy tribes (e.g. agriculture; transportation).[53] Then, came the PARC and the more senior Executive Council, whose memberships would often include party bosses and other senior party leaders. Policy proposals submitted by the bureaucratic agencies would usually pass; however, for politicized issues, such party organs may veto or significantly alter what was prepared by the bureaucracy.[54]

While these two policy making bodies provided formal structures around which bargaining involving bureaucrats, politicians, and industries take place, it should be noted that much of the bargaining process would take place informally, behind closed doors. The coordination within and between industries would take place on and off the deliberative councils; the coordination involving the politicians, on and off the LDP PARC. The formal structures guaranteed the entry points for the industries and the politicians, strongly influencing the informal bargaining process. Thus, the bureaucrats would consult the industries and the politicians beforehand: *nemawashi*, or pre-consultation on an informal basis for garnering support for an initiative, would take place so that the formal process proceeds smoothly.[55] Consensus was to be reached before a policy proposal is produced: thus, decision-making tended to be gradual and lengthy. This was especially true when there was a bitter conflict involving two or more industries: it was often hard to find a solution all parties can accept. As we will see in Chapter 6, it took six years (1985-91) for MOF and its deliberative councils to produce a final report in the financial reforms of 1991-93: the "hundred-year-war" between the banking and securities industries made it hard to build a consensus as to what should be done.

Note that the politicians at the LDP could by-pass part of the process involving the bureaucracy by choosing to submit the legislation themselves. However, as mentioned above, reflecting the relatively scarce resources (e.g. manpower; legal knowledge; policy expertise) commanded by the legislators and their staff, such occurrence has been a rarity in the postwar era, except for some instances in which certain new issues did not fall neatly into one agency's jurisdiction.[56]

We now turn to administrative policy tools. Laws enacted through the above process must be executed by the bureaucratic agencies. There are several policy tools available to the bureaucratic agencies. First, there are administrative orders, as stipulated by the laws. Regulators (e.g. Minister of Finance) are given by laws the mandates to issue legally binding orders that compel private sector actors to engage in some behavior or another. However, under bureaupluralism, or what Okuno-Fujiwara (1997) calls relation-based government (as opposed to rule-based government), it was rare for such legal orders to be issued. Both regulators and the regulated industries would rather avoid such formal sanctions (which would surely lead to scandals), preferring instead an informal solution to keep things quiet.

Second, there is administrative legislation, or Cabinet and Ministerial ordinances, which the bureaucracy enacts under the delegation of the laws.[57] As the legal statutes tend to be worded in general terms (as in other Continental law systems) and to be very costly to change (as a policy initiative has to go through the abovementioned process to become law), many critical aspects of regulation tend to be delegated to lower echelons in the legal hierarchy. Cabinet ordinances, one rank below the laws, involve the ministry in charge, the Cabinet Legislation Bureau (CLB)[58], and the Cabinet meetings involving other ministries: the ministry in charge needs to enlist the support of all affected ministries. Ministerial ordinances, one rank below the cabinet ordinances, involve the bureau in charge within the ministry in charge and the ministry's Secretariat. Administrative legislation is considered to be part of the legal statute; parties violating it face legal sanctions as provided by the laws.

Third, there are authorization, licensing, and other legal forms ("authorization" hereafter) that allow private actors to engage in some behavior if they meet certain conditions (e.g. banking business). As in the above, while the authorization framework itself is established by laws, the criteria of authorization is often left to be set by the administrative legislation.

Fourth, there is administrative guidance, or a non-binding persuasion of the private actors by the government. According to Pempel and Muramatsu (1995), administrative guidance is typically a series of recommendations from the government to specific firms or an industry, which the government believes to be in the best interest of the recipient. Since it is not legally binding, to be successful it requires cooperation on both sides.[59] Administrative guidance may also appear in the forms of *tsutatsu*, or the administrative rules setting the procedures and the interpretation of laws and administrative legislation. *Tsutatsu* only bind the lower organizational bodies within the public administration; however, what binds the regulators may come to *de facto* bind the regulated as well, as was once the case for the *tsutatsu* issued by MOF's Banking Bureau effectively binding the banking industry (the same thing obtained for securities and insurance).[60] Administrative guidance, though not legally binding, may be accompanied with an implicit promise of reward or punishment (e.g. bank branch licensing), effectively increasing the compliance of such moral suasion. Administrative guidance was particularly useful for the government, as it allowed for greater flexibility to the changing environment than other means such as legal rules. Administrative guidance was an effective policy tool, provided that the process was closed to those outside the inner circle of the regulated and the regulators, such as the "outsiders" (e.g. new entrants such as foreign firms; competing industries; the consumer public). Because of its informality, administrative guidance also made the responsibility of the actions taken by the government unclear.[61]

2) Relationship of Interdependence among Actors

All the above policy tools allow for opportunities for the bureaucrats to wield influence through their discretion.[62] Through the enactment process of laws, the bureaucrats engage themselves in influencing the content (mostly through the deliberative councils) as well as the form (especially through the drafting process) of legal statutes; administrative legislation is virtually in their own hands, and so are authorization and administrative guidance. For example, how and when to provide authorization and how to enact administrative legislation are basically up to the bureaucrats. Of course, this does not automatically translate to bureaucratic dominance: disgruntled interest groups may run to the politicians ("fire-alarm").[63] However, this has costs for the industries as well: as this is a repeated interaction with the same actors, the industries run the risk of facing "punishment" by the regulators in the future rounds.

The bureaucrats may have the policy tools to intervene in the private sector, but they also need the support of the industries under their jurisdiction. The bureaucrats depend on the industries for information (regarding the areas of regulation), cooperation (regarding the implementation of their policy proposals), and retirement position (*amakudari*). The bureaucrats do not have the necessary information about the state of the industries: they depend heavily on the regulated industries. The bureaucrats do not have much legally coercive power, and most of the administrative power is exercised through persuasion rather than coercion. (Okimoto 1989; Haley 1995) As noted above, *amakudari* works as part of the incentive structure of the bureaucracy's personnel, and the goodwill of the industries needs to be secured if the bureaucracy wishes to keep such channels.

There is also an interdependence relationship between the politicians and the bureaucrats. The LDP politicians can influence the policy tools, especially the laws: their entry point is guaranteed through the LDP PARC, which in turn provides for their influence over the policy substance in the pre-consultation process. The bureaucrats need the cooperation of the LDP politicians within the policy making process, especially at the LDP PARC and through the Diet deliberation: the worst case scenario for them is the politicians lining up with the industries against the policy proposal made by the bureaucracy (e.g. the banking reforms of 1979-82 in Chapter 6). They also need to be on good terms with the politicians, in that the latter have influence over high-level appointment within the bureaucracy and for public corporations (large recipients of retired bureaucrats). The bureaucratic agencies also need the power of the LDP politicians in the competition against one another: for example, the support of the "tribesmen" regarding the postal service is essential for the Ministry of Post and Telecommunications in fighting MOF's Banking Bureau regarding the postal savings system.[64]

The LDP politicians have reasons to be on good terms with the bureaucrats, too. The scarce resources (e.g. small number of staffs individually and at the party level) the politicians command make it essential that the bureaucracy provides policy expertise, especially regarding legality and technicality. It also makes the bureaucracy the most important source of information. Wielding their influence over the bureaucracy and its administrative, particular decisions, the politicians can demonstrate their worth to the constituencies, thereby justifying the request for contribution (money and blocks of votes). For example, an LDP politician may exercise influence over a mostly administrative process (e.g. authorization / licensing) by making a phone call to the bureaucrats, who, given the repeated interaction, would be pressured to accept the politician's recommendation: a bureaucrat may use this favor as a future trump card in obtaining cooperation from that politician later on regarding other matters.

Let us summarize the relationship of interdependence among actors in bureaupluralism. The politicians, in their pursuit of electoral victory, depend on:

- the "constituencies", firms and interest groups, for money and/or block of votes;
- the "public" for "generalized voter support"; and
- the bureaucrats for policy expertise (legality/ technicality) and favor over the industries.

The bureaucrats, in their pursuit of organizational survival, depend on:

- the "constituencies" for retirement position, information, and cooperation;
- the "public" for support for policy and social status; and
- the politicians for cooperation at the PARC and the Diet, approval over some personnel matters (high-level appointment / retirement), and bargaining power against other ministries.

The constituencies work to influence both the politicians and the bureaucrats to obtain policy outcomes that enhance their interests, through providing money and block of votes to the politicians, and through providing retirement positions, information, and cooperation to the bureaucrats. Such favorable outcomes may be obtained through inducing the politicians to wield influence over the bureaucracy. Or, better treatment from the bureaucracy may result from building up a personal relationship through informal meetings (including wining and dining). While the firms and interest groups do not have much direct channel of political exchange of goods and services with the public, they have reasons to fear becoming a "public enemy". Boycott, mass protest, and widespread social criticism hurt the corporate image, and ultimately their profit: "public enemy" firms may have trouble securing funding from banks or capital markets, or they may experience difficulties in expanding their businesses with other firms, which would have to consider their own corporate image. Regarding the constituencies' political influence, losing public support hurts it significantly: politicians and bureaucrats would be unwilling to listen to such industries, because it would surely result in the loss of public support to these state actors.[65]

The public, along with other "outsiders", is kept outside the policy making process as described above: the policy making bodies of bureaupluralism are heavily biased towards the constituencies. However, the public vote for political parties in the elections, held once in a while, to let their approval / disapproval known; they can also take direct actions (mass protest/ boycott) against any set of actors (politicians , bureaucrats, or firms and interest groups). The public may be even more important as a parameter to political behavior. The actors, reflecting their dependence on the public, may act to maintain or enhance public support: at least, they have reasons to avoid losing public support, or becoming "public enemies".

3) Bureaupluralism as an Institution: Informal, Repeated, Same Actors, and Shared Expectations of Continuity

What emerged in postwar Japanese politics is the institution of bureaupluralism, a stable interaction pattern of politicians, bureaucrats, and the industries, based on the informal interaction of the same actors over time, guaranteed and reinforced by formal rules as well as shared expectations of continuity.[66] There are four important aspects of bureaupluralism, which reinforce each other: informal interaction; same actors; repeated interaction; shared expectations of continuity.

First, as we saw above, much of the interaction among politicians, bureaucrats, and interest groups takes place informally. Coercion on legal grounds is a less preferred option than reliance on cooperation, persuasion, and consensus-building. One necessary condition for the effectiveness of such informal arrangements is that the consequences of one's strategy (e.g. "go along" or "defy") are well understood among all actors. This leads us to two other traits of bureaupluralism. The second nature of bureaupluralism is that it is a system with the same actors; the third is that it is constantly reproduced over time, or it is a repeated interaction with similar results over and again. If the actors are the same over time, and the present arrangement is to continue in the future, then the informal interaction pattern of bureaupluralism is likely to be effective as a "rule of thumb" for actors, as they would clearly understand the consequences of the actions in the tacit arrangements, and the "shadow of the future" would prevent the actors from deviating from the prescribed strategies. In bureaupluralism, the political party in power is always the LDP; the bureaucratic agency in charge is always the agency given the jurisdiction under the statutes (assumed not to change often, given its basic status in the legal order: indeed, it did not change much over the postwar era); the firms in a regulated industry are, most of the time, the same over time. Here, we may see that formal rules operate to reinforce the stable reproduction of bureaupluralism. Laws on public administration guaranteeing the continuity of one agency's quasi-exclusive jurisdiction over an industry, and regulatory statutes limiting entry and exit in an industry, contributed to the reproduction of the "same actors over time in similar interaction".

However, formal rules are only part of the picture: after all, actors could legislate different formal rules. Here, we reach what is at the core of this institution: our fourth nature of bureaupluralism is the expectations of continuity, shared among actors, reinforced by the stable reproduction of the past informal interaction pattern with the same actors under the prevailing formal rules. Although nothing in the formal structures (e.g. laws, constitutions) guaranteed that the current system would be reproduced, the actors operated under implicit shared expectations of continuity. First and foremost, bureaupluralism was based upon the assumption of the continued dominance of the LDP. Once the LDP is out, the LDP PARC would quit being the stronghold of political influence over the bureaucracy, and the exchange mechanism between politicians, bureaucrats, and interest groups would have to undergo a significant shift. The bureaucracy may not necessarily be always the same: again, as shown in the administrative reforms from 1996, the formal structures do not prevent any of the agencies from being stripped of its privileged position over public policy making concerning a certain industry. Moreover, recall that an informal pattern of interaction works best when the actors are the same. If there are new entrants to the market, such newcomers may fail to respect the prevailing informal practice for such reasons as lack of understanding, different priorities (profit or continued employment of core workers), and so on. Thus, if by exogenous reasons (e.g. internationalization), newcomers in the industries (e.g. foreign firms) are brought in, this arrangement cannot but be significantly affected.

All the above three interrelated features of bureaupluralism, "informal interaction", "same actors", and "repeated interaction with similar results", cannot be sustained unless the shared expectations of continuity hold. Suppose one critical aspect of bureaupluralism, "repeated dominance of the LDP" collapses (as it did in 1993): what happens? The actors involved would be different as the non-LDP parties come in. The shared expectations of "continuity" will have to go: as "change of government" would emerge as a plausible possible scenario in addition to "continued LDP rule", the interdependence relationship among actors has to change. "Repeated interaction with similar results", and thus "informal interaction", would hold less in the new world, undermining the shared expectations of "continuity" in turn. In this way, by introducing an exogenous change, "change of government", which undermines the shared expectations of continuity, we may see a start of institutional change in public policy making, or a shift away from bureaupluralism. We will pursue this further in Chapter 8.

3.10 Prevailing Institutions in Japanese Financial Politics (2)— the Convoy in Finance

We now turn to the second "institution", the Convoy System in Finance (hereafter "the Convoy"). The Convoy in postwar Japan was the institution that arose in finance amidst the interaction of the financial industries (e.g. banking, securities, and insurance) and state actors (e.g. the LDP and MOF). This was a system in which the whole convoy (i.e. financial institutions) sets its speed along that of its slowest ship (i.e. the weakest financial institution). The label "Convoy" is often used to denote the system of financial administration. However, we do not limit our "Convoy" to the observable interaction between the private sector actors and the state regulators in financial administration. In line with our views on institutions, we not only look at formal and informal transactions involving the government and actors in the private sector, but also at the institutional environments in which such interaction took place, delving into the shared expectations held by the actors in financial politics on "how finance works". We must note that the public administration component of the Convoy was an important sub-component of bureaupluralism in general as described above.

The Convoy was a complex system of inter-related features.[67] Essentially, as the Convoy analogy suggests, no financial institutions were allowed to fail, and the state provided an implicit guarantee to sustain the "myth of no failure". The larger and more competitive firms were deterred from materializing their advantage; their compliance was secured by the regulatory rent and sanctions, or reward and punishment by the regulator. The actors were always the same, as the LDP was in power, MOF was the exclusive "organizer" of the bargaining process according to legal statutes, and entry and exit were *de facto* restricted, if not eliminated, by the formal rules and other informal constraints providing for the segmentation of finance. Their interaction patterns were largely informal, supported by such features of bureaupluralism as "informal administrative tools", "wining and dining", and *amakudari*: the policy making bodies were the deliberative councils under MOF, and the LDP PARC (in particular, its financial sub-divisions). The system was based on segmentation of finance as well as surrounding institutions such as the main bank system, the financial *keiretsu*, and cross-shareholding. "Continuity" was key to the well-functioning of the Convoy: with future rounds to play, actors would be strongly deterred from deviating from the prescribed strategies under the Convoy.

With our discussion on the definition of institutions in mind, we may dissect the Convoy into four levels:

1) Players
2) Formal rules
3) Interaction patterns
4) Shared expectations

<u>1) Players</u>

As this was within bureaupluralism, the state actors involved were the LDP and MOF. The LDP's continued rule was a given, and so was MOF's role as the exclusive organizer under the basic administrative legal framework. As for the actors who engage in business transactions in the financial market ("financial actors" hereafter), finance was segmented into separate industries (e.g. banking and securities) as well as within industries (e.g. within banking, city banks and long-term credit banks).

The major lines that segmented finance were those between banking, securities, and insurance. Banking and securities were divided by Article 65 of the Securities Exchange Law, enacted in emulation of the U.S. Glass-Steagall Act in the United States as a product of the U.S. postwar occupation. (Vogel 1996) Securities and insurance were basically prohibited by law to engage in other businesses (financial and non-financial) to prevent the risk of other businesses influencing their main licensed business.

Within banking and insurance, there were further lines of segmentation. Within banking, there were the divisions between the specialized banks (long-term credit and trust) and the ordinary banks. Long-term credit banks, created in the early postwar era of scarce capital, specialized in channeling long-term loans (e.g. equipment investment) to sectors that were deemed to contribute to national economic development, as did the governmental financial institutions. (Hosoda 1998) The three long-term credit banks were allowed to issue long-term bonds of five-year maturity, or financial debentures to raise capital.[68] The number of the branches were limited, as they were expected to operate mainly in the wholesale market. On the other hand, the ordinary banks would concentrate on short-term deposits and loans: bond issuance was prohibited, and longer-term deposits have been basically restricted.[69] Trust banks, although being ordinary banks approved to operate in trust banking in theory, were in fact another type of specialized banks. Their branch numbers were kept low, while trust banking businesses were, again, protected from the intrusion of other ordinary banks in return. Within insurance, casualty insurance and life insurance were strictly separated from one another by legal statutes. Thus, protected by segmentation walls set up by the administration, private financial institutions were engaging in a segmented competition against rivals, pursuing the maximization of size rather than profit.[70] (Yoshino, Asano, and Kawakita 1999)

Within each segmented industry, there was a division between the large firms, which dominated the industry, and the smaller, weaker firms. For example, within banking, there was the division between the strong, or the large ordinary banks(the city banks) and the three large long-term credit banks, and the rest, or the weaker, smaller regional financial institutions (regional banks, mutual banks [the later second - tier regional banks], and credit- cooperative type banks). The limitations on the number of branches for the strong banks were to ensure that they would not overrun the weaker financial institutions. The regulatory system was set up so that no firms would fail within the industry (e.g. the control of the deposit and lending rates): the more efficient large firms were able to accrue rents, while they were expected to rescue smaller firms within the industry through merger under the authorities' request.

To sum up, the "insiders", or {MOF; LDP; domestic financial industries (banking; securities; and insurance)}, were the significant players in the Convoy, while the "outsiders" {households; non-financial firms; newcomers to financial business (foreign financial firms, nonbank financial institutions, and non-financial firms entering the financial market)}were largely kept outside of public policy making in financial politics. Under the Convoy, financial politics was, first and foremost, about a distributional conflicts between the domestic financial industries, rather than conflicts between the providers and the consumers of the financial services, as we will see in Chapter 6.

2) Formal Rules

This includes the regulatory rules that provided for the segmentation of finance and some of the important policy tools (e.g. entry control and product control) that MOF could wield. As mentioned above, a large part of the segmentation of finance has been provided for by laws that govern each type of business (e.g. the Banking Law; the Long-Term Credit Bank Law; the Securities Exchange Law; the Insurance Business Law): revision in laws (costly, as seen above) would be needed for the breakdown of segmentation walls prohibiting cross-entry. Such laws also provided for important policy tools for MOF: entry control as well as product control was set up, with the criteria for such administrative actions left to administrative legislation and other policy tools that gave much discretionary power to the regulator.[71]

3) Interaction Patterns

Formal rules were but one part of the Convoy: we may be missing a large part of this institution if we do not pay attention to the ongoing informal interaction. First, we look at the interaction between the government and the private sector, dividing it into three parts: policy making process, policy tools, and policy substance. Then, we will turn to the private sector practice in finance.

In the policy making process, the financial industries would group themselves into industrial associations (e.g. the National Bankers' Associations), which were typically dominated by the large firms within the industry: such industrial associations were given almost exclusive access to the bureaucracy in charge of their industries vis-à-vis the "outsiders". The interaction between the bureaucracy and the industries would mostly take place through an informal basis, through such channels as informal "hearing" and wining and dining.

Regarding the policy tools, the laws set up important ones (e.g. licensing and authorization). However, the implementation process was largely within the bureaucracy's hands (see above). A distinctive feature of financial administration was that it was an *ad hoc* system where decisions were often made on a case-by-case basis under a "flexible interpretation" (i.e. discretionary interpretation) of the rules by the regulators. The focus was on preventive (i.e. regulating the private sector *ex ante* so as to avoid possible troubles) measures as opposed to *ex post* regulation through rule-based administrative actions. Even when troubles (e.g. scandals involving financial institutions) would occur, the preferred way was to keep matters within the inner circle of the "insiders". For example, the regulators would sanction the regulated industries informally (e.g. administrative guidance to force the retirement of management): the industries could still avoid the scandals from becoming public, and the regulators could avoid being held responsible.

As was true for bureaupluralism in general, most policy tools available to the government were not coercive: the effectiveness of administration often depended on the cooperation of the regulated.[72] Informal interaction between the regulators and the regulated, based on the exchange of information, cooperation, and retirement positions against administrative favor (e.g. information on regulatory policy and other policies; smoother licensing) would often involve the personal ties that would be forged through such arrangements as *MOF tan* (person in charge of MOF), or a practice in which the large financial institutions in banking, securities, or insurance, would choose some middle-level officials with similar backgrounds (especially in terms of education) with MOF officials to engage in day-to-day transactions with them. Such ties would often be reinforced by such means as "wining and dining" at night, off-the-record, where each party would be expected to bring out their true thoughts and feelings (*honne*). In this way, the material ties between the regulators and the regulated were further strengthened by the personal ties. As a result, the following observation by Pempel and Muramatsu (1995, 72) certainly held for MOF's sections overseeing banking, securities, or insurance: "Because Japanese government agencies and bureaus are often closely tied to the social groups they oversee, they frequently become their protectors despite any consequent economic irrationality".

Lastly, what resulted from the regulation was a fierce competition within the segmented walls, without exit or entry. While the formal rules did not necessarily prohibit entry, they certainly made it difficult; the administrative practice by the regulator, reflecting the wishes of the industries, was by no means encouraging, if not hostile.[73] The financial institutions, when in financial trouble, would be rescued through a system of *hokacho* (a notebook for contribution pledges), where financially sound firms within finance would provide rescue financing under the leadership of the regulator.

Turning to the practice in private sector finance, we may point to several inter-related institutions that complemented the above: "the main bank system", "cross-shareholding", "financial keiretsu", and "bank dominance". Under the main bank system, the "main banks" would perform delegated monitoring of the corporate borrowers; when such borrowing firms would be in distress, the banks would rescue them, while replacing the management with managers sent from the banks. Under this system, the main banks would rather pursue long-term relational financing than operations with emphasis on short-term profit or capital base. The main bank system, along with the cross-shareholding system and financial *keiretsu*, reinforced the dominance of banking (especially the large six city banks around which financial keiretsu group themselves) over the financial industries (i.e. the dominance of large city banks), and the economy as a whole (i.e. the dominance of indirect finance).[74]

4) Shared Expectations

The shared expectations are, at the bottom of the Convoy, at a time reinforcing and reinforced by, the players, the formal rules, and the interaction patterns. We may see two sets of shared expectations about "how the world works in financial politics": one in politics (institutional environment), and the other within finance (institution).

First, there were two basic shared expectations regarding the political system: "continued LDP rule" and "MOF as the organizer of bureaupluralism in finance". The continued rule of the LDP was a "given" for a long time, giving rise to a stable reproduction of policy making process through such established procedures as the one described above. For instance, that the policy making process would go through the LDP PARC was not guaranteed in any legal statutes; yet, this was considered to be a "given" for those involved in the process. The great confusion among the bureaucrats and politicians shortly after the change of government (the first time in more than three decades) testifies to the extent to which this regularity transformed itself into an assumed continuity of the LDP rule. The other "given" in the Convoy was MOF's standing as the organizer of bargaining among actors: that MOF would take the initiative in financial policy making was not disputed by the actors. MOF did not necessarily dominate financial policy making: the financial industries have successfully challenged MOF with the LDP intervening on their behalf (as in the 1979-82 banking reforms), or have induced MOF's bureaus to fiercely champion the causes of their industries (as in the 1991-93 financial reforms). However, that MOF was responsible for planning and executing the plans for regulatory reforms were not disputed in either case (see Chapter 6).[75]

As for the shared expectations within finance, an implicit state guarantee was assumed to be present over the financial institutions. While the deposit insurance system had been established by legal statutes since 1971, guaranteeing deposits of up to 10 million yen since 1986, not many seriously thought that such a system would need to be activated in the future: as a result, the legal framework for the implementation of the payoffs of deposits as well as the administrative organization (set up within the BOJ, the central bank) remained largely underdeveloped; the same was true for the framework to provide for the failure of securities firms. As for insurance, no such safety net existed until the major revision of the Insurance Law in 1994. That an implicit state guarantee was thought to have existed is supported by the fact that the government had to promise that all bank deposits would be guaranteed for five years (until 2001), and then postponed the payoffs for another year (until 2002): that the legal statutes for the payoffs had existed since 1971 did not matter in preparing the Japanese depositors for the payoffs.

The "implicit state guarantee" was accompanied by "too big to fail": this became apparent when the bubble burst and the bad debt problem arose in banking in the 1990s. Because of the sheer size of the top twenty or so largest banks (called "money-center banks"), the banks would be regarded as "too big to fail" (as in the Continental Illinois case in the United States in the 1980s). As seen later, the authorities would promise that such banks would not be let down, while in November 1997, one among them did go under, eliminating the actors' faith in the Convoy.

Again, no formal rules provided for the state guarantee beyond the limited guarantee by such systems as deposit insurance, but it was commonly believed that the banks and other financial institutions would not be allowed to fail by the government. For example, a major economic newspaper declared in 1993 that "Banks would not fail and, would not be allowed to fail — this was the common sense of postwar Japanese economy".[76] (Nihon Keizai Shimbun 1993)

In this way, the "myth of no failure" held, under the "implicit state guarantee". The formal regulatory rules as well as the interaction patterns gave rise to a segmented competition with no entry and exit, where regulatory protection guarantees that the strong (mostly, large city banks at the center of financial *keiretsu*) do not dominate the weak (other financial institutions). As this practice of financial segmentation was constantly reproduced over time, a shared expectation of symbiosis (*sumiwake*) arose, assuming a normative content as in the case of lifetime employment. The right for survival of the weak financial institutions would come to be openly advocated against the harsh reality of market forces.[77] In this system, the same players or the "insiders" would interact over and again in informal manners, excluding the "outsiders" such as new entrants, non-financial firms, and the consumers: this is a "collusive" system as opposed to an "anonymous" system in a liberal democracy, to refer to the typology of government-private sector transactions as developed by Aoki (forthcoming).[78]

Overall, the policy making process was one of consensus building: it was through cooperation and consensus that government policy worked rather than through confrontation and coercion, in finance as well as in the political economy in general.[79] In one retired MOF official's view, bureaucratic administration and deliberative councils represent "coordination by reason and consensus". On the other hand, he also acknowledges that the MOF bureaucrats found it very hard to coerce financial institutions, often run by local potentates with influence over political and economic leaders, into accepting closures, or "death sentences".(Nishimura 1999, 170 and 110)

To sum up, the "organizing principles" (the fundamental principles recognized by all actors as objective characteristics as well as normative values of the institution) of the Convoy as the prevailing institution in finance were "cooperation and stability". This may not have been peculiar to finance: cooperation between the private sector and the government through the mechanism of bureaupluralism as described above was once characterized to be the strength of the Japanese political system.[80] Financial stability, or the stability of the financial order, was the goal of financial administration as well as the financial industries: we know this, as the recovery of the "stability of the financial system" (*kin'yu shisutemu no antei*) has been repeatedly stressed by MOF, the LDP, and the financial industries, as a policy goal in the 1990s, within the context of the bad debt problem.[81] We must note that this also fits the interest of the non-financial firms, with stable ability to make loans: under the conditions that held under the high growth period, the repressed interest rates would guarantee cheap capital even with an underdeveloped capital market. As long as bureaupluralism obtained across all sectors and the household (consumer public) was systematically excluded from the policy making process, we can see that "stability" in the financial order was reinforcing, and reinforced by, the "producer economy" that Japan had been in the postwar era.

3.11 Actors, Strategies, and Possible Scenarios of Financial Reforms

Based on the above sections, we now turn to identifying the actors and their strategies regarding the financial reforms. We will identify the basic preferences of the actors, assumed to be constant over time: organizations — political parties, bureaucratic agencies, and firms — seek survival. We then construct the possible scenarios for financial reforms: through our empirical analysis in Part II, we will place the Big Bang under one category of our four-by-two typology.

We distinguish the state actors, or the politicians and the bureaucrats, with direct access to governmental decision-making, from the rest of the actors, or the financial actors who engage in market transactions in finance and whose influence on public policy making is indirect. The state actors, the LDP and MOF, would seek to satisfy two sets of interests, "public interest" and "constituencies interest".

The LDP pursues organizational survival through winning elections. It has been in power between 1955 and 1993, and regained power in 1994. The LDP's top priority as of 1995 would be to stay in power, as its ability to command governmental resources, a valuable asset to keep its organizational strength, would be jeopardized otherwise. Regarding finance, it has financial ties with the banking, securities, and insurance industries, which contribute heavily to the party. The LDP PARC and its financial sub-divisions, the policy making bodies in charge of financial matters under bureaupluralism, have closely worked with the financial industries as well as MOF in managing financial politics. Many of its members, or the "tribesmen" in finance, are former MOF officials, and they have strong personal ties with the financial industries at the individual level. Regarding financial reforms, then, LDP policy, as long as the LDP PARC in finance controls it, can be expected to be closely aligned to what the financial industries or MOF's financial bureaus would choose. Financial policy has hardly been at the center of political debates, and financial policy making would not translate in generalized voter support: thus, the politicians would pay more attention to the financial industries than to the public.

Those at MOF seek organizational survival, or keeping and enhancing the organization's political influence and social status. Each of the MOF's three financial sections (the Banking Bureau, the Securities Bureau, and the Insurance Department) in charge of the financial regulation represents the industry under their jurisdiction, in competition against one another. These bureaus depend heavily on the financial industries for information, cooperation, and retirement positions: this results in a heavier attention by the bureaucrats on the industries' interests over those of the public. Under bureaupluralism, the financial industries are better represented than the "outsiders" in the public policy making process centering around the deliberative councils and the LDP PARC. Regarding financial reforms, a consensual style of public policy making translates into gradualism, where the difficult coordination of the conflicting interests between financial industries take place over a lengthy negotiation process, involving a generous compensation for the losers, so that nobody "drowns". The bureaucrats depend on the cooperation of the private sector in carrying out their initiatives, and such reforms that would drastically alter the financial landscape, leading to the emergence of "losers", would be less preferred.

We may group the financial actors into two sets of actors, depending on the expected outcome of the reforms: the "winners" and the "losers". The winners would be expected to press for wider scope, deeper degree, and faster pace of reforms, while the losers would seek to forestall the reforms, if not oppose them right away. However, the winners may or may not know that they are the winners due to uncertainty: unless actors are well aware of their potential gains, they are unlikely to actively pursue the financial reforms by influencing the state actors. The firms, financial as well as non-financial ones, pursue organizational survival: firms engage in profit making activities, but their even more important priority lies with the continued employment of core workers.[82] The non-financial sector as well as the new entrants in the financial market would have fewer stakes involved in financial reforms than those "losers" among the domestic financial industries, as the former has more to gain in terms of profit, while the survival prospects of the latter would be put in jeopardy: we may expect the voice of the latter to be more stringent in opposition. The public may hope for increased choices and efficiency for financial services, while security may be another concern, which may or may not interfere with the increase of competition within finance. We will see, in Chapter 4, how the financial reforms would and did appear in the eyes of the financial actors.

We distinguish the "insiders" from the "outsiders" in line with our discussion of the policy making mechanism of bureaupluralism and the Convoy. The insiders, with privileged positions within the Convoy, would include {the LDP; MOF; the Domestic Financial Institutions}. From the above, we can see that the relationship between the financial industries and the state actors (the LDP tribesmen and the financial bureaus in MOF), or more specifically, the dependence of the latter on the former (votes and money; information, cooperation, and retirement positions), gives the state actors the incentives to pursue the interests of the domestic financial institutions over the interests of the "outsiders", which would consist of {non-LDP parties; non-MOF agencies; new entrants in the market (e.g. foreign financial firms); non-financial corporate sector; consumer public}.

How can financial reforms occur in this situation, taking the faster pace of environmental development (technological innovation and international integration of financial markets) as given? We may posit two criteria by which scenarios of "change" can be classified: *evolution of coalition patterns, and interaction patterns of state and societal actors.* We obtain a four-by-two typology of financial reforms as a result: our rational-actor approach posits that the coalition patterns ("Who wins and loses") corresponds to the possible outcomes of the reforms, in terms of scope and depth ("What to include? How much change to achieve?") as well as timing and pace ("When to do it? How much time to spend?").

First, we may posit a continuum of how coalition patterns change, building up on our discussion of "counter-coalition" and "defection" in the framework of institutional change. At one extreme lies "status quo" (S), where there is no shift in coalitions. The same actors with privileged positions in the prevailing institutions, or the "insiders", will go on to manage financial reforms relying on the policy making process of bureaupluralism. We may expect reforms to take place over a long time, after a careful consensus-making process with compensation to the losers. This corresponds to financial politics as characterized by Vogel (1996) and Rosenbluth (1989). Next, we may proceed to "inclusion" (C), where some "outsiders" who are left out of bureaupluralism are brought in, while the public policy making process itself is left intact. This corresponds to the mechanism of the continuous expansion of the supporting coalition of the LDP as recorded by Calder (1988).

The above two patterns are evolution within the institution of bureaupluralism. However, it may be that the coalition patterns change, bringing about an institutional change in public policy making. Defection (D) is the next category in which some "insiders" shift their strategies and bring about the demise of the old institution in which they previously enjoyed privileged status. In such cases, the "insiders" switching sides would "go around", creating alternatives to the established public policy making process. At the extreme, Replacement (R) is a situation in which "outsiders" displace the "insiders", eliminating the prevailing public policy making process.

The second criterion looks at what drives the state actors' behavior in initiating reforms, reflecting the two sets of interests that state actors seek to enhance: "interest group politics" (I) and "public interest politics" (P). In the first category, the exchange of goods and services between organized economic interests (such as interest groups and firms) and political actors drives politics. Here, the flow of goods and services from the economic "winners" to the political actors would induce the latter to shape, propose, and carry out the economic reforms. In the second pattern, however, reflecting the public interest, economic reforms may be launched in pursuit of not only sectoral benefits but also a welfare increase for the whole economy. While this pattern does not exclude the possibility that the economic winners still influence the political process based on their provision of goods and services, it may also happen that political actors see benefits in advocating economic reforms independent of such transfer of resources. (We call such actors "political winners" in distinction from "economic winners".) For example, if the economic reforms are expected to benefit the national economy as a whole or the unorganized households, such measures may be politically attractive for politicians as well as bureaucrats, even though no economic actors may be inducing them to act in such a way through the exchange of goods and services. Political parties can boost public support, increasing their chance of winning electoral seats. Or, bureaucratic agencies can expect wider acceptance for their policy measures by the public and solidify their reputation within the society, increasing the chance of organizational survival.

Combining "status quo", "inclusion", "defection", and "replacement" with "interest group politics" and "public interest politics", we obtain a four-by-two typology of reforms (Fig. 3.2). In the context of financial reforms, we may ask the question "Who brought about the Big Bang?" once again. By making use of a counterfactual, we may posit the possible actors who might have brought about the Big Bang, which enables us to obtain the following scenarios of financial reforms, regarding the process in which reforms emerge and the content (scope, depth, pace, and timing) of the reforms.

(S,I): domestic financial firms (e.g. banking, securities, and insurance) dominate the financial reforms. Gradual reforms — in terms of timing, scope, pace, and depth — are likely to emerge, after a lengthy consensus-making process with compensation to the losers. No visible change bureaupluralism: the deliberative councils and the LDP PARC would be the central bodies through which the reform initiative would go through, and MOF would organize the policy making process.

(C,I): some outsiders (e.g. nonbank financial institutions and foreign financial firms) are brought in the arrangement of bureaupluralism. The reforms emerge from the public policy making process of bureaupluralism, but the "outsiders" may be allowed to have an equal standing with the established domestic financial firms, under the policy making bargaining organized by MOF. The outcome is gradual reforms; yet, the interests of the outsiders may be more reflected than in the (S,I) pattern, in forms of larger scope of reforms and more liberalization, possibly combined with compensatory measures to the losers among the insiders.

(D,I): some among the domestic financial firms (e.g. large city banks) switch strategies and decide that regulatory reforms are to their own goods, inducing the state actors to bring about reforms through the exchange of goods and services. In order to avoid the clash with the rest of the domestic financial firms, the reforms emerge from elsewhere than the policy making mechanism of bureaupluralism. A drastic regulation in favor of those with competitive strength is likely to result, while the scope of the reforms may be concentrated to the areas of interest to the particular "defectors" (e.g. areas that allow the large banks to benefit) more than other areas.

(R,I): outsiders (e.g. corporate sector) choose to induce state actors through exchange of goods and services to bring about drastic reforms in finance, bringing down the policy making of bureaupluralism in finance. The reforms would be far-reaching, encompassing various areas of finance beyond what is under MOF's jurisdiction, such as postal savings and pension funds. They are likely to be carried out as quickly as possible, reflecting the desperate need of outsiders to have an efficient financial sector.

(S,P) and (C,P): these scenarios are unlikely to result, as the state actors are unlikely to be able to effectively pursue "public interest" over "constituencies interest", if we take the existence of bureaupluralism as given. If bureaucrats and/or LDP politicians seek to achieve such goals as drastic financial reforms at the expense of the financial industries, they are likely to face a tough resistance from the industries in the deliberative councils. The consensual style of policy making would prohibit the state actors to arrive at reforms that contradict the industries' well-being.

(D,P): some state actors (e.g. LDP and/or MOF) alter their strategies, and move to pursue "public interest" over "constituencies interest" by bringing about drastic financial reforms. Expecting the policy making process of bureaupluralism to function as obstacles, the state actors "go around" the process, instead choosing alternative paths to policy making. Financial reforms may be produced from policy making bodies other than deliberative councils and the LDP PARC: the resulting reforms may be of earlier timing, faster pace, larger scope, and deeper extent, in favor of the unorganized public.

(D,R): state actors that are outsiders (e.g. non-LDP parties; non-MOF agencies), in pursuit of "public interest" over "constituencies interest" displace the insiders in financial policy making. Drastic financial reforms, reaching beyond the jurisdiction of MOF, are likely to result from a totally different policy making process than bureaupluralism.

Fig. 3.2 Typology of Financial Reforms: Who Brought About the Big Bang?

Interaction Patterns of State and Societal Actors?

Coalition Patterns?	Interest group politics (I)	Public interest politics (P)
Status Quo (S)	**Domestic Financial Firms**	
Inclusion (C)	**Non-banks and Foreign Firms**	
Defection (D)	Some Financial Firms	LDP and MOF
Replacement (R)	Corporate Sector	Non-LDP, Non-MOF

Shaded: Institutional Change (Departure from Bureaupluralism)

S: same policy making process, insiders only
C: same policy making process, inclusion of outsiders
D: different process, led by insiders switching strategies
R: different process, outsiders displacing insiders

I: state actors act as a result of interest group pressure
P: state actors act independently of interest group pressure

Fig. 3.3 Possible Scenarios of Financial Reforms

Coalition pattern?	*Interaction Patterns of State and Societal Actors?* Interest group politics (I)	Public interest politics (P)
Status Quo (S)	**Gradual as Usual: Non-Change** *(Domestic Financial Firms)*	
Inclusion (C)	**Gradual, More than in the Past** *(Non-banks and Foreign Firms)*	
Defection (D)	**Drastic, Benefiting the Powerful** *(Some Large Banks)*	**Drastic, Emphasis on Finance** *(LDP and MOF)*
Replacement (R)	**Drastic, Overall Reforms** *(Corporate Sector)*	**Drastic, Overall Reforms** *(Non-LDP Parties; MITI)*

In Parentheses: Actors Who Could Have Brought about the Big Bang
Shaded: Institutional Change (Departure from Bureaupluralism)

Gradual / Drastic: concepts regarding scope, depth; timing and pace

More than in the Past: measures benefiting the "outsiders" with compensation to the losers among "insiders"

Benefiting the Powerful: e.g. liberalization of entry into other areas of finance

Emphasis on Finance: private finance (banking, securities, insurance, and foreign exchange) under MOF jurisdiction

Overall Reforms: scope including areas outside MOF jurisdiction (e.g. postal savings, pension funds)

3.12 Conclusion

This theoretical chapter sought to achieve two tasks. First, it introduced our theoretical frameworks of institutional change, which will be later utilized to make sense of the development in financial politics. Second, it constructed an image of the strategies and possible scenarios regarding financial reforms. It discussed how our starting assumption, that organizations seek survival, applies to the empirical reality of political parties, bureaucratic agencies, and firms and groups. Then, it identified the prevailing institutions in finance and public policy making in Japan before 1995.

In our definition, following Aoki (forthcoming), institutions are *"shared, stable, summarized expectations about how the world works, which may not be unique"*. An institution is based on a feedback mechanism between the objective and subjective worlds. We developed a theoretical framework of institutional change that addresses the politics, or the distributional conflicts, involved in the process of change: Fig. 8.1 summarizes our framework. Institutional change is essentially a shift in shared perceptions about "how the world works" through a collective learning process based on an evolutionary selection mechanism of strategies derived from the actors' subjective beliefs about "how the world works". It is caused by the gap between the faster pace of environmental changes (including of institutional environment) and the slower pace of adaptation in domestic political and economic institutions. This gap appears in the form of "failures", or "performance failures" and "scandals", which lead actors to question the "taken for granted" aspect of the institutions. "Nature" — environmental changes in technology or institutional environment— eventually determines the outcome of the competition of the institutions by rewarding various strategies of actors: the successful strategies will increase in the population. Yet, political struggle takes place between those actors who see the process as "resilience" of the institutions and/or have stakes in preserving the status quo on one hand, and those actors who, on the other hand, see that "change" is taking place and/or see enhanced interests in the new institutions. This political struggle is facilitated by symbols derived from such sources as history, foreign practice, ideology, and leadership. In the process, how the "conservatives" are displaced by "reformers" may be either "counter-coalition" (from outside) or "defection" (from within). When a critical mass of the agents shift their views about "how the world works" and the new institutions become "taken for granted", we call it "institutional change". Institutional complementarity often makes institutional change in one institutional field difficult; however, once such change happens in one institution, it is likely that the institutions in its environment will be forced to be re-assessed by the actors, thus starting a chain reaction of change.

We discussed the actors and their behavioral regularities in Japanese political economy in general, moving beyond financial politics to avoid tautology. Four sets of actors were identified: political parties, bureaucratic agencies, firms, and the public. We showed how the assumption of survival translated into the empirical reality for organizational actors. Political parties pursue electoral victory. Bureaucratic agencies as well as firms pursue organizational survival, given the inflexible labor market and the practice of continued employment. Bureaucratic agencies pursue survival through the maximization of organizational prestige, or the maintenance or enhancement of the agency's presence in politics, economics, and society; and firms pursue survival to continue the employment of its core workers. The notion of hierarchy of goals was introduced: the ultimate goal, survival, comes before *ceteris paribus* goals, such as the maximization of regulatory power and budget for the bureaucracy, and maximization of short-term profit for firms, when goals conflict with one another. We discussed the public's role in politics: while elections, boycott, and other means of direct action may be important, we will focus on their role as a parameter, which tends to be under-emphasized in the literature of Japanese politics. On this point, we questioned what public interest is and what its relationship with public support can be.

Then, we identified two prevailing institutions in Japanese financial politics before 1995: bureaupluralism in public policy making, and the Convoy System in finance. Our inquiry into the institutions analyzed players, formal rules, and interaction patterns, ultimately reaching the shared expectations that sustained the institutions at their core. Bureaupluralism in the Japanese political economy was an institution in public policy making which held across sectors under the LDP one-party dominance. In this institution, policies were produced through the inter- and intra- industrial bargaining presided over by the ministerial bureaus in charge, which engage in intra- and inter- ministerial bargaining within the government, with the occasional intervention by the LDP lawmakers on behalf of the industries. The bargaining was carried out through arenas such as deliberative councils and the LDP PARC, as well as through negotiations behind closed doors. After surveying the policy tools available to the government and the way the policy making process operated, we showed how politicians, bureaucrats, and the industries were intricately linked by a relationship of interdependence, while the public was largely outside of the policy making process. Bureaupluralism was a stable interaction pattern of politicians, bureaucrats, and the industries, based on the informal interaction of the same actors over time, guaranteed and reinforced by formal rules: the whole institution depended on shared expectations of continuity.

The Financial Convoy was another institution that arose in finance amidst the interaction of financial actors and state actors. The actors were always the same, as the LDP was in power, MOF was the exclusive "organizer" of the bargaining process according to legal statutes, as well as entry and exit were *de facto* restricted, if not eliminated, by the formal rules and other informal constraints providing for the segmentation of finance. Their interaction pattern was largely informal, supported by such features of bureaupluralism as "informal administrative tools", "wining and dining", and *amakudari*: the policy making bodies were the deliberative councils under MOF, and the LDP PARC (in particular, its financial sub-divisions). The system was based on segmentation of finance as well as surrounding institutions such as the main bank system, the financial *keiretsu*, and cross-shareholding. Essentially, no financial institutions were allowed to fail, and the state provided an implicit guarantee to sustain the "myth of no failure". The larger and more competitive firms were deterred from materializing their advantage; their compliance was secured by the regulatory rent and sanctions, or reward and punishment by the regulator. "Continuity" was key to the well-functioning of the Convoy: with future rounds to play, actors would be strongly deterred from deviating from the prescribed strategies under the Convoy. The "organizing principles" of the Convoy as the prevailing institution in finance was "cooperation and stability". Financial stability, or the stability of the financial order, was the goal of financial administration as well as the financial industries. This also fit the interest of the non-financial firms, which would enjoy stable access to finance: under the conditions that held under the high growth period, the repressed interest rates would guarantee cheap capital even with an underdeveloped capital market. As long as bureaupluralism obtained across all sectors and the household (the public) was excluded from the policy making process, "stability" in the financial order was reinforcing, and reinforced by, the "producer economy" that Japan had been in the postwar era.

Finally, making use of all of the above —the discussion of the theoretical framework, of the actors and their behavioral regularities, and of the prevailing institutions in financial politics — we built a four-by-two typology of financial reforms from the evolution of coalitions and interaction patterns of state and societal actors, obtaining the possible scenarios of financial reforms. (Fig. 3.2 and 3.3) As is always true of ideal-types, the actual events may not fit neatly within one ideal-type (each criterion may be better understood as a continuum); nevertheless, such a classification scheme helps us understand how each set of events differ from one another, and thus how things did or did not evolve over time. In the later chapters, we essentially aim to figure out where the Big Bang and other parallel financial reforms (e.g. MOF reforms) lie within these ideal-types.

Chapter 4 The Economic Realities of the Big Bang

4.1 Introduction

This chapter provides a sense of the economic realities of the Big Bang. What the initiative includes and what it implies to the actors in the financial market will be discussed. The chapter starts with a description of the initiative's backgrounds, drawing upon the initiative of November 1996 and the surrounding developments in finance up until June 1997. Next, a summary of the content of the initiative and the paralleling reforms in finance will be given. A discussion of the expected economic consequences for the financial market in general will follow. The above will lead us to grasp who stand to economically gain or lose, or who are the "winners" and the "losers".

4.2 Backgrounds of the Reforms

The basic concern that appears in the Big Bang plan announced by MOF in June 1997 (hereafter "the plan") is Japan's aging society. The aging of the population is projected to be drastic in pace and to have serious consequences. While the population over age sixty-five occupied 14.5% of the whole population in 1995 (U.S. 12.6%), the ratio is projected to drastically increase to 27.4% in 2025 (U.S. 18.1%). (Ishi 1996, 271) Given the underfunded social security system, the aging population would have to increasingly rely on their past savings: efficiency in the financial services will thus matter in the long run.

On top of this, five concerns are identified by the announcement:

1) 1200 trillion yen of individual financial assets
2) Smooth funding for growing businesses
3) International competition and "hollowing out"
4) Accumulation of the past liberalization and deregulation in the financial sector
5) Bubble years and the bad debt problem

In addition to the above, other important developments were taking place in finance:

6) Wave of scandals hitting MOF and the financial sector, and the resulting change in financial administration

Below, each issue will be explored so as to reveal its implications for later analysis.

1) 1200 Trillion Yen of Individual Financial Assets

In face of the rapidly aging society, 1,200 trillion yen of individual financial assets ought to be managed efficiently, the plan states. The Japanese are known to have had a very high saving rate compared to the rest of the world: it still remains high as of 1996, at 13.8%, compared to 4.4% in the United States. (BOJ 1998) A result of the high savings rate sustained over a long time is the amassed personal financial assets: they amount to 1,230 trillion yen as of 1997.[1] These are heavily invested in banking, compared to the United States. In Japan, 58.8% of them are in deposit, 25.6% in insurance, 5.9% in trust fund, 2.5% in bonds, 2.3% in investment fund, and 4.8% in stocks. In the United States, which has $22.78 trillion of household financial assets, the corresponding figures are deposit 14.0%, insurance 4.2%, pension fund 32.6%, trust fund 4.8%, bonds 8.1%, investment fund 11.6%, and stocks 24.9%. Thus, indirect finance occupies 90.3% of individual financial assets in Japan, while the corresponding figure is 55.5% for the United States.[2]

2) Funding for Businesses: Shift from Indirect to Direct Finance

The plan states that the aging society makes it essential that the economy has growing businesses that act as locomotives to ensure growth. Thus, the financial system needs to become more efficient to effectively funnel resources to the growing sector of the economy. The shift from indirect finance to direct finance, that is, from bank loans to capital market in corporate finance may be a key issue. Traditionally, Japanese firms have heavily relied on indirect finance. Japan of the postwar era has had a financial system based upon a set of financial policies which Hellman, Murdoch, and Stiglitz (1995) call "financial restraint". In this system, deposit rate control and entry control created rents captured by the financial institutions, inducing such institutions to provide such goods and services underprovided in perfect competition markets as monitoring of investments; an addition of lending rate control gave rents to the borrowing firms, which enjoyed lower interest rates than market-clearing level. As a result, a transfer of rents occurred from the household to the financial intermediaries and to productive firms.

However, this system has been significantly undermined due to the financial liberalization taking place since the mid-1980s in two aspects. First, most importantly, corporate borrowers have developed alternative means of financing their investments through the capital market since the 1980s as a result of deregulation: the competition from the capital market undermined the banks' rents in the "financial restraint". Second, while the gradual liberalization of deposit rates (completed in 1994) have not yet led to a significant decrease of bank deposit in household portfolios, this development makes it impossible to sustain this systematic transfer of rent from the household to banks under the deposit rate control of "financial restraint".

The shift from indirect to direct finance may be beneficial to the national economy by increasing its flexibility in facing macroeconomic shocks. According to the U.S. Board of Federal Reserves Chairman Alan Greenspan, "multiple alternatives to transform an economy's savings into capital investment act as back up facilities should the primary form of intermediation fail." In his view, the development of capital markets (or channels of indirect finance) increases the economy's capability to weather macroeconomic shocks, as demonstrated by the stark contrast between the mild U.S. recession in 1991 and the long-lasting problems of bank-dominated Japan of the 1990s.[3]

3) International Competition and "Hollowing-Out"

Hashimoto's initiative of November 1996 clearly stated that one of its goals was to revitalize Tokyo as a financial market on a par with New York and London in five years, that is, by 2001. Tokyo was weakening as a market for securities trades and foreign exchange transactions in comparison to New York and London.(Fig. 4.1 and 4.2) The restriction on bond issuance, which once guaranteed banks' dominance over corporate finance, had been driving yen-denominated bond issuance largely over to the London off-shore market. (Kaizuka 1996) Restricted competition under the Convoy System (see Chapter 3) has resulted in the lack of competitiveness in financial product developments and inefficiency, when measured in international standards. Japanese financial institutions, hampered by government regulations and restricted entries, are behind their Western counterparts in terms of derivatives trading and asset-backed securities (ABS). As for efficiency, the return on assets (ROA) in the banking sector had been 0.5% for 1985-1994, compared to about 1.7% for Canadian, U.K., and U.S. banks. (Dekle 1998; IMF 1997)

While the plan only mentions New York and London as Tokyo's rivals, intra-regional competition in Asia cannot be ignored: Hong Kong and Singapore have developed themselves as possible alternatives to Tokyo in the 1990s. Because of the difference in time zones, Asian financial centers can operate while the major international financial centers in the United States and Europe have little operation during the night. Thus, Asian financial centers are in a competition with each other at a different level from the competition with the United States and Europe. (Ueda 1996) The two Asian markets had been steadily closing the gap between Tokyo and themselves in the foreign exchange market.(Fig. 4.3)

Fig. 4.1 **London, New York, Tokyo: Stock Exchange Turnover**

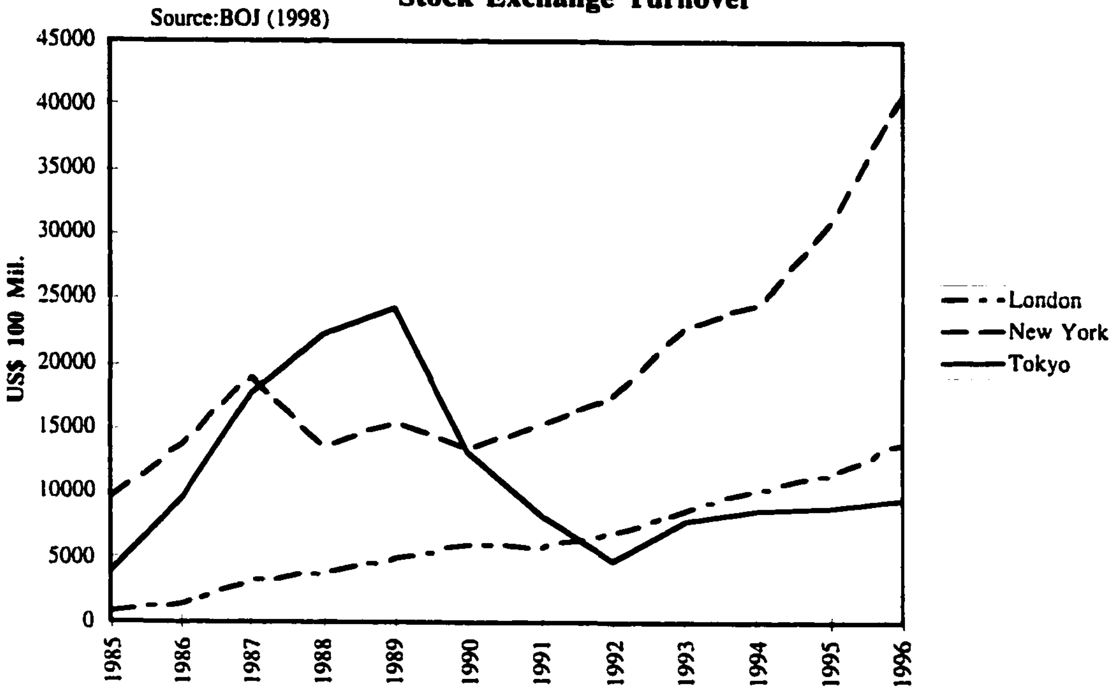


Fig. 4.2 **London, New York, and Tokyo: Foreign Exchange Transactions**

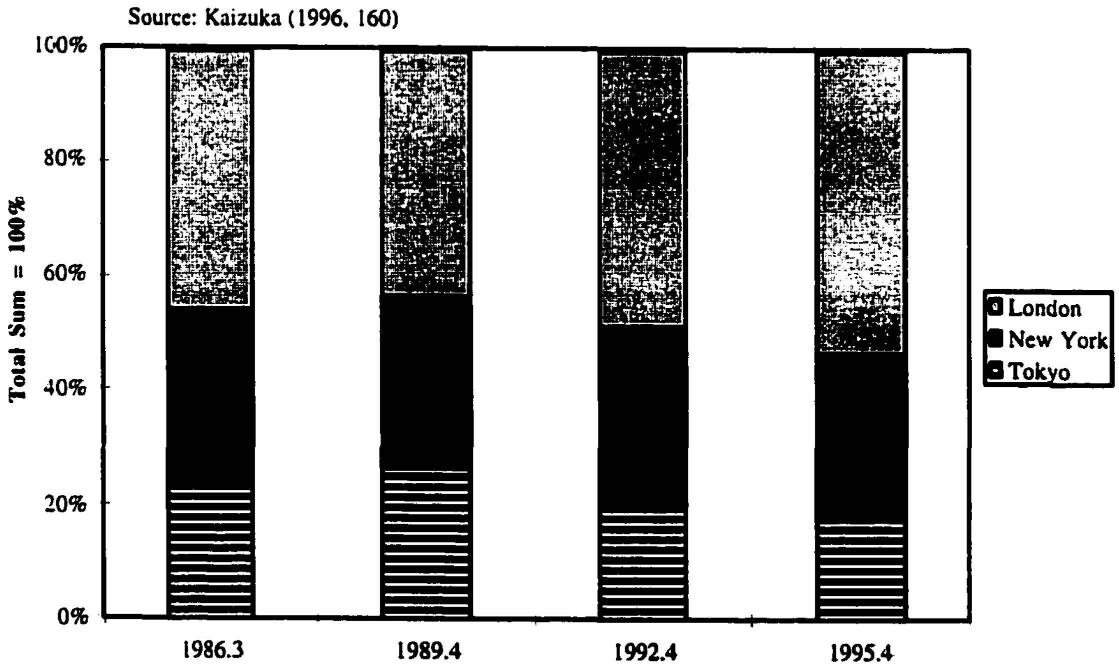
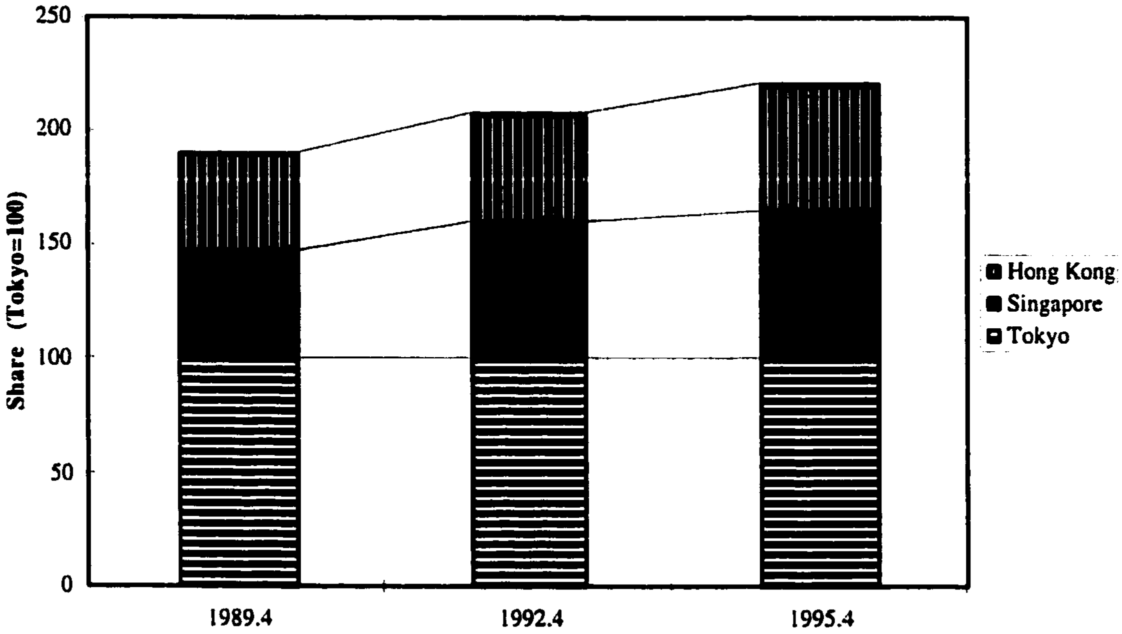


Fig. 4.3 **Hong Kong, Singapore, and Tokyo: Foreign Exchange Transactions**

Source: Kaizuka (1996, 160)



Tokyo's relative decline as a financial market vis-à-vis its rivals, New York, London, Hong Kong, and Singapore, led to the alarms in the policy circles being raised concerning the "hollowing out" (*kudoka*) effect in finance in the mid-1990s. Having an international financial center is not only beneficial but also vital to a country.[4] Globally, the financial industry is growing rapidly within the service sector, which has a high potential for employment in countries where manufacturing may wither. However, when the demand for financial services falls below a certain point, because economies of scale and the fixed costs apply, the center disappears: even if the demand recovers to the prior level in the future, the financial center will not revive. The loss of a financial center not only causes loss of income, but may trigger an increase in the cost of financial intermediation (including retail) and thus in the cost of capital for investors, ultimately lowering economic growth. (Ito 1996; Ueda 1996)

Another implication of the "hollowing out" effect is that having Tokyo as a financial market does not necessarily mean that Japanese financial institutions will flourish: it may well be the case that the benefit of having an international financial center (or the risk of losing one) can be taken care of by fostering market participation by the most efficient financial institutions, whether Japanese or not. Thus, the sustenance of the Tokyo market as an industrial policy to promote the competitiveness of Japanese financial firms may not be compatible with the function of Tokyo as an international financial center, as such a center needs to be indifferent to the nationality of the actors. (Kaizuka 1996)

4) Accumulation of Past Liberalization and Deregulation in the Financial Sector

It is commonly observed that MOF had not carried out reforms of consequence over the ten years starting from 1984, when financial liberalization had started. According to one account, while the reforms were introduced, the pace was very slow, as MOF "guided the process in a gradual and orderly manner, managed liberalization to protect domestic financial institutions, and designed the reforms to maintain its own authority over these financial institutions." (Vogel 1996, 192) However, in the plan of June 1997, MOF claims that the Big Bang is a continuation of a "progress" since before the Bubble. How much liberalization has it been achieved at the time of the announcement, November 1996?

Financial liberalization in Japan has its origins in the massive deficit spending of the Japanese government in the post-Oil Shock, low-growth era after 1975. The large scale issuance of government bonds that financed this deficit spending forced MOF to move away from the system of purchase where banks (and the BOJ from the banks) purchased such bonds with artificially low coupon rates. MOF opened up a secondary market of government bonds in 1977 and introduced the sale by public auction system in 1978, resulting in a government bonds market where bonds are traded at market price. Now, the savers and the borrowers were able to by-pass the regulated markets to the government bonds markets: as a result, interest rates, an important feature of "financial restraint", were liberalized by mid-1980s, except for deposit rates. The deregulation "took off" in 1984, following a report coming out of the U.S.-Japan Yen-Dollar Committee under U.S. pressure for deregulation. (Osugi 1990; Hoshi and Kashyap 1999)

The Financial Reforms of 1991-93 (see Chapter 6) commenced the breakdown of the segmentation in finance, in which banks and securities were allowed cross-entry as well as entry into trust banking through financial subsidiaries. However, this breakdown was not complete because of tight business restrictions on financial subsidiaries. Besides, the implementation of the reforms, such as the establishment of subsidiaries, was meticulously supervised by MOF so as not to disturb the status quo.[5] The subsidiaries were established all according to the rules of "compensation", where such "losers" as long-term credit banks and securities firms were allowed by MOF to set up subsidiaries earlier than city banks. (Vogel 1999, 15)

The process can be reconstructed from the perspectives of three actors in finance: firms, households, and financial intermediaries , following Hoshi and Kashyap (1999).[6] First, for firms, the deregulation greatly increased their choice over financing, because of the emergence of vibrant bonds markets both at home and abroad. The manufacturing sector, where the effect was clearest, saw its ratio of bank debt to assets drop from 29.5% in 1983 to 16.5% in 1989.[7] The liberalized areas in the international markets included: international banking (e.g. Euro-yen lending), international bond issues (e.g. Samurai and Shogun bonds[8]), foreign exchange transactions (e.g. the abolition of the "real demand principle"[9]), and the establishment of the offshore market.[10] In the domestic market, the tight control on bond issuance by banks — another feature of the "financial restraint" system of the postwar era — had been increasingly relaxed, largely due to the availability of the international bond market, allowing the firms to by-pass the Bond Issuance Committee controlled by the banks. In 1993, the ratings system were introduced to substitute the bond issuance criteria, which was finally abolished in 1996. The domestic commercial paper (CP) market, an alternative to bank borrowing, was established in 1987.

Second, for the household, the liberalization of deposit rates, which had begun in 1985 with large-scale time deposits, was completed in 1994. However, because the deregulation of other saving options that would allow the household to directly participate in capital markets (such as stock trading, investment trust) were slow to come, the households had not seen a sizable increase in options for managing their savings.

Third, as for the financial intermediaries, the banks were not allowed to pursue new businesses outside traditional banking when they faced the loss of traditional customer base, the large firms, especially in the manufacturing sector. New financial products were slow to be authorized, and entry into other financial businesses were virtually prohibited until 1993. As a result, they committed themselves increasingly to property-related lending to smaller firms.

We can summarize the characteristics of the financial liberalization that preceded the Big Bang as follows. First, the liberalization of finance had steadily been taking place since the 1980s: the claim by MOF that the Big Bang was a continuation of the past efforts for liberalization was not entirely misplaced. Second, however, the pace of liberalization had been uneven within finance. The liberalizing trend had been most significant in markets of corporate finance, where market forces outside government control (such as the Euro-market) greatly accelerated the pacė. While the massive issuance of government bonds eventually led to the liberalization of interest rates, this was achieved at a much more gradual pace; so was the diversification of financial products for the household (such as securities and investment trust) as well as diversification of businesses for financial intermediaries (such as cross-entry and liberalization of products). In these areas, where the regulation such as the foreign exchange control could prevent the pressures of globalization, the considerations for the "stability of the financial order"[11] (i.e. the organizing principles of the Convoy) prevailed: the reforms had indeed been very gradual.

5) Bubble Years and the Bad Debt Problem

The Japanese economy saw a dramatic boost in economic performance in the late 1980s, or the bubble years. However, this bubble economy, in which asset inflation (real estate and stock, in particular) and a boost in private investment occurred under record-low interest rates, had collapsed by 1991. The slowdown resulted from stalling domestic demand; private investment rate declined, reversing the trend of over-investment during the bubble period, and consumption was dampened by falling stock and real estate prices. (IMF 1998, 6) An economic stagnation resulted: the economic growth for the period of 1992-1995 averaged a dismal 0.85%. (Fig. 4.4)

Among the various reasons for the collapse of the bubble (which the return to economic rationality would have brought about eventually[12]) and the ensuing economic stagnation, two factors appear to have been mostly important. The first one is the massive hike in interest rate, introduced by the BOJ (possibly under keen MOF pressure). The second factor is that of overinvestment during the bubble years. The Japanese private sector, benefiting from the record low interest rate of the late 1980s, overinvested during the late 1980s, resulting in a stock adjustment period: private investment soared in the years 1986-90, peaked in 1991, and dropped sharply in 1992. (Fig. 4.5)

Fig. 4.4 **Japan: Real GDP Growth 1980-98**

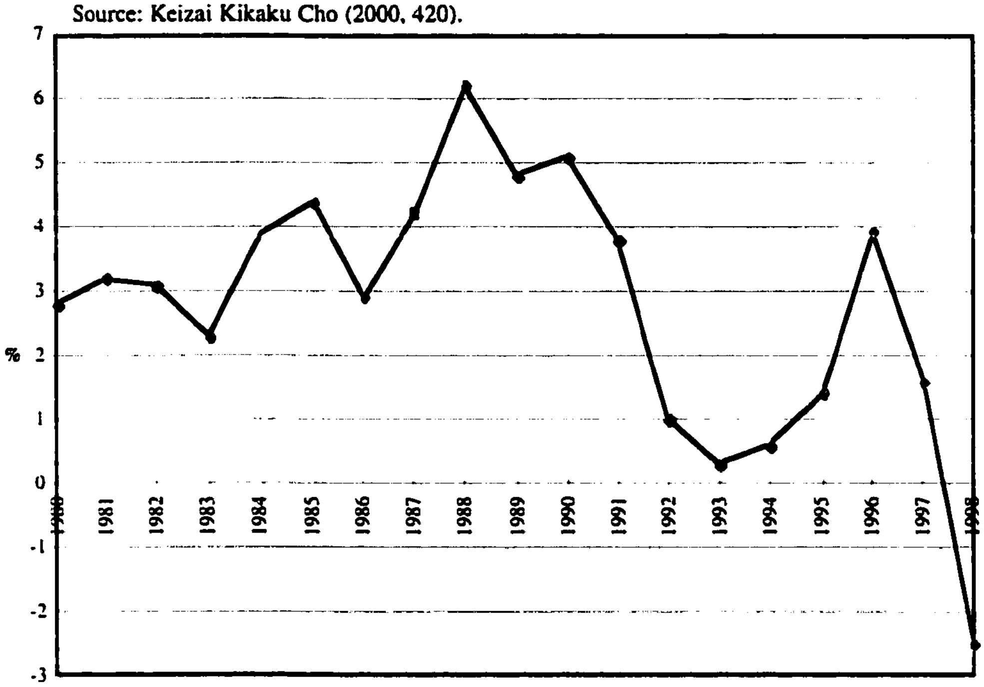
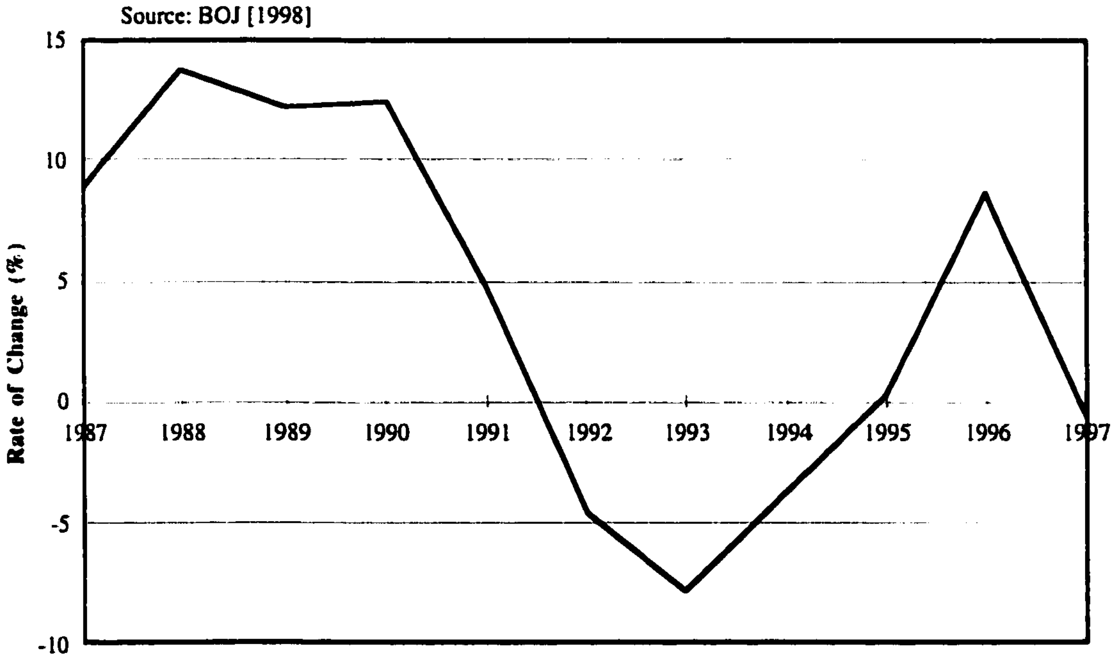


Fig. 4.5 **Japan: Private Sector Investment 1987-97**



To cope with the post-bubble economic stagnation, fiscal policy was geared to providing stimulus to the economy by a series of economic stimulus packages (IMF 1998) In addition, starting from 1995, the government introduced a series of temporary cuts in the income tax. As a result, while the fiscal situation considerably worsened in the first half of the 1990s, the economy seemed to have regained vitality, as the growth rate resumed to 3.9% for 1996.

With signs of economic recovery in 1996, the policy emphasis shifted toward consolidation with a contractionary budget for fiscal year (FY[13]) 1997, the withdrawal of temporary income tax cuts introduced in 1995, a change in the consumption tax rate from 3% to 5%, and an increase in the national medical insurance co-payment. These fiscal developments and other factors, such as banking sector instability and the Asian crisis which reduced external demand, contributed to bring the Japanese economy into recession from the second quarter of 1997. (IMF 1998)

However, we must bear in mind that the recession that lasted until the second quarter of 1999 was not yet apparent when the Big Bang was conceived in 1996-97. While the recession was partly brought about by the changes in fiscal and health care policy, it must be understood that such changes were also part of Prime Minister Hashimoto's main political agenda for his second administration, following the victory in the Lower House election of October 1996. It was called Hashimoto's Six Large Reforms: the strategy was to carry out structural reforms in six policy areas all at once. The Big Bang was one of them, alongside "Fiscal Structural Reforms" and "Social Security Structural Reforms" as well as "Administrative Reforms", which included MOF reforms.[14] Thus, the Big Bang, especially its birth process, ought to be treated separately from the later recession partly caused by the other Hashimoto Reforms: while the financial system was increasingly destabilized, there were reasons for policy makers to believe that the economic situation had come out of its worst stage, although, in hindsight, this belief was erroneous. (See Chapter 5.)

Deeply related to the economic stagnation is the bad debt problem. As a result of the asset deflation following the bubble burst and the macroeconomic stagnation of the 1990s, banks and other financial institutions amassed a massive heap of bad loans. While the large manufacturing firms had shifted to capital markets following the financial liberalization since the mid-1980s, loans made by banks were increasingly directed towards real estate projects and small- and medium-size enterprises, often collaterized by real estate. (IMF 1998, 101) Not only the fall in land price, but also lower stock price hurt the balance sheet of the banks, as the market value of their holding in stocks decreased.[15] Because of the accounting standards that relied more on acquired values instead of market values, banks saw their off-balance assets increasing in size during the Bubble years, as their asset holding gave them "unrealized gains" or hidden assets. However, the reverse could also happen, and the banks had to cope with serious hidden losses in the 1990s.[16]

What are the deeper causes of the bad debt problem? Some blame the lack of adequate monitoring of banks, due to the lack of competition and inadequate financial regulation. (Horiuchi 1998) Others point to the lopsided nature of the deregulation process: the deregulation in the capital markets were much faster than those in financial products for households and in banking businesses. Thus, the firms borrowed less from the banks, the savers continued to pour in money to the banking sector, and the banks, unable to start new businesses because of regulation, had to stick to traditional lending, chasing riskier business opportunities, deteriorating their financial health. (Hoshi and Kashyap 1999)

The amount of bad debts is often a source of confusion, as definitions of problem loans have varied over time; besides, the amount itself varied according to macroeconomic conditions. With these caveats in mind, according to estimates by Hoshi and Kashyap (1999), here are the estimates for September 1996: the twenty-one major banks had 18,846 billion yen of bad loans, 9,508 billion yen of loan losses; the figures were 24,383 and 12,035 billion yen, respectively, for all banks.[17]

The banking industry and the government were slow to react in the first half of the 1990s, believing that economic recovery would resolve the problem. (IMF 1998) Restructuring was slow to come in the banking industry, and loan write-offs did not happen until 1996.[18] According to Horiuchi (1998), what the government introduced as "emergency measures" were *ad hoc* measures that procrastinated the fundamental resolution of the problem. What it did can be classified into four categories: 1) promoting the write-offs of bad loans, 2) promoting the liquidation of bad loans, 3) supporting the strengthening of banks' capital base, and 4) strengthening the deposit insurance system (in 1996). What it lacked was a mechanism that would motivate the banks to recover its capital base, such as prompt correction measures and public funds injection schemes.[19]

However, the instability of the financial system had increasingly become a large concern for the nation, as more and more financial institutions started to collapse in the mid-1990s. First came the smaller financial institutions, credit cooperatives and small banks. In 1994, two credit cooperatives in Tokyo had made the newspaper headlines for questionable loans and operational difficulties. In July 1995, Cosmo Credit Cooperative in Tokyo went under, starting a chain of failures of financial institutions, centered around smaller ones such as credit cooperatives and regional banks.[20]

In the winter of 1995, the Housing Loan Problem became the focus of national attention.[21] The housing loan companies(*Jusen*) are financial firms originally set up by financial institutions (most of them were banks) to provide housing loans to individual households in the 1970s. As banks were later allowed to enter into this market, the housing loan companies had shifted its businesses to loans to the real estate sector: the housing loan companies would borrow funds from the banks, lending them with added premium. This trend had become even stronger in the early 1990s, as an administrative guidance issued by the Banking Bureau of MOF instructed the banks to curb the funds available to the real estate sector in 1990: the housing loan companies, exempt from this regulation, were used by their parent banks to by-pass this regulation. Not only banks, but also the financial arms of agricultural cooperatives provided the funds to the loans made by the housing loan companies, which increasingly flowed into risky projects.

Because of the economic downturn and asset deflation, housing loan companies amassed a large amount of bad loans. While there were proposals from some banks to liquidate them in 1993, MOF instead chose to prepare a rescue package that lowered the interest payment to the lenders, which were mostly banks and agricultural co-operatives. In 1995, as the asset deflation worsened, it became clear that the seven housing loan companies could not survive: the loss resulting from reckless loans amounted to 6.4 trillion yen. The problem was how to liquidate them, as it would deal a severe blow to the banking sector as well as agricultural cooperatives, already damaged by the bad debt problem. A tug of war between the banks and the agricultural cooperatives, with the former led by MOF and the latter backed by the Ministry of Agriculture, Forestry, and Fisheries (MAFF) and the LDP agriculture "tribesmen", took place to settle the issue of how to split the losses. The agricultural sector emerged as the winner, as it successfully refused a burden-sharing scheme proposed by MOF. This part of the loss, which amounted to 685 billion yen, had to be covered by the national coffer: the decision within MOF and the government was made in December 1995; the measures became law by June 1996.

This affair stirred up a public uproar, initiating a heated political debate between the LDP and the opposition in the Diet. Not only did it hurt MOF and the banking industry as addressed below, it also made the injection of public funds into the financial system very unpopular, and hence unattractive for policy makers. The Housing Loan Problem was one of the turning points for the relationship between the LDP, MOF, the financial industry, and the public, as we will see in the later chapters.

Along with the Housing Loan Affairs, to cope with the financial instability, the government introduced three bills to the Parliament in April 1996, following the submission of the bill on Housing Loan companies in February. The "three financial laws" of 1996 included four important measures. First, prompt correction (early warning) measures[22] were to be introduced from 1998 to strengthen prudential regulation. Second, a special legislation that amended the corporate bankruptcy laws was introduced to cope with the failure of financial institutions.[23] Third, the deposit insurance system was improved in its procedure for coping with bank failures.

Fourth, most importantly, temporary measures effective for five years, that is, until 2001, were introduced. Among these measures[24], the most relevant for the financial reforms was the decision not to start the payoffs in bank failures until 2001 to protect the depositors, in spite of the letter of the Deposit Insurance Law. Deposit payoffs would not be carried out even in case of bank failures (notwithstanding the statute existing since 1971), and the deposits would be guaranteed for their full values, in excess of the legally guaranteed amount of 10 million yen (notwithstanding the statute existing since 1986). As noted in Chapter 5, this had a large impact on the Big Bang by influencing its timing, or setting a deadline for the financial reforms. This also demonstrates that not the statutes but the common expectations of the actors are what really matter, as we will see in our discussion of the breakdown of the Convoy system in Chapter 8.

The three bills became laws in June 1996, allowing the government to declare that the worst for the financial system was over. In hindsight, this optimism of the government was misplaced. With the knowledge of the later course of events, the measures taken by the government, including the strengthening of the deposit insurance in 1996, can be said to be "patchwork" efforts to procrastinate, as Horiuchi (1998) charges.

However, it must be noted that the necessary measures to stall the financial instability caused by the Housing Loan Affairs and a chain of failures of small financial institutions appeared to have been taken by the summer of 1996, while the bad debt problem and the related doubt on the reliability of the disclosure by the financial institutions loomed in the background. It is important to keep in mind that when the Big Bang initiative was launched (November 1996- June 1997), not one of the mega banks and securities firms that consist the core of the financial system had failed yet, although rumors of financial trouble existed for some financial institutions.

6) Wave of Scandals Hitting MOF and the Financial Sector

Scandals involving MOF and the financial industry were uncovered one after another, and public outrage increased exponentially in the mid-1990s. In 1991, there was a scandal over loss compensation by the securities firms, which were secretly favoring corporate clients over the ordinary individual customers by promising compensation in case of losses. This resulted in public criticism against the securities industry, and also in the creation of the Securities Exchange Surveillance Commission (SESC) within MOF, marking the first time that criticism of MOF's financial administration actually forced a change in its organization.[25] (See Chapter 6)

On top of the failures of financial institutions starting in the summer of 1995, policy failures and scandals brought further instability in the financial system. Three incidents were critical. First, in the fall of 1995, the Daiwa Bank Scandal took place: a huge loss incurred by a bond dealer in New York evolved into a cover-up scandal, involving MOF being accused of failing to promptly report to the U.S. authorities as well as adequately regulating the overseas branches of Japanese banks. This resulted in the eviction of Daiwa from the U.S. market, and in the emergence of Japan Premium, a practice of charging an interest premium against the Japanese banks in inter-bank call markets.

Second, as mentioned earlier, in the winter of 1995-1996, the Housing Loan Affairs became the center of political debate: the first decision to inject public money into the financial mess created by the housing loan companies, the banks, and the agricultural co-operatives stirred up a public uproar against MOF, the LDP, and the banking industry. The Housing Loan Affairs were a scandal for MOF as well as a policy failure: many retired MOF officials were involved in the management of the seven housing loan companies;

MOF did not take actions earlier, resulting in larger losses; and MOF and MAFF bureaucrats, unknown to their Ministers, secretly exchanged memoranda that may (or may not) have guaranteed that the financial arms of agricultural cooperatives would be given special treatment. Large city banks originally founded the housing loan companies, then used them to by-pass the regulation to provide funds to shady businesses, making a huge profit during the bubble years; they were perceived to dodge responsibility when their affiliated housing loan companies were in trouble. Such behavior by MOF and the banking industry came to be publicly known, as the policy measures were debated in the Diet, resulting in heavy criticism from the politicians, the media, and the public in general.

Third, the Wining and Dining scandals of MOF bureaucrats with their questionable relationship with rogue financiers caused a public uproar in 1994-96, resulting in the dismissal of two of the most senior and influential officials from the agency in 1995.[26]

These scandals raised the following concerns about financial administration. First, MOF's limited competence as the regulator became apparent by the Housing Loan Affairs and the Daiwa Bank Scandal, altering the prior image of MOF as being powerful and competent. Second, the integrity and ethics of the bureaucrats came to be highly questioned by the wining and dining as well as Housing Loan scandals, which brought the nexus woven through *amakudari* into light. Moreover, the scandals also tore down the banking sector's reputation vis-à-vis the public. We will turn back to this issue in the later chapters.

4.3 Basic Concepts of the Reforms: Principles, Pace, and Sequence

The Big Bang initiative rests on four basic concepts, according to the June 1997 plan. First, the initiative of November 1996 made it clear that the Big Bang was to be carried out according to three principles: *"Free, Fair, and Global."* "Free" stands for the overarching liberalization and deregulation measures to ensure that market principles regulate the financial market. "Fair" represents the revision of old regulations and the introduction of new ones that aim to make the market transparent and reliable. "Global" stands for the measures to harmonize standards and supervisory regimes with international ones across the world, aiming to render Tokyo an international and advanced market.

Second, the plan spells out the timing for each measure to be enacted so that the reforms can be carried out all at once. This creates a self-imposed deadline, which makes it harder to slow down the reforms later on. Third, however, the importance of the "stability[27]" of the financial system is also stressed in the initiative. The bad debt problem needs to be resolved quickly, and the stability of the financial system as well as the confidence from home and abroad to it must be secured. Reflecting this concern for the "stability" of the financial system, the plan sets up a five-year period, in which some areas such as insurance are gradually reformed, in contrast to the U.K. Big Bang reforms which seemed to have lacked such concerns to the existing businesses.[28] Curiously enough, however, it must also be noted that the initiative is reticent on its expected effects on the existing financial institutions. If the Big Bang has negative effects on their prospects for survival, then, the package and this "basic concept" of financial stability may conflict with each other. Lastly, the reforms are to benefit the "users". Unlike the reforms in the past, where the industries' interests were at the center of the policy debate, the users of the financial services are professed to be the main beneficiaries of the reforms.

We may be able to classify the measures in the plan from two perspectives.

1) *Liberalization and deregulation*[29]:
Enhanced competition and reduced government control

2) *Enhancement of market infrastructure*:
Market development, fairness, and transparency

Table 4.1 shows a summary of the important measures in the package, followed by paralleling measures that are outside of the package but often associated with the Big Bang.[30]

While the decision to launch the initiative at this timing (1996-97) and scope (across finance) attracts our primary focus as the most important choices, there are also two important choices involved: pace and sequence. The reforms as a whole are to be carried out by 2001; however, the pace of each of the measures was not delineated in the Hashimoto initiative of November 1996. The precise timetable emerged in June 1997, only after a considerable deliberation at MOF's deliberative councils. The interplay of the industries and MOF which determined the pace of the implementation of the measures will be explored in Chapter 6.

Another policy choice is the sequence of the reforms. The Big Bang has two phases: the first phase materialized with the liberalization of foreign exchange control in April 1998, while the bulk of the Big Bang reforms took effect in December 1998 (with major exceptions set forth, reflecting the above issue of pace of reforms). This choice ("foreign exchange reforms first") was controversial. A BOJ economist who turned into a lawmaker from the Shinshinto (now the Liberal Party), Yoshio Suzuki, sees a large dilemma here. If the financial deregulation is carried out gradually, the "hollowing-out" of the financial market may take place, as a result of the foreign exchange liberalization; however, if the reforms are to be carried out at once, it may destabilize the Japanese financial system. In short, it is a dilemma between efficiency and security. (Suzuki 1997) Likewise, Seiichiro Saito, another economist and veteran of the BOJ, sees a dark future brought about by the Big Bang, precisely because of the problem in sequencing: a domestic financial panic may result by the large capital outflow, if foreign exchange liberalization materializes before the domestic system gets ready. The needed preparations would include the secure establishment of payoff system, the liberalization of control over entry, price, and products, as well as the safety net providing for transitory crisis. The liberalization of capital transfer ought to be the last one to come, after all these measures would be secured. (Saito 1997) Why, then, adopt this sequence? The political story behind this choice will be considered in Chapter 5.

Table 4.1 Big Bang Initiative: Principal Measures

1) Liberalization and Deregulation
Enhanced competition and reduced government control

- Liberalization of international capital transactions
- Product liberalization (securities, investment trust, derivatives, loan securitization, ABS)
- Complete deregulation of cross-entry among banking, trust banking, securities, and insurance
- Liberalization of bond issuance for commercial banks and nonbank financial institutions
- Removal of the ban on financial holding companies
- Deregulation of entry control for securities business
- Liberalization of fixed brokerage commissions
- Abolition of legalized cartel in casualty insurance
- Liberalization of the foreign exchange business

2) Enhancement of Market Infrastructure
Market development, fairness, and transparency

- Abolition of the monopoly of Securities Exchanges in securities transactions
- Strengthening the registered markets
- Harmonization of accounting standards with international practice
- Stricter disclosure rules for banks and securities
- Creation of safety net for securities and insurance

3) Reforms Paralleling the Big Bang

- Creation of the Financial Supervisory Agency (FSA) [MOF break-up]
- Full revision of the Bank of Japan (BOJ) Law [increased central bank independence]
- Change in the style of financial administration: towards a rule-based system

4.4 Contained Measures

This section provides a brief explanation of measures with high relevance to the later analysis with focus on how such measures affect the actors in the financial market.

1) Liberalization and Deregulation

The below measures aim to promote competition and reduce governmental control.

- Liberalization of international capital transactions

Japanese residents would be allowed to hold deposit and brokerage accounts overseas, and overseas remittance will not require prior notification, starting April 1998. As this measure would take effect earlier than the bulk of the deregulation measures, the users of the financial services would have the option of "exit", if they find the investment options abroad to be more attractive.

- Product liberalization (e.g. securities, investment trust, derivatives, ABS [asset-backed securities])

This brings wider opportunities for some businesses with liberalized products, while hurting the other businesses by bringing competition in their domain. For example, the introduction of Money Market Fund Accounts with settlement functions (the equivalent of asset management accounts) will benefit the securities industry, while it lessens the monopoly of deposit-taking institutions on the lucrative business of managing households' settlement accounts.

- Complete deregulation of cross-entry among banking, trust banking, securities, and insurance

This measure breaks down the compartmentalization of finance. While the financial reforms of 1991-93 first broke down the segmentation in finance, it strictly restricted what the financial subsidiaries could do in the new line of business they entered.[31] These restrictions are to be abolished by the Big Bang, and the financial firms would become free to enter other financial businesses through its subsidiaries. However, the pace of cross-entry varies, reflecting the concerns by the "weak" in the financial sector. The trust banking and securities businesses by the subsidiaries of the city banks would be allowed in the latter half of FY1999, while the insurance industry would be guarded from intrusion from other businesses until the end, or the year 2001.

- *Liberalization of bond issuance for commercial banks and nonbank financial institutions*

This measure also brings down an important line of segmentation within banking (that divides long-term credit banks and ordinary banks[32]) as well as the line between banking firms and nonbanks. This would annihilate the distinction between long-term credit banks and city banks by abolishing the monopoly on bond issuance enjoyed by the former.[33] The non-bank financial institutions would be given increased financing options by being allowed to issue corporate bonds and commercial paper (CP).[34]

- *Removal of the ban on financial holding companies*

This measure complements the above measure of cross-entry deregulation. This is achieved through a revision of the Anti-Monopoly Law which banned holding companies, preventing the resurrection of pre-WWII *zaibatsu*. A new law is enacted as well to create a legal framework for financial holding companies.

- *Deregulation of entry control for securities business*
- *Liberalization of fixed brokerage commissions*

These two measures are designed to increase competition in securities. The first measure lessens the cost for entry in the securities businesses by downgrading the legal requirement.[35] The second measure drastically increases competition within the securities industry, which traditionally relied much of its revenue on fixed commissions. Its implementation would be in two steps. Following the liberalization of larger transactions in April 1998, the complete liberalization would take effect by the end of 1999.[36]

- Abolition of legalized cartel in casualty insurance

The casualty insurance firms were compelled by law to use the insurance premia calculated by an association set up by the industry. The deregulation abolishes this legal obligation, thereby abolishing this quasi-cartel. This introduces a severe competition in the field, undermining the regulatory rents enjoyed by the industry as a whole. This measure would benefit the consumers as a whole by a decrease in premium rates. However, because the insured will be segmented and different premia will be applied, some consumers (e.g. young car drivers) will see their insurance fees go up, according to casualty insurance firms.[37] This measure is in line with the U.S. - Japan Insurance Talks' agreement reached in December 1996 (see Chapter 6).

- Liberalization of the foreign exchange business

Foreign exchange transactions had to be carried out through banking institutions authorized by MOF. This regulation, stemming from the days when Japan had to control its foreign currency transactions due to balance-of-payment concerns, increased transaction costs for non-financial firms, which saw their international business dramatically expand in the 1980s and 1990s. It created a regulatory rent captured by the banking sector in the form of handsome commissions. This measure abolishes the monopoly of banks in the foreign exchange business. While it hurts the banks, the non-financial corporations, especially those heavily involved in international business, will benefit by setting up their own system that would allow them to by-pass the banks.

2) Enhancement of Market Infrastructure

The below measures seek to enhance the market infrastructure by increasing the utility of the securities market for the users, augmenting the transparency of the financial institutions, and providing for the failures of the financial institutions.

- Abolition of the monopoly of Securities Exchanges in securities transactions

All the securities transactions had to be made through the eight securities exchanges, regionally distributed in Japan. This monopoly would be abolished, reducing the transaction costs for stock-issuing firms.[38]

- Strengthening the registered markets

While the registered markets (the secondary markets, the equivalent of the U.S. NASDAQ) were complementary to the listed firms for larger firms with tighter restrictions, in order to facilitate the financing of start-up companies, the registered markets will be strengthened and given a standing equal to the listed markets.

- Harmonization of accounting standards with international practice

Balance sheet disclosure for corporations will be required on a consolidation basis. Accounting standards will be made consistent with international principles, introducing the market-value based standards (as opposed to acquired-value standards in the past, which gave rise to hidden assets and losses) for financial derivatives and securities holding.[39]

- Stricter disclosure rules for banks and securities

Banks and securities will be subjected to stricter disclosure rules, designed to facilitate access to information for the depositors and investors.

- Creation of safety net for securities and insurance

While the deposit insurance system had been in existence, similar mechanisms providing for failures for securities firms and insurance companies were lacking. In the securities industry, a client protection fund would be established[40], covering funds received from clients but not yet invested in securities, with no limit until 2001 and up to ten million yen per client thereafter. As for the insurance industry, while the revised Insurance Law of 1996 provided for a fund for the protection of insurance policy holders, the scheme was inadequate: the size of the fund was too small and the contribution to the company was to be made afterwards according to their market share.[41] The newly established policyholders' protection fund[42] would fully cover the policyholders' contribution plus interest until 2001, and 90% afterwards. (IMF 1998)

3) Reforms Paralleling the Big Bang

In response to public criticism, significant changes had materialized in financial administration at three levels: 1) the organizational form, transforming the relationship between fiscal and financial regulation; 2) the relationship between the government and the central bank (or between fiscal and monetary policy making); and 3) the administrative practice from the traditional style (*ex ante*, informal regulation) to adversarial (*ex post*, legalistic) regulation. While the results of the first two measures only materialized in later days, it is important to note that policy discussions regarding these matters had been in place since early 1996: as we will see in Chapter 5, this mattered by affecting the political actors' calculations. Also, these three changes occupy a significant part in the "institutional change" in finance, or the breakdown of the Convoy System. (See Chapter 8.)

- Creation of the Financial Supervisory Agency (FSA) in June 1998

The Securities Exchange Surveillance Commission (SESC) was created in 1992 within MOF in the aftermath of the loss compensation scandal. Since 1994-95, MOF had to face increasing criticism over the amount of power concentrated in its organization. Its wide jurisdiction --- encompassing budget, taxation, tariff, the Fiscal and Investment Loan Program (FILP), national property, banking, securities, and international finance --- came under criticism. In particular, critics charged that fiscal policy and financial regulation ought to be burdened by separate agencies.[43]

The talks of MOF breakup had picked up steam by the beginning of 1996, as the Housing Loan package was debated in the Diet, and the policy failures by MOF (the Housing Loan Affairs, the Daiwa Bank Scandal and the ensuing Japan Premium) were revealed to light. At the same time, reports of misbehavior by MOF officials had been rampant in the media, lending force to this talk. The ruling three-party coalition set up a committee in February 1996, chaired by Shigeru Ito of the Social Democratic Party of Japan (SDPJ), while the LDP had its own policy caucus on administrative reform and deregulation, the LDP Administrative Reform Promotion Headquarters (ARPH), which increasingly looked into the issues regarding the breakup of MOF and the independence of the Bank of Japan (BOJ). After a heated political debate from August to December 1996, the ruling coalition decided to create the Financial Supervisory Agency (FSA) in December 1996, divesting the financial supervision power to it, while keeping the policy planning power on financial matters with MOF.[44] (See Chapter 5.)

- *Wholesale revision of the Bank of Japan (BOJ) Law, effective in April 1997*

The relationship between MOF and the central bank, the BOJ, was transformed to allow increased independence to the latter. Enacted in 1942, the old BOJ Law reflects the militaristic regime of the time, according strong governmental control over the central bank by such means as the power of removal of BOJ President from office. This governmental influence was more significant *de facto*, as monetary policy decisions were made not by the *de jure* policy making body of the Bank, the Policy Committee (sometimes chided as the "sleeping board"), but by the BOJ Executive Board in consultation with MOF. MOF's strong influence over the BOJ has consistently attracted widespread criticism, as the lack in central bank independence was suspected to be one of the causes of the bubble economy, in which fiscal policy skewed monetary policy into keeping interest rates too low for too long.[45] After a heated political debate in the ruling coalition parties as well as two governmental advisory panels, this resulted in the increased independence of the BOJ through a major revision of the BOJ Law, effective in April 1997.

- Change in the style of financial administration since 1995

In the wake of the Daiwa Bank Scandal and the Housing Loan Affair, in reaction to the criticism of MOF's past relationship with the financial sector as "cozy" and "collusive", MOF announced a departure from its past, *ex ante*, informal administration, toward a more transparent, *ex post*, legalistic regulation in December 1995. Also, as a response to the discussion of its organizational breakup, MOF issued a report on the "new image of financial administration" in September 1996, developing this issue further.[46] (Nihon Keizai Shimbun, 1997)

4.5 Projected Economic Consequences

The Big Bang initiative is expected to bring about the following four economic consequences.

First, the Big Bang may benefit the Japanese national economy, stimulating economic growth as well as the performance of the financial sector. According to an estimate by MITI, it may push the GDP growth up for 0.3%. (Tsusansho 1997) It is projected to stop the declining trend for Tokyo as an international financial center. A survey by the Organisation of Economic Cooperation and Development observes that "the planned reforms should lead to greater integration of Japanese markets and companies into the global arena, while keeping some transactions, which would have otherwise moved overseas, in Japan". (OECD 1997, 86-7) The Big Bang is expected to bring innovation in financial products, as the underdeveloped derivatives as well as ABS products will be more developed, thanks to the more experienced foreign financial institutions (Dekle 1997).

Second, the result of increased competition would be a drastic change in the Japanese financial landscape, with the emergence of takeovers, mergers, and strategic alliances at an unprecedented number and scale. On one hand, greater competition should make the weaker financial firms more vulnerable to bankruptcies and restructuring. (Dekle 1997). On the other hand, as the entry barrier will be significantly lowered, a larger participation by foreign financial firms in the Japanese financial market is expected. As financial firms in the U.S. and European markets have boosted their efficiency through fierce competition in contrast to the protected Japanese firms, the most efficient among them are likely to establish their presence in Japan.[47]

Many events under way demonstrate the effect of increased competition in two ways. A large number of mergers and acquisition (M&A) and strategic alliances have emerged in expectation of further deregulation and increased competition, linking domestic firms to other domestic firms as well as foreign firms.

Four types of alliances and takeover are emerging: within *keiretsu*, between *keiretsu*, with outside the financial sector, and across borders.[48] Alliances within *keiretsu* is significant for the Mitsubishi group: the four banking institutions within the group will be consolidated into the Bank of Tokyo-Mitsubishi, the core "main bank" for the Mitsubishi *keiretsu*, adding to the loose alliance with two major financial firms within the group, Tokio Fire and Marine Insurance and Meiji Life Insurance. Inter-*keiretsu* alliances are taking place *en masse*: the most important of all may be the mergers across *keiretsu* lines of mega banks, which cannot have but significant effect on the economic landscape by altering the grouping of firms around the six major *keiretsu*. The mega merger of Daiichi Kangyo Bank (DKB), Fuji Bank, and the Industrial Bank of Japan (IBJ) creates the largest bank in the world by 2001. The merger of Sumitomo Bank and Sakura Bank means not only a creation of another financial giant but also a merger of the main banks of the Sumitomo and

Mitsui *keiretsu*: in line with this development, the merger of the Sumitomo and Mitsui Life Insurance has also been announced. The merger of Sanwa Bank, another among the six largest city banks, with Tokai Bank and Asahi Bank, two city banks, announced in March 2000, signifies that the consolidation of the banking sector has reduced the number of large banks from about twenty in 1995 into four major groups: the Mitsubishi group, the Mizuho group (DKB - Fuji- IBJ), the Mitsui-Sumitomo group, and the Sanwa-Tokai-Asahi group. Alliances with outside the financial sector is also significant: the Nippon Credit Bank (NCB), which was temporarily nationalized in 1999, was decided to be sold to groups of firms headed by Softbank, a software company known for its investment in the high-tech sector.

Lastly, international alliances and takeover have mushroomed as of late as noted above. As of writing (May 2000), the banking, securities, and insurance industries have all seen the takeover of domestic firms by foreign ones. Foreign financial firms have already increased their presence in the Tokyo market, through M&A operations, often taking over troubled Japanese financial institutions, and through strategic alliances.[49] Compared to the virtual nonexistence of foreign takeover of Japanese financial institutions prior to 1995, many such instances have occurred since: the Long-Term Credit Bank of Japan (LTCB), once a prestigious long-term credit bank, was taken over by a consortium of U.S. and European investing firms led by Ripplewood Holdings; mid-sized life insurance companies have been bought up by foreign entities; Merrill-Lynch took over the businesses of the bankrupt Yamaichi Securities —the fourth largest and once the leader among the Big Four of the securities industry—. Table 4.2 shows some examples of important M&A and strategic alliances in place since the Big Bang was announced in November 1996.[50]

Table 4.2 Announced M&A and Alliances Since November 1996: Some Examples *(as of May 2000)*

Source: Nihon Keizai Shimbun, Asahi Shimbun, and Yomiuri Shimbun.

1) Within *Keiretsu*

- Consolidation within the Mitsubishi Group: Mitsubishi Trust Bank, Nippon Trust Bank, and Tokyo Trust Bank merging with the Bank of Tokyo-Mitsubishi.

- Alliance across banking, securities, and insurance within the Sanwa Group: Sanwa Bank organizes "Financial One", grouping six other financial firms in trust banking, life insurance, casualty insurance, and securities.

2) Across *Keiretsu*

- Merger of Sumitomo Bank and Mitsui Bank: the Mitsui-Sumitomo Bank will group together two large banks that historically functioned as the core bank for the Sumitomo and Mitsui *keiretsu.*

- Merger of Mitsui and Sumitomo Life Insurance: this follows the above merger in the banking sector.

- Merger of the DKB, Fuji Bank, and the IBJ: the newly created Mizuho Bank will be the largest bank in the world in terms of asset size.

- Merger of Sanwa, Tokai, and Asahi Banks: the new bank will be the second largest in Japan, and the third largest in the world in terms of asset size.

3) With outside the Financial Sector

- Takeover of the NCB by a three-company alliance led by Softbank: Softbank (software and high-tech investment), with Orix (non-bank financial company) and Tokyo Marine and Fire Insurance, are entering into the banking sector.

4) Across Borders

- Takeover of the LTCB by a consortium of U.S. and European companies led by Ripplewood Holdings (U.S.)

- Takeover of Yamaichi Securities by Merrill Lynch. (U.S.)

- Takeover of Heiwa Life Insurance by Aetna (U.S.)

- Strategic partnership [including management participation and stock ownership] between Nikko Securities and Travelers Group (later Citigroup) (U.S.)

The third expected outcome of the Big Bang is the following: *the shift from indirect finance to direct finance will be accelerated, as non-financial firms and the households will see their options increase and banking sector shrinks in size.* As for the corporate sector, Hoshi and Kashyap (1999) estimates that the banking loan demand would shrink at least 20% under the most conservative scenario.[51] If a scenario of 30% shrinkage for bank loans materializes, the deposits' share in personal financial wealth will decrease from 59% to 48%. Reflecting the above, a contraction in size seems inevitable in the banking sector, which dominated Japanese finance throughout the postwar era. This implies a great reduction in number for the banking firms as well. Under the above estimate by Hoshi and Kashyap, the 45 lowest among the 142 major banks may have to go out of business in order to accommodate the loan shrinkage of 20%.[52]

Fourth, the second and third points as well as the change in financial administration suggest the following: *the dominance of the banking sector in the economy and the main bank system under the postwar era will face increased pressure for change.* For the banking sector, the Big Bang increases competition within the sector and against direct finance, resulting in a decrease in size in loan demands and a decrease in the number of banks. Moreover, an important part of the main bank system was the regulatory framework by the government (MOF and the BOJ) which constrained the behavior of the financial industries to be consistent with the implicit rules of the main bank system as well as provided regulatory rents for the banks so as to ensure their monitoring function over firms. (Aoki, Patrick, and Sheard 1994) However, the change in administrative practice and the deregulation brought about by the Big Bang break down this very regulatory framework.

These two effects of the Big Bang undermine the banks' incentives to act as main banks. This trend results from the pressure for survival brought about by increased competition, the abolition of regulatory rents, and the disappearance of regulators who (at least were believed to) have the power to punish and reward. It may be most salient at the rescue stage of failing firms, to which three options — abandon of the position of main bank by withdrawal of bad loans, rescue by supply of refinancing, and bring the case to court-led bankruptcy procedure — are available, according to Aoki, Patrick, and Sheard (1994). The concern for short-term profitability (due to increased competition), combined with the disappearance of positive inducements (i.e. regulatory rents) and sanctions (i.e. intervening regulators), may override the perceived benefits of long-term relationships with firms that can be reaped through relational financing. Thus, the main banks will increasingly opt for the first and third options rather than the second one: as a result, we may see less rescue of the troubled firms by their main banks.

4.6 Distributional Effects of the Big Bang

We now turn to the task of identifying what the initiative implies to the financial actors so that we may anticipate their strategy in the political process. If the actors stand to "win", or see gains, they would have the incentives to push for the Big Bang; in contrast, if they expect to "lose", or expect their interests to be hurt, they would have the incentives to forestall the initiative. To this goal, we will reassess the Big Bang measures from the standpoint of each financial actor. Our chief task is to separate the "winners" from the "losers" of the Big Bang reforms.

The financial actors — those who engage in business transactions in the financial market — comprise the following: the households; non-financial firms; newcomers to financial business (foreign financial firms, nonbank financial institutions, and non-financial firms entering the financial market); the banking sector (large city banks and weaker banking institutions — smaller city banks, long-term credit banks, trust banks, regional financial institutions); securities firms; and insurance companies.

1)Households

The Big Bang may imply two potentially conflicting concerns for the households: profitability and security. Concerning profitability, the households stand to benefit from the competition promoting measures of the Big Bang initiative, as the returns on their financial asset are expected to increase. Greater options for their asset management will materialize thanks to foreign exchange liberalization (through "exit" option) and product liberalization. Greater competition among financial firms will enhance the efficiency of the financial services provided to the households. The liberalization of entry control (i.e. introduction of cross-entry among banking, securities, and insurance; reduction of entry control in securities; liberalization of foreign exchange business) will bring newcomers to financial businesses, increasing the likelihood that the consumers will be able to enjoy better services. Likewise, the abolition of price control (e.g. fixed brokerage commission and quasi-cartelized casualty insurance premia) is likely to result in lower prices for financial services in general.

On the other hand, the Big Bang may potentially raise concerns for security among consumers. The introduction of these reforms means that the security of their deposits under the Convoy System will be gone, and the depositors will be held accountable for their own choices from 2001 onward, although market enhancing measures such as the creation of safety net and improvement in disclosure standards will ensure that increased information will be available for making investment decisions.[53]

Thus, each individual faces higher risk in the post-Big Bang world. It must be noted, however, that the rise in insecurity may have materialized anyway with the deepening of the financial instability since the summer of 1995. Regardless of whether the rise in risk is brought about by the Big Bang or not (at the objective level), this concern for security must have been salient at the time of the Big Bang initiative, especially in the environment of financial instability.

How did the consumer public balance these concerns of profitability and security? How did they perceive the Big Bang? Although these are tough questions to answer, we may be able to benefit from a survey of the households ran by a non-profit organization affiliated with the Bank of Japan (BOJ) in June 1997, seven months after the announcement by Prime Minister Hashimoto and two weeks after the MOF package.[54] First of all, only 33.9% knew about the Big Bang, while 65.8% did not. Among those who knew, asked what its consequences were likely to be, 33.4% saw positive effects and 35.9% gave negative forecasts, while 13.2% saw little influence on their lives. Asked about the criteria for choosing their means of savings, "safety" came on top at 49.3%, followed by "liquidity" at 30.9% and "profitability" at its record low at 15.3%. Regarding self-responsibility (*jiko sekinin*), or the investors' responsibility for their own choices, 52.1% thought that investors ought to be held accountable for their stock investment, while the figures were respectively 29.2% for investment trust (in bonds), 25.6% for deposits, and 19.5% for insurance. The share of people who "would be at a loss if told to take responsibility" (*jibun de sekinin wo mote to iwaretemo komaru*) was, 13.2% for stocks, 20.7% for investment trust in bonds, 46.5% for deposit, and 47.5% for insurance. (Hirasawa 1997) In another survey on dwellers in the Tokyo metropolitan area performed by the think tank, Dentsu Soken (affiliated with the top advertisement agency, Dentsu) in July-August 1997, 76% responded that they did not know the content of the Big Bang.[55]

The above surveys strongly suggest that the consumer public was largely unaware of the Big Bang at least during the main time frame of our analysis, 1996-97. In the first survey, among those one-third who knew about the initiative, those who saw negative outcomes were slightly more than those who saw positive results; only one-third among those who knew about the Big Bang, that is, one-ninth of the surveyed households saw beneficial results from the Big Bang. As regards the choice between profitability and security, the latter was clearly important for most of them, as can be seen by the survey on the criteria for selecting means of savings ("safety" was more than triple over "profitability"). Thus, while they may benefit from the increasing returns on their financial assets in the long run "objectively", the consumer public was largely unaware of the issue at the time, and only a small share among them saw the Big Bang to be beneficial.

2) Non-Financial Firms

Non-financial firms stand to benefit from the "user-friendly" reforms, while the resulting shift towards indirect finance and the downsizing of the banking sector may bring about the loss of protection provided by their main banks and all the other benefits associated with the main bank system.[56]

The pro-competition reforms are beneficial to the corporate sector in that they increase efficiency in the financial services provided to the firms. The liberalization of international capital transactions and products increase the firms' financing options. The liberalization of foreign exchange business may mean less transaction cost for international businesses. In addition, the measures enhancing market infrastructure will benefit the corporate sector. The smaller firms will have better access to the "registered markets"; the consolidation of Securities Exchanges as well as the abolition of their monopoly on securities transactions may mean a decrease in stock issuance costs.

While the above imply better financial services and financial market access for the firms, the Big Bang may have negative implications to the firms as well. As mentioned earlier, the Big Bang lessens the incentives for the main banks to act as such. This issue is especially crucial to the firms whose dependence on the main banks is high. Even when the firms' financial health is maintained, the banks, conscious of their capital requirements, are highly likely to curtail their loans. When such firms are in financial trouble, the main banks will be especially reluctant to provide refinancing and will increasingly choose to resort to the abandon of the main bank position or court-led bankruptcy procedure.

Thus, the Big Bang imply mixed results for the corporate sector, depending on the reliance on the banking sector of firms and industries. The corporate sector can be divided into two segments: large manufacturing sector with low bank loans dependence, and the rest --- small manufacturing sector and other sectors --- with high bank loans dependence. According to Hoshi and Kashyap (1999), as of 1995, the former had 17.56% of ratio of bank debt to assets, while the figure was 29.95% for the large firms in wholesale and large retail and over 30% for the rest.[57] Large manufacturing firms are likely to see the benefits brought about by the Big Bang, as their little dependence on the main banks will insulate them from the change in the main bank system. However, for the smaller firms and those in industries with tougher prospects (e.g. debt-ridden construction firms), the Big Bang make their banks survival-conscious, possibly leading them to adopt harsher standards for their loans and becoming less willing to provide protection in case of financial trouble.

In sum, the large, manufacturing firms are the clear "winners". The rest --- small firms and firms in other industries--- may have to face the same situation that the consumers face. In the long run, they may be able to gain advantage from the "users' reforms" in terms of profitability; however, in the short-term, in the context of the economic stagnation, the likelihood of tighter credit and less protection from their banks may worry them.

3)Newcomers to Financial Markets: Foreign Financial Firms, Nonbank Financial Firms, and Firms Entering the Market

Three entities — foreign financial firms, nonbank financial firms, and non-financial firms setting up a financial business — may qualify as "newcomers" to the financial markets, traditionally dominated by the established, domestic banking, securities, and insurance industries.

First, foreign financial firms clearly stand to gain from the Big Bang reforms. The liberalization of international capital transactions and product control mean that they will be able to make use of their efficient services developed abroad, gaining a competitive edge over their domestic competitors. The liberalization of entry control as well as price control is also likely to benefit the foreign firms which would try to build up a presence through market niches. For example, the abolition of legalized cartel in casualty insurance is expected to benefit the foreign insurance firms with expertise in products with segmented customers (e.g. car insurance).

Indeed, the foreign financial firms strongly support the Big Bang measures. For example, Tadao Ishihara, Board Chairman of the Japanese subsidiary of an American investment bank (Goldman Sachs Japan), gives a full endorsement of Hashimoto's initiative in an interview. He suggests that globalization and information technology drives the transactions to the most efficient, low-cost market; in general, the Japanese "corporate capitalism" — based on such features as lifetime employment, enterprise unionism, *keiretsu*, and cross-shareholding that build long-term trust relationship — needs to give way to the U.S. style market, which is based on the belief in the market efficiency. He strongly advocates the necessity of the liberalization measures included in the Big Bang initiative: cross-entry deregulation, brokerage fee liberalization, and so on. In sum,

"it is important to build a market in which the real worth [of financial institutions] will be taken at face value without the constraints of such relationships as main banks or main underwriter. It will take time to untie the bureaucratic interests and the egotism of the [financial] industry. However, nothing gets done if we allow 'support in principle, oppose in particular' (*souron sansei kakuron hantai*).[58] ... I strongly hope for policies that make it possible to have a real feel of the positive aspects of deregulation such as 'what could not be done can be done' and 'what used to be expensive becomes cheap'." (Nihon Keizai Shimbun 1997, 79-80)

Second, nonbank financial firms may have greater opportunities to start new businesses with the decrease in entry control. Moreover, they would obtain an important means to finance their operation with the deregulation on bond issuance. President Yoshihiko Miyauchi of Orix Corporation, a major lease firm, had been a vocal advocate of deregulation, as an "outsider" trying to enter the financial market dominated by the banking industry.[59] In an interview, he states that the Japanese Big Bang deserves positive evaluation to a certain extent in that it makes reforms with deadline, although much more is needed to make the Tokyo market internationally competitive. He shows his past frustration against regulation as follows:

"in the past, there was a thought current in Japan that there was no need for other financial institutions than the established ones such as the banks. Commercial paper (CP) originated in such financial service industries as the U.S. lease business, as a means of financing. However, in Japan, there was a regulation keeping us from using it. I feel that this prohibition has been without just cause. In the Big Bang, our existence [in the financial sector] will be rightly situated."

He sees that the nonbank financial firms would be able to lend money financed through CP and corporate bonds, and reveals his strong sense of rivalry against the banks in this interview. (Asahi Shimbun, 28 June 1997)

Miyauchi's comments endorse the view that nonbank financial firms would benefit from the Big Bang reforms. The nonbank financial firms would have better means of financing other than bank loans, and would be able to better compete with the banks.

Third and last, non-financial firms entering the financial market would benefit from the Big Bang measures which drastically lower the entry barrier: to see this, we may refer to an interview of the founder of a non-financial firm which had started the insurance business. The top firm in the security guard industry, Secom, entered the casualty insurance market in September 1998; its founder, Ryo Iida, states that he had been hoping for entry for the past twenty years, but was unable to do so by all means although he consulted MOF and other casualty insurance firms. However, with the Big Bang breaking down financial segmentation and materializing liberalization, his firm was able to enter into the business with such environmental change. (Kin'yu Zaisei Jijo 4 January 1999)

In sum, the newcomers to financial businesses --- the foreign financial firms, the nonbank financial firms, and new entrants to financial industries --- share their strong support for the Big Bang initiative, which includes liberalization measures that advance their business interests. The interviews produced above distinguish themselves from the ones with domestic financial actors (see below) in that they are unreserved as to the benefit of the Big Bang reforms, and they are pushing for more. These actors are the clear "winners" of the Big Bang.

4) Banking Sector

The Big Bang initiative contains measures that reflect the banks' long-held wishes to break into other financial markets by bringing down the wall of segmentation between banking, securities, and insurance. However, it also includes measures that are expected to hurt the banking sector in general. Banks may suffer from the liberalization of international capital transactions and product liberalization, as these measures will decrease the importance of bank deposits and loans for their customers. The liberalization of foreign exchange business will eliminate their lucrative monopoly in this domain. The increase of competition in the banking sector may potentially result in forcing the less competitive banking institutions to exit the market.

Thus, we see a fissure between two segments of the banking sector. Large city banks may be the few ones to emerge as those who stand to gain from the reforms, while their prospect for survival itself is uncertain. The others, that is, the weaker deposit-taking financial institutions, including the smaller city banks, long-term credit banks, and trust banks as well as regional financial institutions (regional banks and credit cooperatives), would not gain much from the Big Bang reforms, as they are heavily constrained in their ability to benefit from the reforms by aggressively entering into new financial territories.

a) Stronger Banks: Large City Banks

While the increased competition against foreign financial firms threaten domestic banks' prospect for survival, the liberalization of cross-entry and the removal of the ban on financial holding companies may mean a new line of business, and the issuance of bonds a new means of financing, for powerful city banks with large capital base. However, the bad debt problem damaged the banks' balance sheets, while the extent of damage differs from one bank to another. The relatively unscathed banks, with their more secure capital base, are in a better position to exploit the benefits from the reforms than the others with damaged balance sheets.

The powerful city banks have the potential to benefit from the Big Bang, while their prospects for survival are uncertain. Two interviews of large city banks' managers, recorded by a journalist, Soichiro Tahara, exemplify this ambiguity that the Big Bang initiative implies for the large city banks: one shows confidence while the other shows ambiguity. President Yoshifumi Nishikawa of Sumitomo Bank, the second largest city bank, welcomed the Big Bang, stating that their bank had not been able to adequately provide new products to their customers because of heavy regulation by MOF: the result was their bank being eventually shut out of the world of corporate finance. While the competition with foreign financial institutions might be tough, he showed confidence for the prospect of winning the competition through their customer base in wholesale and personal banking. On the other hand, a board member of Sanwa Bank, the third largest city bank, Takayo Mochizuki, told Tahara that the Big Bang had both positive and negative sides, and that, to be honest, there were no Japanese banks which would be able to compete with foreign financial firms on a par. He said that his bank would rather "survive than win" in the post-Big Bang world, where the probability of foreign banks winning would be one half. (Tahara 1998, 212-17)

Thus, some large city banks with large and sound capital base may be the few ones to benefit from the Big Bang reforms. However, they also face a high degree of uncertainty as to their prospects for survival.

<u>b)Weaker Banking Institutions: Smaller City Banks, Long-Term Credit Banks, Trust Banks, and Regional Financial Institutions</u>

Below, we will see how the Big Bang affects the weaker institutions within the banking sector. First, the less powerful city banks may have trouble surviving the increased competition unless they drastically restructure their operations.[60] Reflecting their low capital base and profitability, they would need to concentrate their available resources to the retail businesses, in which they may have the competitive edge vis-à-vis the larger city banks or foreign financial firms. If the restructuring proves insufficient, consolidations of their businesses or mergers may be needed to benefit from economies of scale and generate the necessary funds for the investment needed in information systems.

Journalist Soichiro Tahara records an anonymous interview with a president of a smaller city bank (*kai togin*).[61] Asked why the smaller city banks did not oppose the Big Bang, the banker answered, "it reflects the nature of Japanese banks, nourished over a long period of time, to accept the intentions of MOF without being able to oppose them". The president also said that they were unable to come up with a rationale that oppose the Big Bang's "right cause" (*taigi meibun*), which claimed that the Japanese financial industry might be left out of the world and the Japanese customers would flee to New York and London, if they would stick to the outdated Japanese style of business. (Tahara 1998, 216-17) This interview supports the view that the smaller city banks were far from pushing for the Big Bang.

Second, the long-term credit banks expected to be negatively affected by the Big Bang. True, the powerful among the three, the IBJ, could benefit from cross-entry measures by fully entering into securities and trust businesses, where the subsidiary of the IBJ had already proven its strength even under strict restriction.[62] In contrast, the two other long-term credit banks, hard hit by the bad debt, lacked the capital necessary to benefit from the Big Bang.[63]

Still, even for the IBJ, the Big Bang reforms would hurt its vital interests: the wall that protected them from the powerful city banks would be torn down by the liberalization of bond issuance, or the abolition of the monopoly on long-term bonds enjoyed by the long-term credit banks. The long-term credit banks would be left with a small number of branches, making it impossible to compete with the city banks in the retail market. The wholesale market would be their strategic focus, in which they must face tough competition with the more competitive foreign financial firms.

The IBJ's role in forestalling the financial reforms have been prominent in the 1990s. Any efforts to liberalize the bond market would immediately face the IBJ's staunch opposition, according to government officials in charge of the issue.[64] IBJ President Masao Nishimura states his views in an interview with Nihon Keizai Shimbun, a leading economic daily. Basically he agrees with the "Free", "Fair", "Global", reform plans by Prime Minister Hashimoto. He thinks that liberalization measures such as the abolition of financial segmentation need to be discussed not all at once, but those with priorities first. While he is not against the bond issuance by ordinary banks, these measures ought not to be treated at the same level as other measures in neglect of past discussions. He does not think that the liberalization of bond issuance would result in the vitalization of the Tokyo financial market, the goal of the Big Bang; he believes that other measures such as financial holding companies, taxation, and accounting standards, are of much greater urgency. (Nihon Keizai Shimbun 1997, 105-6)

The above views expressed by IBJ President Nishimura endorse the expected positions by the long-term credit banks. While they are "basically" for the reforms, in fact, they are rather interested in slowing down the measures that hurt their vital interests (in particular, the bond issuance by city banks) by mentioning other issues of "greater urgency" and trying to question the benefits of such measures.

Third, the picture looks bleak for trust banks as well. The powerful city banks would be able to fully encroach their territory, while the trust banks already engage in the banking business with much fewer branches compared to their rivals. The trust banks also saw their assets severely damaged during the bubble years, because of their heavy reliance on the real estate sector: their average ratio of non-performing loans to the outstanding loans was twice as much as that of city banks as of September 1996.[65] The resulting weak capital base decreases the likelihood of trust banks going into other financial sectors. On top of this, the increased competition from the foreign financial firms must be added: trust banking had been authorized since the mid-1980s for them, and they have steadily gained grounds in the Japanese market since.

Chuo Trust Bank President Shozo Endo states the following in an interview. He does not have any objections to the goal of the vitalization of the Tokyo financial market, but he believes that the "hollowing-out" comes mainly from taxation, procedure, and cost. He thinks that the cross-entry for financial institutions have little direct links to this problem. He also mentions that nine foreign firms were allowed to open up their branches in 1985-86 and to operate without restrictions on their businesses. According to him, the trust banks had historically been limited branch openings, while engaging in loan trust business.[66] The introduction of "Fair" and "Free" in a formalistic manner in the market reality — where such peculiarities as public finance[67], cross-shareholding, and the influence of the main banks exist — may lead to unpredictable problems and to oligopoly in the financial market. The most important thing in financial reforms is to secure political and social stability, as the case is different from experimenting in a laboratory and an irretrievable loss may result. Accordingly, there is a need to maintain "fair terms of competition" without being overwhelmed by the prevailing "mood". (Nihon Keizai Shimbun 1997, 55-6)

This interview by a president of a trust bank matches the expected stance of the trust banks. While supporting the Big Bang in principle, Endo raises other concerns (e.g. taxation) than those which hurt the vital interests of his bank (the wall keeping the powerful city banks at bay from trust banking), endorsing the view that they would prefer to slow down such measures. That they perceive threats from the city banks and the foreign firms, and that the trust banks do not welcome the Big Bang measures on the whole are clear from his comments.

Fourth and last, regional financial institutions would be hurt by the Big Bang and liberalization measures in general. Regional banks and smaller financial institutions (e.g.

credit cooperatives) would be hurt by the enhanced competition brought by liberalization measures[68] (which would enable the city banks and securities firms to encroach their customer base), while the liberalization of cross-entry would be of little benefit to them, as most institutions would lack the capital needed to aggressively engage in new financial businesses.[69]

Nagoya Bank President, Senmaro Kato, a former chief of one of the industrial associations[70] in the sector, states his view in an interview. In his view, the Japanese Big Bang Initiative is "unavoidable" (*yamuwo enai*) as a countermeasure, considering the gap between Tokyo and the overseas market. However, it brings about problems for regional financial institutions; bringing down the walls between securities [and banking] may mean hardship for smaller financial institutions, as they are unable to respond. In finance, if the "symbiosis" (*sumiwake*) goes away, the large banks will come attacking smaller financial institutions' business base, while foreign firms will come in as well. There will be situations in which smaller financial firms will be phased out of the market. However, Kato asks, is it good for the Japanese finance? While he does not oppose deregulation, he hopes for measures that would keep the lifeline of smaller, regional financial institutions. For example, he asks, wouldn't it be necessary to have a system that prevents "useless competition" (*mudana kyoso*)? In his words, "it is important that the profit margin is secured." (Nihon Keizai Shimbun 1997, 80-81) President Takashi Tamaki of Chiba Bank, a major regional bank, expresses a similar view. While the reforms aimed for stopping the "hollowing-out" of Tokyo ought to be carried out as quickly as possible, the cross-entry issue affects the whole financial structure of Japan; a mere liberalization will bring unnecessary "confusion" (*konran*), and we ought to spend considerable time over such a "grand design". (Nihon Keizai Shimbun 1997, 91-92)

These two interviews by heads of regional banks clearly show the regional financial institutions' stance towards the Big Bang. While they do not openly oppose the Big Bang initiative as a whole ("unavoidable"), they see that liberalization would result in a losing war against the large banks and the foreign firms, and thus fear that the measures enhancing competition may threaten their prospects for survival. Thus, they would opt to slow down the pace of measures regarding cross-entry ("grand design needs time") and try to stall the extent of competition enhancement brought about by the measures ("useless competition" and "unnecessary confusion" are to be avoided; "the lifeline of smaller financial institutions" and "the profit margin" ought to be preserved).

5) Securities Firms

The Big Bang may deal a severe blow to the securities firms by abolishing the price control on brokerage commission and bringing the powerful banking sector in the securities business.[71] Those developments as well as the liberalization of entry control increase the likelihood that the more efficient foreign investment banks will present themselves as formidable rivals. The liberalization of international capital transactions may result in the loss of business to overseas markets.

However, the Big Bang has a positive aspect to the securities business as a whole: the pie itself may become bigger. The liberalization of product control as well as the strengthening of the stock markets would accelerate the shift from indirect to direct finance for both depositors and corporate borrowers. For example, investment trusts are expected to attract a larger portion of households' assets; bond issuance, of which the securities firms would underwrite, is expected to increase as means of corporate finance.

President Hideo Sakamaki of Nomura Securities, the top firm in the industry, claims in an interview that he supports the Big Bang, and provided that taxation issues will be resolved and restrictions on securities firms' businesses will be lifted, he would willingly accept the liberalization of brokerage commission. According to Sakamaki, Nomura would "be still able to fight" (*mada tatakaeru*), as it still has a net asset which is three times as large as Merrill Lynch, despite recent losses due to affiliated non-bank financial institutions. He shows his sense of rivalry against the banks by scoffing at the idea of banks aiming for universal banks by integrating securities businesses as "nonsense". (Nihon Keizai Shimbun, 1997, 162-63)

Despite the potential benefit of the Big Bang, the sense of insecurity seems to be quite high even for the top firm, Nomura, which may be the most likely candidate to survive the race, as the comment that they would "still be able to fight" suggests. For the vast majority of securities firms, the Big Bang may not be beneficial at all: their prospects for survival are directly threatened.[72] Because the new opportunities for profit are largely to be found in wholesale businesses, an oligopolistic situation by large securities, foreign securities firms, and large banks' securities subsidiaries may be the result. (Mitsubishi Soken 1997) As mentioned earlier, the increase in competition is expected to drive many smaller firms out of business through exit or takeover. Thus, the securities industry as a whole would not actively promote the Big Bang measures, which may jeopardize the prospect for survival for many firms in the industry. Indeed, the securities industry's strong opposition was part of the reason why the revision towards further deregulation of the cross-entry deregulation that took effect in 1993, originally scheduled to take place by the end of FY (March) 1996, was put off until the end of 1997. (Asahi Shimbun 26 March 1996)

6) Insurance Companies

The Big Bang measures bring about the liberalization of cross-entry between insurance and other financial businesses, hurting the industry by allowing the large banks to sell insurance products, while few insurance companies would deem it beneficial to be deeply involved in the banking business, where over-banking is a salient concern. The insurance reforms of 1992-94 had already been bringing about changes, prior to the Big Bang: the cross-entry between life and casualty insurances through subsidiaries had already started in October 1996. The industry also has to compete with foreign insurance companies, whose domestic presence had historically been limited to the "third field", or niche markets that fall in between life and casualty insurances (such as cancer insurance), but whose pressures for liberalization were intensified by the U.S.-Japan insurance talks that had been held since 1993. (See Chapter 6.) Thus, the increased competition within the insurance industry, among domestic life and casualty insurance firms as well as foreign insurance companies, may be of more urgency to the firms' survival than the distant threats of banks' intrusion into insurance businesses. Nevertheless, however distant such threats may be, the insurance companies would seek to curtail threats from the outside as much as possible.

The life insurance industry had attracted a large amount of capital during the bubble years of the late 1980s, thanks to the high guaranteed rates on the products compared to the low long-term interest rates. However, the burst of the bubble and the following years of low interest rates hurt this industry by creating a wide gap between its high guaranteed rates to the insured and the low returns on their investment. Thus, with their short-term survival in doubt for many firms, the life insurance firms were not in a mood to welcome any increase in competition that would threaten their survival.

The casualty insurance industry does not suffer from this problem, and except for a few firms, their balance sheets look healthy as a result of amassed regulatory rents. However, it is strongly affected not only by the cross-entry liberalization, but also, more importantly, by the abolition of the legalized cartel on the insurance premia. This legalized cartel created rents that enabled the insurance industry to sustain its high costs. The industry would face tougher competition with foreign insurance firms which would drastically cut insurance premia in products such as car insurance. (Sanwa Soken 1999)

Reflecting the above, the insurance industry in general may be expected to be reluctant to accept the Big Bang measures, if not opposed to them outright. There are two interviews, one from life insurance and the other from casualty insurance, that enable us to confirm our views on the preferences of the insurance industry. (Nihon Keizai Shimbun 1997, 183-84 and 197-98) President Sukenari Ito of Nippon Life Insurance, the largest life insurance company, claims that the financial reforms must be carried out quickly.

However, regarding life insurance companies, he states:

"the roles of life insurance companies which manage long-term, and preserve, the personal financial assets are increasing in importance with the aging population. [However,] if the competition becomes extremely intense (*kyokutan ni gekika*), the stability of the management (*keiei no antei*) of the life insurance companies may be lost, making them harder to fulfill their given roles."

Speaking of cross-entry,

"it is important that each financial institution secures profitability in its own core business. To enter into other fields because the core business is not doing well is an expansion without profit, and is not to learn from the lesson of the bubble. The discussion on cross-entry should be carried out after instituting the holding company system."

Speaking of his company, which is the candidate most likely to enter into other financial fields because of its fiscal health and size,

"the core business will be insurance, and if we are to engage in banking and securities, it will be of a minimal necessary degree."

President Kimihiro Higuchi of Tokio Marine and Fire Insurance, the top firm in casualty insurance, welcomes that the reforms talks had begun under the leadership of the Prime Minister. However, while the point of the reforms lies in the vitalization of market functions, he doubts whether the cross-entry between banking and insurance leads to it. While the walls of segmentation are right in coming down, a "soft-landing" is necessary. He cites the example of insurance products sold in banks, and calls attention to the danger of the banks' possible misuse of their large power. "While the insurance industries may go into banking and securities in the future, the casualty insurance has just entered life insurance in October 1996" and such prospects are distant. Speaking of the reforms on the premia calculation association (the quasi-cartel):

"that system applies to the areas of individual insurance that highly affects the public (*takai kokyosei*) such as fire and car insurance. With liberalization, on one hand, a discount competition will take place, while on the other hand, premia on high risk will drastically increase and there may be cases in which people may not be able to receive insurance payments."

Thus, the insurance industry would prefer to curtail increased competition in their industry and slow down the cross-entry liberalization. Ito's comments such as "expansion without profit is not learning from the lesson of the bubble", as well as Higuchi's skepticism of the link between the cross-entry and market vitalization, and his alarm against bank dominance endorses this view. The casualty insurance firms would also hope to curtail the liberalization of price control, as Higuchi's alarm on the danger that drastic competition may bring about demonstrates. That they are not likely to be the ones to promote the introduction of the Big Bang seems to be obvious from the comments of the presidents of the two most powerful firms in the insurance industry.

4.7 Conclusion

In this chapter, we gave an overview of the economic realities of the Big Bang. We first identified its backgrounds — the aging population; 1200 trillion yen of financial assets largely held in deposits; the shift of indirect to direct finance; international competition and the danger of "hollowing out" or losing the international financial center; liberalization from the mid-1980s; the bubble economy and the bad loan problem; and the scandals hitting MOF and the financial sector. Then, we looked into the content of the Big Bang package: we classified them into the two categories of "liberalization and deregulation", promoting competition and reducing government control, and "market infrastructure enhancement", increasing transparency and fairness in the market and developing the market.

We identified four expected economic consequences of the Big Bang. First, the Big Bang may benefit the Japanese national economy, stimulating the economic growth as well as the performance of its financial sector. Second, the result of increased competition would be a drastic change in the Japanese financial landscape, with the emergence of takeover, merger, and alliance at an unprecedented number and scale. Third, the shift from indirect finance to direct finance will be accelerated, as non-financial firms and households will see their options increase and the banking sector will shrink in size. Fourth, as a result, the dominance of the banking sector in the economy and the main bank system of the postwar era will face increased pressure for change.

We then discussed the distributional effects of the Big Bang on the following sets of actors: 1) households; 2) non-financial firms; 3) newcomers to financial markets (foreign financial firms, nonbank financial firms, and non-financial firms entering the markets); 4) banking sector [a) stronger banks — large city banks; b) weaker banking institutions — smaller city banks, long-term credit banks, trust banks, and regional financial institutions]; 5) securities firms; and 6) insurance companies.

How can we sum up our analysis of the implications of the Big Bang initiative to the financial actors? The above analysis enables us to group those actors into three categories, according to the ways the actors are affected by the Big Bang, which determine how they perceive the measures contained in the initiative: "winners", "potential winners", and "losers".

The first category is the "winners", including the "newcomers" to the markets as well as firms with little dependence on banks who can raise capital in capital markets on their own (such as large manufacturing firms). The measures clearly benefit these actors, and they perceive this fact. Such actors are clearly aware of the expanded business opportunities, the increased efficiency of financial services: they are expected to support the policy package, if not actively bringing it about.

The second category, "the potential winners", comprises the households, non-financial firms with dependence on banks, as well as a few powerful city banks. There is a high degree of uncertainty involved: while the "objective" result of the Big Bang may prove to be positive over the long-run, the actors may not be aware of it or expect the opposite. Under such circumstances, the actors are unlikely to initiate the reforms, while it may be possible that they support the reform package. The households were largely unaware and only one-ninth of them saw benefits in the Big Bang as of June 1997, when the detailed plan came out from MOF. The firms with dependence on bank loans (such as the small and medium firms and those in troubled industries) are likely to face uncertainty as well: while they may benefit from the "users' reforms" in the long run, in the short term, they may suffer from the souring of their relationship with their banks. For large city banks with large and sound capital base, which can benefit from the new business opportunities resulting from deregulation, the Big Bang may turn out to be positive, albeit with a high degree of uncertainty with the increased threat of competition with foreign financial firms, kept at bay by protective walls until then.

The third category is the "losers", comprising most financial institutions, or the rest of the banking institutions, securities firms, and insurance companies.[73] The Big Bang takes away the regulatory protection such as the segmentation walls keeping the powerful banks from invading their sectors as well as the protection against the more efficient foreign financial firms; such weaker domestic financial institutions are heavily constrained in their ability to benefit from the fruits of the liberalization measures. They see their prospects for survival threatened, and thus they are likely to be opposed to the reforms. The comments of the leaders of these financial institutions demonstrate this point. While they do not openly oppose the Big Bang, they attempt to forestall the measures that negatively affect them with rationales with anti-competition connotation, expressed by such terms as "stability in management", "useless competition", "confusion", and so on.

Table 4.3 summarizes this three-way distinction among "winners", "potential winners", and "losers". To relate our findings in this chapter to later ones, we stress here that most firms in the domestic financial industries, save a few exception, stood to lose from the Big Bang. As many have observed, the financial reforms of the past — such as the 1981 banking reforms and the 1991-93 financial reforms — have been dominated by the concerns of the financial industries, as we will see in Chapter 6. Why would the financial industries bring about the Big Bang, if most of them stood to be the "losers"? This suggests that a departure from the past pattern of financial reforms can be seen in the Big Bang process, as we will observe in Part II (Chapters 5, 6, and 7).

In the next chapter, we will turn our attention to the political process of the Big Bang initiative. The analysis of the interplay of state actors, political parties and the bureaucracy, will lead us to distinguish the "economic winners" ("winners and "potential winners" in this chapter) that we found through this chapters' analysis, from "political winners" who would see political benefits to be reaped from the reforms. Whether the reforms were brought about by "economic winners" or "political winners" will be the focus of our attention.

As for the "losers", who are highly unlikely to have brought about the reforms, we will consider how they affected the course of reforms in Chapter 6. More specifically, why they were unable to significantly forestall or even reverse the reforms will be analyzed, through a comparison with financial reforms in the past such as the 1991-93 reforms.

Table 4.3 Distributional Effects of the Big Bang:
Winners, Potential Winners, and Losers

Financial Actors:

1) Households
2) Non-financial firms
3) Newcomers to financial markets (foreign financial firms, nonbank financial firms, and non-financial firms entering the markets)
4) Banking sector
   a) stronger banks — large city banks
   b) weaker banking institutions — smaller city banks, long-term credit banks, trust banks, and regional financial institutions
5) Securities firms
6) Insurance companies

1. "Winners": Supporters or Potential Initiators of the Reforms
The Big Bang reforms clearly benefits the actors, and they are aware of this fact.

- Newcomers to financial markets (foreign financial firms, nonbank financial firms, and non-financial firms entering the markets)
- Non-financial firms with little dependence on banks (e.g. large manufacturing firms)

2. "Potential Winners": Potential Supporters of the Reforms
The Big Bang reforms may benefit the actors, but things are unclear for them.

- Households
- Non-financial firms with dependence on banks (e.g. small and medium, troubled sectors)
- Stronger banks (large city banks)

3. "Losers": Opposition to the Reforms
The Big Bang reforms hurt the actors, the actors are aware of this fact.

- Most banking institutions except large city banks
- Securities firms
- Insurance companies

Part II Analysis of Financial Politics (Chapters 5-7)

In Chapter 1, we identified four research puzzles.

a) Why was MOF willing to propose and carry out the Big Bang? More generally, what makes a bureaucracy willing to abandon tokens of organizational power such as regulatory power and beneficial networks? Or, was the Big Bang MITI's plot and basically a bureaucratic turf war?

b) Why were the financial industries unable to forestall the Big Bang as they did in the past?

c) How can we explain the LDP's behavior, supporting the Big Bang while making decisions that drastically undermine MOF's presence in finance? What happened to the stable the LDP - MOF alliance of the postwar era?

d) How can we understand this new, "user-friendly" orientation of the Big Bang vis-à-vis "bureaupluralism, or the provider-friendly model of the past? Is the Big Bang a victory of a counter-coalition of the corporate sector and MITI over the financial sector and MOF? Or, is this a victory of the consumers that the electoral reforms of 1994 brought about? Do we have a better explanation?

We seek to provide answers to the above puzzles in the following three chapters. In Chapter 5, we will mainly deal with puzzles a) and c) by providing an "analytic narrative" of the emergence of the Big Bang, while Chapter 6 will address puzzle b) through a "longitudinal comparison" with three cases of financial reforms in the past. The discussion in the two chapters will enable us to develop our inquiry into bureaupluralism in financial politics, concerning puzzle d) in Chapter 7, which will refer to a case taking place after the Big Bang in an adjacent policy area (the Financial Diet of 1998, dealing with the bad debt problem in banking) as a reality check.

To give an account of the political process that produced the Big Bang, it may be useful to divide the process into two time phases.

<u>Phase I: Fall 1995 — November 1996</u>
<u>Phase II: After November 1996</u>

Phase I covers the emergence of the Big Bang Initiative; Phase II deals with the process in which the detail of the Big Bang plan was formulated. The reforms of foreign exchange regulation, the first bulk of the Big Bang reforms, took off in the fall of 1995. In November 1996, Hashimoto announced the Big Bang initiative. Subsequently, the detail of the plan was worked out through MOF's deliberative councils, being announced as the Big Bang Plan in June 1997, and later legislated into laws by the Diet by June 1998. The Hashimoto initiative of November 1996 (hereafter the "Initiative") laid out the overall framework of the reforms, or its timing, scope, sequence (foreign exchange reforms first), and deadline (the year 2001): what was to be included in the initiative was determined during Phase I, which we will discuss below. The pace of the reforms, or when each measure would be implemented, was determined in Phase II through the interaction of the regulated industries and state actors. It must be noted that the overall framework of the Initiative of November 1996 was not modified in any significant sense in either the MOF Plan of June 1997 (hereafter "the Plan") or the laws enacted to implement the measures. Hence, our problematique in the following two chapters centers around the following two points. First, what decided the content of the Initiative in Phase I? (Chapter 5) Second, how did the content of the Initiative get affected in Phase II, and why did it not result in significant modification (such as reversal) at later stages? (Chapter 6)

Chapter 5 The Emergence of the Big Bang Initiative: A Political Analysis

5.1 Introduction

This chapter will analyze the political process of the Big Bang, up to November 1996, when the Initiative was announced by Prime Minister Ryutaro Hashimoto. The question of "Who brought it about, and why?" will be the focus of our inquiry. As we saw in Chapter 3, our inquiry starts from the behavioral regularity of organizational survival, which holds across organizations such as political parties, bureaucratic agencies, and firms. Political parties are expected to pursue maximization of electoral seats in the Diet, which would ensure their survival. Bureaucratic agencies pursue organizational survival, which would ensure the well-being of their individual members: the pursuit of tokens of organizational power (budget, regulatory power, discretionary power) ranks lower in priority, compared to this ultimate goal. Firms, in the Japanese context of stakeholder capitalism, pursue organizational survival, which would ensure the continued employment of its core workers.

Our goal is to show that the political economy of the Big Bang can be best explained according to the above logic of actors' behavior which was derived independently from our case, the financial reforms. To this goal, we make use of the "analytic narrative" approach (Bates et al. 1998), emphasizing the dialog between theory and evidence, as discussed in Chapter 2. We first reflect on two sets of interests that the political actors need to enhance to ensure their survival: this produces a hypothesis. Embodying this hypothesis, we provide our preliminary story. Then, we will provide the narrative of the events in the political process up to November 1996. The evaluation of the facts presented in the narrative will follow, reshaping our initial account into our explanation. Finally, we will compare our explanation to alternative ones.

5.2 Balance between Two Sets of Interests: A Hypothesis

Let us remind ourselves of the discussion of state actors' behavioral regularities in Chapter 3.[1] State actors, political parties and bureaucracies, have two sets of interest to cater to, in their quest for organizational survival.[2] One set would be that of the constituencies which provide goods and services to the political actors. Interest groups provide votes and money to political parties, *sine qua non* for their electoral campaign. The regulated industries provide information, cooperation to administrative measures, and retirement positions to bureaucratic agencies. The other set of interest that political actors need to satisfy is that of the general public: the reputation among the general public affects the chance of the actors' survival. Needless to say, public support is vital for political parties which face elections regularly. The bureaucratic agencies also need public support: they can expect better acceptance for their policy measures, and hence secure the prospect of continued existence by demonstrating their positive contribution to the nation.

How do the political actors strike the balance between the two sets of interest? As Aoki (1988) notes for the bureaucracy, these two may or may not be compatible with each other. As long as the two sets coincide, there is not much contention; however, if the constituencies want one thing, and the public needs another, how are the political actors to react? The short answer would be that it depends on how important the support of the constituencies or the public is to the actors' survival. How is this degree of importance determined?

Here, we offer the following hypothesis:

In a democracy where all political actors respond to both the constituencies interest and the public interest, when the two sets of interests diverge, the degree of public support on the organization in question determines its behavior by affecting its prospect of survival. In particular, the loss of public support leads the organization to re-coup its loss by adjusting its behavior.

Imagine a situation in which public support is high: the organization would choose to pursue the constituents' interests, as it can risk some loss in public support without risking its organizational survival. Now, suppose that public support is lost for some reasons: the organization cannot risk further loss of public support by catering to the jurisdictional interest, as other political actors who respond to public interest would seek to boost their public support by intervening, and thus their organizational survival would be threatened.

We will focus on public support rather than constituencies support. Imagine an organization in which public support is high and constituencies support is low. As long as we are in an industrial democracy where there is a mechanism that translates popular discontent into outcome (e.g. elections, mass protest, boycott), to challenge such an organization would be a highly risky strategy for the constituencies, as they might be the ones singled out as acting against the public interest. Thus, we focus on the loss of public support, which can be seen to generally affect the prospect of organizational survival for political actors more than the loss of constituencies support.

5.3 Preliminary Account

Our story of financial reforms is one in which there was a split between the constituencies interest and the public interest. The constituents of financial administration under bureaupluralism, or the domestic financial industries, wanted gradual reforms on the whole. The public interest seemed to lie in "drastic reforms" which would stop the "hollowing-out" of the Tokyo financial market, while undermining the prospect of survival for most financial firms. Our preliminary account is a simple one that attributes the emergence of the Big Bang Initiative to the concern for survival of the LDP and MOF, which also explains other developments in financial politics such as MOF breakup: the loss of public support, largely caused by the Housing Loan Affairs, led those actors to re-coup public support.

As for the LDP, it is the new dynamics of party competition that mattered. Table 5.1 shows the seat distribution before and after the 1996 Lower House elections. The Housing Loan affairs in 1995-1996 reduced public support for the LDP. At that time, the ruling LDP was seeking electoral victory over its rival parties, Shinshinto and the newly formed Democratic Party of Japan (DPJ), both of which advocating fundamental reforms (including administrative reforms) and deregulation. The LDP was also in a three-party coalition with the Social Democratic Party of Japan (SDPJ) and the Sakigake Party. The LDP thus faced competition from within and outside the ruling coalition: this situation was quite new, since the LDP had not faced a similarly believable threat of replacement from its opponents before the breakdown of the one-party dominance in 1993. This concern for survival ultimately drove the LDP's behavior: the LDP incorporated the issues of its rivals into its own party agenda. (Otake 1999) In the absence of fierce electoral competition, the LDP may have preferred different options, reflecting its privileged status within bureaupluralism; however, the electoral dynamics pushed the LDP to follow its rivals' positions.

Table 5.1 Lower House Elections of October 1996:
Seat Distribution Before and After

Source: Asahi Shimbun, 21 October 1996.

	Before	After
LDP	211	239
SDPJ	30	15
Sakigake	9	2
Others	34	10
CPJ	15	26
DPJ	52	52
Shinshinto	160	156
Total	511	500

Notes
Before: 511 seats (Multi-Member Districts) including 18 vacant seats
After: 500 seats (300 seats from Single-Member Districts and 200 seats from Proportional Representation)
Parties in Bold: The Ruling Three-Party Coalition

LDP: the Liberal Democratic Party
SDPJ: the Social Democratic Party of Japan (the former Socialist Party of Japan)
Others: including other parties and non-partisans
CPJ: the Communist Party of Japan
DPJ: the Democratic Party of Japan (newly formed in September 1996)
Shinshinto: the Shinshinto (the New Frontier Party, formed in 1994)

MOF suffered an even more severe loss of public support in the wake of the Housing Loan affairs and other policy failures and scandals, and it acted according to the dictate of organizational survival, too. Thus, it arduously opposed any outside efforts to break up its organization, as it had done in the past. MOF's behavior during Phase I would always reflect the fact that its top priority, organizational survival, was in jeopardy. Drastic financial reforms might have lessened its regulatory power and its ties with the financial institutions. Thus, in the absence of concerns for organizational survival, MOF might have preferred different options. However, the need for organizational survival dictated that MOF push for drastic financial reforms that might increase the chance for their organizational survival.

The account provided above is yet a crude version focusing on the organizational level. It needs to be checked against the narrative of the events, which will reach down to the interplay of the individual politicians and bureaucrats. Using the narrative, we will delineate what the actors were perceiving as options, and we will provide a more sophisticated image of how the logic of organizational survival operates. Our revised story, or our explanation, will be contrasted against alternative explanations as a further check.

5.4 Narrative

Who brought about the Big Bang? Many guesses have been made up to the present. While many naturally credit Prime Minister Hashimoto for this initiative, which emphasized his political leadership, there seems to be little consensus beyond this fact. The newspaper Nihon Keizai Shimbun claimed that it was a strategic "reform from above" by MOF, which made selective use of the Ikeo Report (see below), a report by a governmental panel. (Nihon Keizai Shimbun 1997). Some said it was MITI that saw opportunities to encroach upon MOF territory (Saito 1997); others have identified two top officials at MOF, including Eisuke Sakakibara (whose flamboyant personality later earned him the nickname of "Mr. Yen"). (Tahara 1998)

Given this confusion, we would like to first provide an accurate image as to who brought about the Big Bang. However, to merely identify those who advocated the Big Bang is not satisfactory as an explanation. To know why these reforms materialized at this timing, scope, pace, and sequence, we need to examine the incentives of those actors who brought about the reforms, and identify the logic that dictated their behavior.

The emergence of the Big Bang Initiative is a very intricate process, and below, we dissect it into ten interrelated groups of events during this phase. A summary will point out who brought about the Big Bang Initiative.

1) Foreign exchange reforms (Fall 1995-)
2) Financial instability, the Housing Loan Affairs, and the scandals (Fall 1995-)
3) Housing Loan Diet (January - June 1996)
4) BOJ and MOF reforms: a response to criticism (February - August 1996)
5) Political debate on the MOF reforms: the Ito Plan and the possible options (August-September 1996)
6) Critical juncture for the MOF reforms: the LDP Group of Eight on 18 September 1996
7) Lower House elections of October 1996, the Six Large Reforms, and the conclusion for the MOF reforms
8) Ikeo Report
9) Developments within MOF on the Big Bang
10) Developments within the LDP on the Big Bang
11) Summary: Who brought about the Big Bang Initiative?

1) Foreign Exchange Reforms (Fall 1995 -)

The Council on Foreign Exchange and Other Transactions, a MOF advisory panel, began its deliberation on the reform of foreign exchange regulation in November 1995. The Council issued the final report in June 1996; a task force to draft the legislation based on this report was set up within MOF; and the legislation was submitted to the Diet in March 1997.[3]

A critical event in this process, which looks as if it were a normal policy making process under bureaupluralism, deserves special notice. The Project Team (PT) on administrative reforms within the three-party ruling coalition (of the LDP, the Social Democrats, and Sakigake — as later addressed) issued a proposal towards a drastic revision of foreign exchange regulation in March 1998, and this report set the pace for the later deliberation on foreign exchange reforms at the MOF panel.

Two sets of actors played an important role in this event. First, two lawmakers from the LDP's Administrative Reforms Promotion Headquarters (ARPH) were behind the PT's proposal advocating drastic liberalization: its head, Kiyoshi Mizuno (who also chaired the PT), and Yasuhisa Shiozaki, an LDP lawmaker from the Upper House. (Tahara 1998) Mizuno had been a vocal advocate of deregulation since earlier. As a former cabinet member and senior member of the LDP, he wielded a large influence within the LDP regarding the administrative reforms and deregulation. His organization, the ARPH, was independent from the policy making body, the Policy Affairs Research Council (PARC), and only had to report to the LDP's Executive Council, of which he was a senior member, and to the LDP President, Prime Minister Hashimoto. Shiozaki, as a former official at the BOJ, was a junior Diet member whose expertise in finance attracted the attention of Mizuno, who included him into the ARPH, assigning him to financial matters.[4] Shiozaki had been a strong advocate of financial liberalization: he authored an article as early as February 1995 stressing the need for financial liberalization to halt the financial "hollowing-out". (Shiozaki 1995) While the ARPH played pivotal roles in other financial matters such as the BOJ reforms, MOF breakup, and other aspects of the Big Bang (later discussed) as well, the role of the ARPH in the foreign exchange reforms was critical. It set the content of the reforms by accelerating and deepening the revision, according to the MOF official who was in charge of foreign exchange reforms, Tomotaka Kojima. (Tahara 1998)

The second actor was a senior MOF official in charge of foreign exchange control, Eisuke Sakakibara. Sakakibara wanted to press for foreign exchange deregulation, yet was unable to do so because of opposition from within MOF. Thus, he came to Mizuno implicitly asking to take up the issue at the ruling coalition's PT and pressure him so that he would be forced to consider the issue in favor of drastic deregulation. Mizuno, realizing that his knowledge about the matter was limited, asked Shiozaki to question Sakakibara at two PT meetings held in February and March 1996. According to Mizuno, Sakakibara wrote the scenario and played the title role while Mizuno directed it; Shiozaki also confirmed this story. (Tahara 1998)

While Sakakibara appears to be the main actor here, the role played by the political actors should not be discounted: without their involvement, Sakakibara would have been unable to surmount the opposition within MOF. According to Tahara, a MOF official "very close to Sakakibara" recalls that the opposition was formidable, especially from those "veterans"[5] from the International Financial Bureau: the abolition of the foreign exchange law meant a complete abandon of regulatory power by the International Financial Bureau

(IFB), and thus those "veterans" will lose their *raison d'être* and their secured retirement positions in the private sector. (Tahara 1997, 143-45) Sakakibara (2000, Chapter 9) recalls that there was a sharp division of opinions in his bureau (IFB) at MOF, regarding the abolition of the monopoly over foreign exchange business enjoyed by the banking industry: only a minority was pushing for the abolition (as he did), while most of its senior officials were opposed to the idea, because the reforms were too drastic and the banks were vehemently opposed to it. Mizuno confirmed that Sakakibara's position was not supported by the entire agency, and that the involvement by the ARPH was essential in surmounting opposition within MOF.[6]

That the foreign exchange reforms were decided and implemented first had a great effect on the remainder of the financial reforms. Because the foreign exchange deregulation would give an exit option to the Japanese asset holders, the deregulation of the domestic financial market became inevitable. That is why the deregulation of the foreign exchange became known as the "forerunner" of the Big Bang reforms. Sakakibara was aware of the implications of the reforms: the sequencing has been a conscious choice. In his memoirs, he argues that he was aware that changes in international finance was likely to trigger a drastic change in domestic finance, as was the case in the U.S. financial deregulation of the 1970s and 1980s, which was triggered by the emergence of the Euro-dollar market.[7] He explains his reasoning as follows: while he had been opposed to "deregulation without principles" in the past, given the revolution in information and communication technology in the past ten years which bring about the cyber-market and globalization in a fast speed, Japan would have to alter its strategy towards opening up its closed system of finance and information to stay in competition with Europe and America. (Sakakibara 2000, Chapter 9)

2) Financial Instability, the Housing Loan Affairs, and the Scandals (Fall 1995-)

As these issues were discussed in Chapter 4, we will briefly restate the relevant facts. The financial instability started with the fall of a small financial institution in Tokyo in

July 1995 and intensified with the failure of other financial institutions in the fall of 1995. The Daiwa Bank Scandal brought down public trust in MOF's competence in handling financial matters. This gave rise to the Japan Premium in the international inter-bank market, which showed a similar loss of trust in the Japanese financial system. The Housing Loan Affairs dealt a severe blow to MOF. Public anger, stirred up because of the use of public money, was directly unleashed towards MOF: trust from the public and the political world regarding its competence was lost. The Wining and Dining scandals involving some of MOF's top officials brought down public trust in the ethics of these officials as well. The budget proposal containing the use of public funds was finally submitted to the Diet in December 1995, as the negotiations on how to split the losses of the housing loan companies between the agricultural sector and the banking sector resulted in agriculture's victory, and thus a defeat for MOF which oversaw the negotiations. The loss that neither the banks nor the agricultural financial institutions were willing to bear had to be filled in by public money.

During this process, MOF's political influence steadily decreased over time: one earlier downfall led to another disaster later. According to the head of the Banking Bureau at that time, Yoshimasa Nishimura, MOF did not have the power to change the course of the policy discussion in the Housing Loan Affairs, which increasingly became an agricultural more than a financial matter. He recalls: "as for me, that I lost credibility because of the Daiwa Bank Affairs and lost the initiative in the resolution of the Housing Loan Problem was critical". He overestimated MOF's ability to deal with the issue; the conclusion to the Housing Loan Affairs became as such because MOF lost influence due to the lost credibility. (Nishimura 1999, 144-45)

3) Housing Loan Diet (January - June 1996)

The regular session of the Diet starting in January 1996 was called the "Housing Loan Diet" (*jusen kokkai*) because of the importance of the Housing Loan package, which included the budget proposed in January 1996 and the legislation submitted in February 1996.[8] As the Diet deliberation proceeded, public anger rose increasingly against this package. Public opinion surveys indicated that the Housing Loan package was wildly unpopular; the bureaucracy was hit hardest, followed by the banks, as these parties were perceived to be the most responsible. According to an Asahi Shimbun poll in February 1996, 87% were in opposition to the package.[9] To the question, "Who do you think is the most responsible for this Housing Loan Affair?", the bureaucrats at MOF and MAFF (agriculture) were the highest with 27%, while the large banks[10] which set up the housing loan companies were second with 20%, ahead of the housing loan companies (19%) and the politicians (15%); the agricultural sector's financial institutions received a mere 3%. Public trust in politics was low: 73% responded that they did not trust today's politics. However, the LDP's support was up, to 46% (from 43% in December 1995), while its rival, Shinshinto, dropped to 16% (from 13%). (Asahi Shimbun 28 February 1996)

In a different poll in March 1996, published two weeks later, Asahi Shimbun reported that the approval rate of Hashimoto dropped from 61%[11], when he took office in January 1996, to 36%. This time, the public support of the LDP was down: it was down from 36% to 24%, and Shinshinto's support was up from 9% to 14%.[12] (Asahi Shimbun 12 March 1996)

The main opposition party, Shinshinto, heavily criticized the government, pushing a solution utilizing legal bankruptcy schemes supported by the media as being more transparent. In March, its lawmakers picketed the Lower House's Budget Committee for over three weeks to prevent the budget proposal from passing.[13]

4) BOJ and MOF Reforms: a Response to Criticism (February - August 1996)

As a response to the heated public and political opposition to the budget proposal in the Housing Loan Diet, the LDP and the ruling coalition began to pursue the responsibility of MOF in order to smoothly pass the package as well as deflect public criticism. The first call for MOF reforms came from Koichi Kato, Secretary-General of the LDP, in February 1996. The media mistook his televised comments, which proposed to move the BOJ and MOF's financial administration to Osaka, for a call for the breakup of MOF. While MOF's top career official requested him to modify his comments, Kato consciously did not revise his misinterpreted comments and let the media heat up the frenzy. (Tahara 1998)

The ruling three-party coalition of the LDP, the SDPJ, and Sakigake set up a Project Team (PT) on MOF reforms in February 1996: it was headed by Shigeru Ito from the SDPJ, including the LDP ARPH members such as Mizuno and Shiozaki.[14] While Sakigake was clearly pushing for the breakup of MOF, the SDPJ's position was unclear, and the LDP's position widely varied from that of Shiozaki, who represented the BOJ and strongly pushed for the breakup, to Hakuo Yanagisawa, a former MOF official cautious to such prospects.[15] (Mabuchi 1997)

Along with the plans to reform the organization within MOF, the reforms of the BOJ came up from the LDP's ARPH. Shiozaki at the ARPH first convinced Mizuno to include this topic in the agenda of MOF reforms. Although this plan to reform the central bank did not originate from MOF, MOF was happy to go along with it, according to Mizuno, who held a discreet talk with a senior MOF official in February and March 1996. When Mizuno presented to him the idea of the BOJ reforms, that official accepted it, being fully aware that something needed to be done, given the amount of MOF-bashing. (Tahara 1998)

MOF accepted the BOJ reforms. The conflict of interests between fiscal and monetary policy, which may have led to the rise of the bubble, was a major criticism against MOF. If that was the case, however, what was really at stake was rather the independence of the central bank, in charge of monetary policy, than MOF's financial bureaus, in charge of financial supervision and inspection.[16] Yanagisawa at the ARPH, who later raised an unsuccessful opposition to the BOJ independence, corroborated this view by stating that he thought that MOF was willing to concede pretty much as long as its financial administration was not shaken up, as there was no reason for anybody to oppose the revision of a wartime legislation, the Bank of Japan Law. (Tahara 1998)

Following Mizuno's advice to Ito to proceed with the BOJ issue first, the ruling party's PT worked from March 1996 on this issue. Within the LDP, there was resistance from Yanagisawa and other Diet members who were skeptical of the idea of giving independence to a central bank, which is legally a private bank, devoid of outside checks. However, Shiozaki and those who wished to see increased independence got the upper hand within the PT, as such voices of dissent were ignored. Shiozaki recalls: "This was possible only because it was a three-party coalition. It was not possible if it was an LDP-only government". (Tahara 1998, 36-9)

That the BOJ would be given independence was decided. The PT issued a "basic document" setting the basic course of MOF reforms in June: it stated that bills revising the BOJ Law and MOF's organizational forms would be submitted to the next regular session of the Diet, which would start in January 1997. According to Mizuno, as the discussion of the BOJ progressed in the PT, Prime Minister Hashimoto wanted to take the matter in his own hands.[17] Thus, the Study Group on the Central Bank, an advisory panel to the Prime Minister, was set up in July 1996.[18]

In the meantime, the discussion of the MOF reforms was going on with much heat involving MOF, politicians, and the media. In its early stage, the debate centered around the issue of whether the financial inspection and supervision departments, given the policy failures, ought to be kept under MOF's aegis or not. Between February and June 1996, there was a tug-of-war between, on one hand, the PT led by Ito, Sakigake members, and some LDP members such as Secretary-General Kato and Shiozaki who pressed for the breakup, and on the other hand, MOF and other LDP Diet members who sought to limit the change within the organization of MOF. As the budget proposal containing the Housing Loan package passed the Diet in April 1996, the LDP became less interested in the reforms of MOF, and the latter party seemed to gain forces. However, Ito, being under heavy pressure from the media to push for MOF breakup, managed to put together the PT "basic document" (see above paragraph) in June, specifying that the reform bill for MOF reforms would be submitted to the Diet in January 1997, and that the splitting up of the financial supervision/inspection functions would be examined, while its specific content was left to be determined by September 1996. (Tahara 1998)

5) Political Debate on the MOF Reforms: the Ito Plan and the Possible Options (August-September 1996)

In August 1996, Ito came up with his own plan which would a) integrate the Banking, Securities, and International Finance Bureaus into one Financial Bureau, and b) break up MOF and set up an independent commission over responsibilities on financial inspection and supervision. Because Ito made sure that this plan went through the ruling party coalition by leaking it to the media before he showed it to the other parties, the LDP's Kaoru Yosano refused to accept the draft plan, calling foul play. Although Yosano was a member of the PT, he was known to be close to MOF and advocating the separation of the financial inspection (but not the supervision) function. While there were many within the LDP who supported Yosano, LDP Secretary General Kato, in charge of the preparation for elections, made clear to Ito that he did not approve of Yosano's conduct, as he feared the negative impact of being portrayed in the media as close to MOF upon the upcoming Lower House elections. (Tahara 1998)

This incident highlights a clear split that emerged within the LDP during this process. On one hand, there were lawmakers who, reflecting their close ties with MOF in the past, adopted pro-MOF positions. Besides Yosano's widely supported action, there were those "tribesmen"[19] in finance: for instance, in the discussion leading to the June 1996 "basic document", the lawmakers at the financial sub-divisions of the Policy Affairs Research Council (PARC) vehemently expressed their disapproval of the fact that MOF reforms were being discussed at the ruling party's PT outside its control.(Tahara 1998) On the other hand, there were also a set of lawmakers who chose to adopt positions in conflict with MOF's wishes. Some lawmakers at the ARPH, the LDP's spearhead for administrative reforms, such as Mizuno and Shiozaki, pressed for the MOF reforms. Kato's reaction to Yosano's refusal clearly shows that this cause made it into the party's top echelon.

To sum up this complex issue, there were two dimensions of contention: first, whether to split only the function(s) of inspection, or inspection and supervision altogether from MOF; and second, the legal form of the new organization.[20] Regarding the first issue, MOF sought to limit its loss to inspection, while Ito and others pressed for inspection and supervision. Regarding the second issue, there were other issues to be decided as well: under which agency the new organization would be placed; whether the organization would have a Cabinet Minister or not for Article 3 organization; and whether it would be a Commission with a steering board or an Agency with a single head. As shown in Table 5.2, there were seven options available altogether, while all the options were not clearly observable at that time. [21] (Mabuchi 1997)

Table 5.2 Available Options for the MOF Reforms

(in parentheses: agencies under the same legal status)

1) Article 8. Under MOF (Securities Exchange Surveillance Commission [SESC])

2) Article 8-3. Under MOF (National Prosecution Agency[22])

3) Article 3. Agency under MOF without Minister (National Tax Agency)

4) Article 3. Agency under Economic Planning Agency without Minister
(Defense Equipment Agency[23])

5) Article 3. Agency under Prime Minister's Office (PMO) with Minister
(Environment Protection Agency)

6) Article 3. Agency under PMO without Minister (Imperial Household Agency)

7) Article 3. Independent Commission under PMO (Fair Trade Commission [FTC])

Source: based on Mabuchi (1997, 194-99).

Ito's August 1996 paper listed both options 2) and 7). In the deliberation at the ruling party's PT on 10 September 1996, the LDP added option 3) (National Tax Agency), which seemed to be more acceptable to MOF. (Mabuchi 1997). MOF first sought to repeat the 1992 establishment of SESC under option 1); seeing that this was unacceptable to the PT, it shifted its claim to 2) or 3).[24]

6) Critical Juncture for the MOF Reforms: the LDP Group of Eight on 18 September 1996

On 18 September 1996, a critical event happened to set the course of the events: the LDP's Group of Eight, grouping its top officials[25], decided to split inspection and supervision from MOF and adopt the option 7), the FTC model, the plan that was opposed the most by MOF. This meant that the LDP, despite its earlier internal split on this issue, adopted the toughest option as the party platform.

At the meeting, Executive Council Chairman Shojuro Shiokawa argued that both financial inspection and supervision ought to be separated from MOF under the FTC model: otherwise, the Lower House elections could not be fought. Other members seconded this view, and the party decision was reached. Clearly, the coming Lower House elections on 20 October 1996 determined the conclusion: the competition against the opposition parties which strongly advocated the MOF breakup was at work. MOF was shocked by the LDP's unexpected decision: one of its top officials visited Kato the following day and threatened to quit his job to no avail. (Mabuchi 1997; Tahara 1998) Following the LDP's decision, the ruling coalition's PT adopted the same decision on 25 September 1996. (Asahi Shimbun 25 September 1996)

This episode is a clear marking point for the LDP-MOF alliance. The LDP did not choose to protect MOF, in face of a believable threat to its continued rule. Despite MOF's supposed influence on the LDP, MOF failed to prevent the LDP from adopting the toughest stance on its most crucial issue of all, organizational survival. This event, as will be discussed later, may have impacted MOF's behavior regarding the Big Bang as well.

7) Lower House Elections of October 1996, the Six Large Reforms, and the Conclusion for the MOF reforms [26]

The Lower House election was held on 20 October 1996 (see Table 5.1). This election was about administrative reforms, which was the main agenda for all parties' electoral platforms. (Asahi Shimbun 29 September 1996) The LDP won with 239 seats, 12 short of majority: it formed a coalition again with the Social Democrats and Sakigake, who did not send any Cabinet Ministers. Shinshinto came in second with 156 seats, while the newly formed DPJ obtained only 52 seats. Prime Minister Hashimoto formed his Second Cabinet on 7 November.[27]

Hashimoto made structural reforms the main political agenda for his Second Cabinet. The administrative reforms, including MOF reforms, topped his priority list: Hashimoto stated that he would carry out this agenda even if he were to "burn out". (Otake 1999) The Big Bang initiative, which he announced on 11 November 1996 by giving directives to the Finance and Justice Ministers, followed suit as a proposal for drastic financial reforms. Eventually, his agenda would include six areas: administrative reforms, fiscal reforms, financial reforms, social security reforms, economic structural reforms[28], and educational reforms. His approach is explained in his Diet speech on 20 January 1997: because Japan's rooted "systems"[29] are closely interrelated, in order to bring the needed changes, "the six reforms must be resolutely carried out all at once". (Asahi Shimbun 20 January 1997)

The MOF reforms had its twists and turns after the October 1996 elections, as some LDP members and MOF sought to reverse the decisions reached before the elections. However, Prime Minister Hashimoto, who had MOF reforms at the core of his top agenda of administrative reforms, broke his silence: in late November to early December 1996, he made clear that the financial inspection and supervision functions would be altogether separated from MOF, settling the issue. As the final conclusion, the ruling three-party coalition adopted option 6), an Article 3 agency under the Prime Minister's Office without a

Cabinet Minister, on 24 December 1996. (Later, this plan materialized as the Financial Supervisory Agency (FSA), created in June 1998.)

8) Ikeo Report[30]

A report authored by a group of experts may have largely influenced the debate on what was necessary as financial reforms. This group, a three-person working group (WG), was chaired by Kazuhito Ikeo, an economist.[31] The WG had its origin in a request made in early 1996 by Shusei Tanaka, the Chief of Economic Planning Agency (EPA) from Sakigake, to Prime Minister Hashimoto to speed up the deregulation. Hashimoto requested Tanaka to concretize his proposal, and it was decided that the Economic Council, administered by Tanaka's agency, would be in charge of the task of coming up with action plans to speed up deregulation in six major policy areas, including finance. An EPA official requested Ikeo to head a working group on finance.[32] It was agreed between them that the group would be small in size, without representatives from the financial industries and without *nemawashi* [33], and would be free to say what was necessary for Japanese finance. The WG, with the help from EPA officials, spent the summer of 1996 working on the proposal, and published a report (the Ikeo Report) containing a proposal for financial reforms on 17 October 1996, days before the Lower House election.

The WG did not have a direct impact on the actual outcome of the Big Bang. Ikeo confirms that there was virtually no input from the financial industry, and that the WG was working "separately" from the political world, where the actual Big Bang policy package was prepared. No active campaign was made by the WG to the government to materialize the proposal to the actual policy.

Nevertheless, the Ikeo Report may be relevant to our discussion because it contained much in common with the Big Bang initiative. First of all, the contained measures are very similar: the measures in the report, which reflected the three basic principles of the proposal (increased competition, liberalization of asset transactions, and revision of regulation and supervision), have much in common with those included in the Big Bang. Second, the timing and scope of the reforms were basically similar: both stated that an encompassing reform, including domestic finance and foreign exchange, ought to be carried out immediately with a delineated time frame and deadline.[34] Third, the proposal contained a reference to the Big Bang in its discussion on the pace of the reforms. Because many factors were entangled, the past gradual approach would not work, and a "Big Bang approach" was necessary. However, although Ikeo gave a press conference, only one financial industry paper gave a large headline as "Big Bang Japanese Version" (*nihon ban biggu ban*), while this notion attracted little notice in the major daily newspapers.[35]

Thus, while the WG cannot be construed as one of the main actors who brought about the Big Bang, the Ikeo Report may have had an effect on the political process. That a proposal with similar measures, timing, scope, and pace emerged from a committee of experts at the advisory panel to the prime minister may have increased acceptance among the political actors for the Big Bang measures, whose benefits to the whole economy was endorsed by this report. It certainly increased the burden of proof on those who would have preferred to forestall the initiative.

9) Developments within MOF on the Big Bang

The 1991-93 financial reforms brought down the wall that segmented the world of finance; however, in order to "alleviate the drastic change", the newly established financial subsidiaries faced severe limitations as to what they could engage in. According to MOF, a revision was to be made within two or three years after the law took effect (April 1993), and MOF initially planned to revise the business restrictions on financial subsidiaries by the end of FY1995, or March 1996. However, this was postponed for one year for the following reasons: the securities and trust banking sectors were opposed, as they feared that the powerful banks would further increase their presence in their markets; the banks had to face the more imminent bad debt problem and could not take care of their cause; the

Banking Bureau of MOF, which was supporting the banks' position, could not handle the discussion for the reforms, overburdened with the Housing Loan Affairs. (Asahi Shimbun 26 March 1996)

Thus, the financial reforms, which were assumed to be discussed and negotiated under the arrangements of bureaupluralism, seemed stalled on the surface: at the end of the Housing Loan Diet in June 1996, "works on the financial reforms that look at the change of the economic structure had not been proceeding". (Asahi Shimbun 16 June 1996) However, in hindsight, this observation held only if one looked at the traditional policy making channels of bureaupluralism. Underneath, there were three separate streams for financial reforms, which were later integrated into one Big Bang proposal endorsed by the whole Ministry: a) the Securities Bureau's "Petit Bang"; b) the International Finance Bureau's foreign exchange reforms; and c) the Working Team (WT).

a) Securities Bureau's "Petit Bang"

MOF's Securities Bureau, under the leadership of its chief Atsushi Nagano, created a new sub-division under its advisory panel, Securities and Exchange Council (SEC), in June 1996: its goal was to discuss the necessary, drastic reforms in the securities market to reshape it to fit the twenty-first century. Although this initiative did not attract much attention in the media, Nagano personally started a wide campaign from the summer of 1996, paying "visit to five hundred people" in the worlds of business, academia, and media. He used to call his plan for the securities reforms the "Petit Bang", but not the "Big Bang". (Tahara 1998) Being the head of the Securities Bureau, the scope of his reform plans only included the securities, but not banking and other fields in finance.

The problematique of the reforms was clear: it was the "hollowing-out" of the Tokyo market, in which transactions in the capital market flowed out to freer overseas markets such as New York, London, and Singapore. According to Nagano, the priority for the financial reforms were first, those who manage assets or raise money, second, the

Tokyo market, and third, the financial intermediaries. (Nagano 1997) That this shift in priority, from the "providers" to the "market" and "users", was clearly identified was an important development: policy making under bureaupluralism was biased towards the providers, or the financial intermediaries in our case. Whether this policy shift was supported by the securities industry was another matter: as the above Asahi Shimbun reports suggest, the industry was opposing such breakdown of financial segmentation.

b) International Finance Bureau's Foreign Exchange Reforms

Earlier in the chapter, we saw how Sakakibara, the head of MOF's International Finance Bureau (IFB), collaborated with the LDP ARPH (Mizuno and Shiozaki) to push for foreign exchange deregulation despite internal resistance. While it appeared on the surface that the LDP was pressuring MOF, we know from this episode, revealed by Mizuno himself, that MOF was not pushed into accepting these reforms at all. There was an internal rift within MOF; yet, Sakakibara, the top MOF official in charge, advocated deregulation, and this measure became MOF's policy.

How does Sakakibara account for this action, which would certainly cause a great loss to his organization? He replies to this question:

"The largest problem of MOF's financial administration, including the handling of the Housing Loan [Affairs], was that its responsibility was too much while it did not have much regulatory power. Thus, taking the plunge, we abandon regulatory power. For example, the regulatory power of the IFB could be easily by-passed backdoor [by private actors]. ... While the world thinks that MOF has strong regulatory power, in reality it is not so strong. ... [In the Housing Loan Affairs,] there was a myth that MOF was strong and ultimately in charge, and the world, the media, and even MOF itself believed in it. That is why there was an absurd mistake. The IFB's regulatory power was *de facto* becoming just a name, and it is ridiculous to reign over such regulatory power. ... Times have changed. Like in Europe and America, the financial industry acts freely, and we abandon regulatory power as much as possible. Because we (the bureaucrats) know this best, we ought to be the first to speak out."[36] (Tahara 1998, 150-51)

c) Working Team (WT)

A project team on the financial reforms, grouping middle-level officials from various Bureaus, and headed by a Division Director in the International Finance Bureau, was set up within MOF in February 1996. The Working Team (WT), as it was called, was engaged in the discussion of drastic, overreaching reforms which would resolve all the remaining issues from the long process of financial deregulation. (H. Noguchi 1997) While the Banking Bureau, officially in charge of the financial reforms, was unable to cope with this issue because of the Housing Loan Diet, the strategy for all-out reforms including banking, securities, and foreign exchange, was being formed discreetly in the WT, which incorporated the parallel developments in the areas of securities and foreign exchange reforms. Sakakibara (2000, 143) suggests that there was an inter-bureau coordination in place within MOF concerning the Big Bang: his agenda, foreign exchange reforms, had the support and understanding of the Securities and Taxation bureaus through his close relationship with their heads. According to Sakakibara, an elaborate plan was ready by October 1996.[37]

The plan was not presented immediately to the outside world: there appears to have been an internal split between those who argued for and against.[38] However, immediately after the election of October 1996, Prime Minister Hashimoto and his staff began to materialize his agenda for all-out structural reforms. When finance was raised from the Prime Minister's aides as one of the issues, MOF presented its plan largely through Hashimoto's secretary from MOF; the plan was promptly adopted by Hashimoto.[39] (Otake 1999) We will later address this process from Hashimoto's side.

To sum up MOF's activities regarding the Big Bang, it is important to note that MOF did not go through the usual policy making mechanism of bureaupluralism. Regarding foreign exchange reforms, while Sakakibara talked with the chiefs of the related MOF Bureaus, he did not pre-consult the related industries. (Sakakibara and Tahara 1999) Sakakibara (2000, Chapter 9) recalls how he passed his proposal through the deliberative council on foreign exchange control, whose important members included the banking industry, which was clearly in opposition.[40] The same kind of by-passing of the affected industries was clear from Nagano's views and actions in the securities reforms and the discreet operation that took place in the WT.

Why did MOF distance itself from the regulated industries, its partner under bureaupluralism? Sakakibara recalls,

"Had we consulted the industries, it would have been opposed. We knew that public opinion would be on our side, and we decided that if we launch it with large noise, it could not be opposed. ... It is obvious that the deregulated businesses would be in trouble. Thus, we cannot consult the industries which would have troubles because of deregulation. " (Sakakibara and Tahara 1999, 135-36)

Admittedly, views that advocate drastic reforms such as Sakakibara's did not enjoy full support within the Ministry, and there was opposition from within. In addition to those who worried about losing ties with industry and regulatory power, there were those who believed that the bad debt problem ought to be handled before the Big Bang.[41] However, the important thing is that Sakakibara's (and Nagano's) views eventually got the upper hand in the agency, becoming MOF's policy on the financial reforms. We need to understand what drove this process of integrating the Ministry's policy.

In short, MOF began to by-pass its own policy making arrangement of bureaupluralism to escape the influence of the regulated industries. It adopted a new priority, placing the "users" of financial services or the market to be more important than the financial intermediaries, whose interests were largely dominant in financial politics in the past. MOF bureaucrats were aware of the negative aspects of the drastic reforms, including giving up regulatory power; there was an internal rift between those who support the drastic reforms and those in opposition. However, the former got the upper hand and their views became MOF's policies: MOF, through its three sub-organizations, proceeded towards drastic, overreaching reforms. From Sakakibara's comments, we know that MOF was anticipating opposition from the industries and strove to overcome it, that it was willfully abandoning regulatory power in recognition of the change in times, and that it was counting on the support of the public opinion for the cause of deregulation.

We now need to advance our inquiry into the mechanism that led the above views to prevail over opposing views which stressed the losses such as regulatory power and the ties with the regulated industries or which pointed to the possibly devastating result of not taking care of the bad debt problem first. Was it, as Sakakibara's comments imply, a rational behavior by enlightened bureaucrats? Or, do we have a better explanation? We will return to this issue in the next section, Section 5.5.

10) Developments within the LDP on the Big Bang

There were two sets of actors within the LDP who were actively involved in the Big Bang: a) the LDP ARPH, and b) Prime Minister and LDP President Hashimoto. What is important here is that the organizations through which financial matters would go through under bureaupluralism, the LDP's Policy Affairs Research Council (PARC) and its sub-divisions, Finance Division and Financial Issues Research Council, were by-passed, largely as a result of a three-party coalition.

a) ARPH[42]

In our discussion of foreign exchange reforms, we already saw the ARPH's peculiar standing within the LDP, as being independent from the PARC, the policy making body. Mizuno, the head of the ARPH, explains that because the LDP Diet members were busy savoring their return to power, the activities at the ARPH did not get much intervention from the PARC as far as financial deregulation was concerned. The ARPH also enjoyed a close working relationship with Hashimoto: Mizuno and other core members of the ARPH were meeting with him on a weekly basis discussing administrative reforms and deregulation in fall 1996. Shiozaki characterizes the PARC divisions on finance as being uninterested in reforms. He thinks that it was critical that the LDP was in a three-party coalition: this temporarily shifted the decision making power into the hands of the ruling party coalition's Project Teams (PT) from the PARC divisions.

The ARPH, with Mizuno as its head, Yanagisawa as the chief of secretariat, and Shiozaki as his deputy as well as in charge of finance, took up the issue of deregulation as of December 1995: since then, it had worked to put together the annual deregulation government action plans such as the ones adopted by the Cabinet in March 1996 and 1997. As mentioned earlier, the ARPH worked closely with a MOF official to introduce drastic foreign exchange reforms. Regarding administrative reforms, the ARPH was actively involved in the ruling coalition's PT on MOF Reforms established in February 1996.[43]

During the summer of 1996, upon a request from Mizuno who realized that a piecemeal approach would not work, Shiozaki worked on his own plan to bring drastic, overreaching financial reforms. His draft plan shared the time frame with the Big Bang Initiative: "five years until 2001, when payoffs start." The contained measures, including deregulation and de-segmentation in banking, securities, and foreign exchange, were overlapping with the Big Bang. An important difference is that his plan was even more encompassing than the Big Bang: it also included taxation, public finance (including the integration of public financial institutions), and pension fund regulation.[44] His plan was drafted without much prior consultation with either MOF or the financial industries. He presented his draft plan to the ruling coalition's Project Team on Administrative Reforms in August 1996. In September 1996, based on this draft plan, the ARPH held hearings from MOF and the affected industries.[45] The industries would agree to the need for reforms in general, yet once discussions came down to each measure, they would ask the ARPH to "spare" them. A high ranking Banking Bureau official from MOF stated that MOF supported the idea in principle, but because the bad debt problem was not resolved, the reforms could not be done. The ARPH's draft plan seems to have stopped here, in terms of its impact on the policy initiative that actually came out in November 1996: that the Initiative mainly dealt with MOF's jurisdiction over finance, in the exclusion of public finance and social security issues captured in Shiozaki's plan, seems to suggest that the ambitious ARPH plan was not the one adopted as the Big Bang.

However, the ARPH made sure that its agenda became party policy by including it in the party electoral platform prepared in September 1996 for the October elections. Yanagisawa drafted the first part of the platform, which stated out the basic party goals, including the administrative reforms. The platform also included a section on deregulation, in which it stated that the party would aim for a deregulation and development of the financial market toward the Big Bang, Japanese Version.[46] (Jiyu Minshu Tou 1996)

In sum, the LDP ARPH, in close cooperation with Hashimoto, pushed through the foreign exchange reforms, drafted an encompassing plan on financial reforms, and made their cause for deregulation and administrative reforms an important part of the party platform. An interesting issue here is the relationship between the ARPH and MOF: the ARPH and MOF worked together regarding the financial reforms, while the ARPH went after MOF regarding its breakup. The ARPH worked closely with MOF officials towards foreign exchange reforms. It competed with MOF in drafting its own plans for financial reforms: it did not cooperate or coordinate in planning, yet its substance was overlapping significantly with MOF's draft, which included mostly matters under its jurisdiction (thus, such areas outside its jurisdiction as public finance, which involved the Postal Saving system, was out). Later, the ARPH would be actively involved in carrying out the Big Bang, once it came out as the Prime Minister's initiative. However, the LDP ARPH was the most ardent advocate of the breakup of MOF, which was fiercely opposed by MOF bureaucrats. As mentioned earlier, although a division of views existed in the ARPH regarding the MOF reforms, the reformers got the upper hand largely because of the dynamics of a three-party coalition. The ARPH went after the MOF bureaucrats, leading the LDP to adopt its stance amidst the internal difference regarding the issue. How can we understand this behavior of the ARPH, cooperating with MOF on financial reforms and pressuring MOF towards organizational breakup? This issue will be dealt with in Section 5.5, which will evaluate the facts provided in our narrative.

b) Prime Minister and LDP President Hashimoto

Ryutaro Hashimoto was elected as the LDP President for a two-year term in September 1995. He took office as Prime Minister in January 1996, after Tomiichi Murayama, a Social Democrat, resigned from his office right after submitting the budget proposal including the Housing Loan package to the Diet. The top priority of his administration was to sail through the tumultuous session of the "Housing Loan Diet", which began days after his Cabinet was inaugurated. He successfully managed to pass the Housing Loan and other financial packages through the Diet by June 1996. As mentioned earlier, the Lower House election was held on 20 October 1996, and the LDP won and continued to form a three-party coalition with the Social Democrats and Sakigake; Hashimoto formed his second Cabinet in early November 1996.

Regarding administrative reforms (his top political agenda), the dynamics of party competition with rivals and coalition partners was driving the LDP's position before and after the elections. Shinshinto, under its head Ichiro Ozawa, was advocating fundamental reforms of the Japanese system from the neoliberal viewpoint.[47] The newly formed Democratic Party of Japan (DPJ) was advocating the challenge to the "bureaucracy" (*kan*) from the "people" (*min*), cashing on the wild popularity of Naoto Kan, its leader, who successfully fought off the bureaucracy while serving as Minister of Health and Welfare under Murayama.[48] Sakigake, the LDP's coalition partner, was trying to avoid being submerged in the three-party coalition. Seeing that its efforts for the reforms of government corporation were not working, Sakigake pushed for even more reforms. Given this party configuration, Hashimoto had to appeal to public opinion by pushing the administrative reforms to compete with Ozawa of Shinshinto and Kan of the DPJ. Thus, he engaged in the reorganization of all the central government agencies, outdoing Kan's agenda[49], and situating the reforms within a reorganization of the state, the economy, and the society, basically embracing Ozawa's program. (Otake 1999)

After the October 1996 elections, when he finally had a cabinet earned through electoral victory, he started to implement his agenda — administrative reforms as part of the larger, structural reforms of the Japanese "system". He personally decided to launch the financial reforms at that timing.[50] The successive reforms launched one upon another would eventually grow into his Six Large Reforms. Hashimoto, a specialist in welfare and social security matters in the LDP, appears to have developed this agenda of structural reforms at least since he had served as MITI Minister under Murayama, at which time he had had numerous policy discussions with MITI officials on the need for structural reforms.[51] His strong ties with MITI were noticed when, upon taking office in January 1996, he took the unusual step of appointing a MITI official as secretary in charge of political affairs, a position usually filled by the Prime Minister's own personal staff.[52] MITI had a large influence on the basic strategy of the Six Large Reforms, the economic structural reforms and administrative reforms in particular.[53]

While MITI had a large impact on Hashimoto's agenda of structural reforms as a whole, its role in the Big Bang itself should not be overestimated. The initiative to start the financial reforms originated from Hashimoto, who decided to launch financial reforms at this timing; the content of the Big Bang plan itself had been in preparation in MOF for the past few months, as we saw earlier. Hashimoto's personal secretary from MOF was deeply involved in the Hashimoto's initiative of November 1996; the announced paper, outlining the "Free, Fair, Global" principles, was mainly drafted by him.[54] (Otake 1999) While MITI had been working on financial reforms through its advisory panel, especially on the liberalization of corporate finance, since 1992[55], the Big Bang initiative itself was MOF's product, which was implemented by MOF through its deliberation councils. That MOF was in charge of the Big Bang led a former MITI senior official to casually observe that MOF, which had been unwilling to carry out financial reforms in the past, came later in the process to take away the issue that MITI had been strenuously working on for quite some time.[56]

11) Summary: Who brought about the Big Bang?

In sum, the following can be said about the roles of the LDP ARPH, Prime Minister and LDP President Hashimoto, and MOF in the emergence of the Big Bang. There were two sequences in the reforms. Regarding the sequencing (i.e. foreign exchange first), it was largely a strategic move by Sakakibara at MOF, while it may reflect the following coincidences: that such "mavericks" as Sakakibara and Shiozaki were controlling the particular issue-areas (Sakakibara in charge of foreign exchange control and Shiozaki in charge of deregulation), as well as the opacity of causal relationship between foreign exchange control and domestic finance, certainly helped this potentially explosive issue to sail smoothly through the Diet. (Otake 1999) The first sequence, the foreign exchange reforms, was largely a product of cooperation of the LDP ARPH and some MOF officials: that this went through smoothly by the summer of 1996 made drastic reform of the domestic financial market inevitable, as a massive capital outflow may have occurred otherwise. Regarding the second sequence, the bulk of the financial reforms, Hashimoto was obviously the person who decided the timing (November 1996), scope (encompassing private finance), and pace (until 2001). He was the person who gave the direction, seeking to enhance public support of the LDP and his administration.

The other actors' influence on Hashimoto's decision can be seen at two levels: first, bringing the agenda (financial reforms) on the priority list of the Hashimoto's Second Cabinet, and thus influencing the timing of the reforms; and second, coming up with the actual plan and implementing it later, thus setting the scope and pace of the reforms. The LDP's ARPH played the first role while MOF was influential in the second. The LDP ARPH carried administrative and other reforms through the ruling three-party coalition; it drafted its plan of financial reforms and made it a campaign promise. The LDP ARPH made sure that overreaching, drastic financial reforms would be carried out by the Hashimoto government, while not determining the actual content of the reforms (such as "scope"). The LDP ARPH, outside the financial administration under bureaupluralism (which came under the jurisdiction of the LDP's PARC and its sub-divisions), was pushing for reforms that would affect jurisdictions over ministries other than MOF (such as social security and public finance).

The latter role, of coming up with the actual plan (and implementing it later), has been almost exclusively played by MOF (although competition existed from the LDP ARPH, MITI, and the Ikeo group). The Big Bang Initiative of November 1996 was mainly drafted by Hashimoto's staff from MOF. The actual plan, on which the policy discussion would be developed through MOF's deliberation councils, was the one already prepared, yet not presented, by MOF: the internal split between those who advocated the reforms and those who were cautious or opposed was not resolved, and the plan was kept under vault until it faced the political initiative of the Prime Minister.

We now have a partial answer to this question, "Who decided the timing, scope, pace, and sequence?" Regarding Phase I, the emergence of the Big Bang, Hashimoto deserves credit over timing, pace, and scope; the LDP ARPH deserve additional credit for the timing, while MOF may have determined the scope and pace, and MOF and the LDP ARPH would share the credit over the sequencing. In the next chapter, where we will address the financial industries' influence over the Big Bang, we will find a more thorough answer to this question.

5.5 Evaluation

We now turn to the evaluation of the facts provided in the narrative. While the narrative inevitably involved significant individuals such as Hashimoto, we now integrate the narrative into our analysis which operates at the organizational level. We show not only that the logic of organizational survival is what drove the actors' behavior, but also how the logic of organizational survival operates to integrate sub-organizational behavior into organizational strategy.

1) Why Was MOF Willing to Propose and Carry Out the Big Bang?

Sakakibara's interview clearly shows that MOF was willing to give away regulatory power. The positions advocated by Nagano and others in the Ministry promote a departure from the relational networks (based on regulatory power) that characterized the policy making style of bureaupluralism, which would provide valuable information, cooperation, and retirement positions. We would like to find out why MOF would willingly engage in the abandon of such benefits to its organization. After all, the opposition from within the ministry fits the expectations derived from conventional explanations of bureaucratic behavior that emphasizes maximization of tokens of organizational power such as regulatory power, discretionary power, or budget. Why, then, would such abandon of regulatory power and the benefits associated with bureaupluralism get an upper hand as the policy of MOF?

We contend that it is misplaced to situate the maximization of tokens of organizational power as the driving force of the bureaucracy's behavior: clearly, such assumptions do not hold in face of the actual events. However, this does not necessarily mean that we see the process of the emergence of the Big Bang to be one in which the bureaucracy spontaneously engages in an enlightened action, as Sakakibara seems to imply. It is only by incorporating the context in which financial reforms were taking place that we can obtain the real picture: all political parties, the media, and the public were after MOF with a view to breaking it up, largely because of its policy failures and scandals. Why wouldn't MOF take into account this concern in its strategy towards the financial reforms, in line with the generally observed behavior of pursuit of organizational survival among bureaucracies?

We saw earlier that there are two sets of interests that the political actors enhance in order to ensure their survival: constituencies interest and public interest. When public support is lost because of policy failures and scandals, and when organizational survival is in jeopardy because the bureaucratic agency's ties with the regulated industries are heavily criticized by the public, naturally, we can expect the priority of that agency to shift from constituencies interest towards public interest.

This is what happened in our case. MOF had strong incentives to shift its focus from the past benefits of bureaupluralism to public support in order to prevent its organizational breakup: it chose to re-coup the loss of public trust by advocating "good measures" (to the economy as a whole) which may also entail negative effects to its organization by hurting its constituent's interest (and cutting its support). It appears that those within MOF who advocated the financial reforms were well aware of the possible beneficial impact the initiative might have on the discussion of the MOF breakup: such concerns were raised following the LDP's Group of Eight meeting in September 1996 which decided to dismantle the organization, although this consideration did not lead to the earlier announcement of the WT's prepared plan.[57]

Hashimoto's political leadership, by deciding to launch the reforms at that timing, settled the internal differences within MOF. However, while openly resisting the Prime Minister may not have been an option, it is not that MOF had no choice but to launch the reforms as told: it could have reasonably argued that a cautious approach was needed as the bad debt problem needed to be resolved first.[58] On the other hand, MOF could have hopped onto Hashimoto's Initiative to launch the drastic reforms that were impossible in the past because of the industries' resistance.

In short, MOF had two choices: "forestall" and "seize the moment", corresponding to its two sets of interests, constituents and public (although it may also have been in the "objective" public interest to choose the former). In the absence of the concern for organizational survival, "forestall" may well have been chosen, as such seemingly legitimate concerns as "stability" in finance may weigh heavier than the Prime Minister's political will: if so, the bureaucracy could have negotiated or attempted to persuade the Prime Minister on the possible negative consequences of his initiative. Besides, given the uncertainty of the future, it is hard to definitively reject the contention that bad debt problem needs to be resolved first.

However, if we bring in the concern for organizational survival, the option "seize the moment" becomes obvious. Hashimoto's top agenda was administrative reforms and he wanted the Big Bang; MOF faced organizational breakup amidst wide political and public criticism. It makes sense for MOF to cooperate with the Prime Minister to seek the Prime Minister's support in its main cause, the preservation of its organization. Even if uncertainty is high, that Hashimoto's drastic deregulation would get public support was quite obvious compared to the cautious approach, which would have inevitably entailed the preservation of MOF's ties with the industries, the focus of public criticism. The bureaucracy did not dominate the policy discussion by its expertise: the Ikeo Report showed that Hashimoto's position was backed up by experts as well. Thus, it was apparent that the public's perception of public interest would reside with the "seize the moment" option.

While Hashimoto's political leadership certainly shaped MOF's behavior, the whole story should be distinguished from one of political dominance over the bureaucracy, which would hold if MOF were resisting the Big Bang initiative. In fact, MOF was not: it is important to note that MOF was preparing to launch drastic financial reforms from early 1996, when it faced talks of organizational breakup, well before Hashimoto's initiative arose in fall 1996. This fact supports our interpretation that stresses the shift from constituencies interest to public interest when organizational survival is at stake because of the decrease in public support: while it did not appear in observable forms at the organizational level, MOF was already developing efforts to re-coup public trust at the sub-organizational level.

In hindsight, the calculation of the bureaucracy was erroneous: the organizational breakup did occur, and thus the aim to influence the breakup through the Big Bang failed. (As we will see in the next chapter, the bureaucracy faced a dilemma: in order to ensure the program's success, it had to emphasize political leadership and minimize its role, which made its aim to re-coup public support unattainable.) However, this should not concern us: how the actors perceived the world rather than the objective reality (that materialized as a result of their choice) determined their calculations and hence their behavior.

In sum, while there was a fissure within MOF along the two sets of interests, those of the industries and those of the public, MOF as an organization acted to re-coup its loss of public trust by choosing "seize the moment" over "forestall", when facing Hashimoto's directive to initiate drastic financial reforms at that timing. While Hashimoto's political leadership should be given credit for deciding the matter, the fact that some sub-divisions of MOF started to craft plans much earlier, when organizational survival had begun to be put in question, points to the fact that the logic of organizational survival was what ultimately drove the process of integration of different sub-organizational actors' views into the behavior of MOF as a whole organization.

Let us now turn to the LDP's behavior before we examine the two issues of how the logic of organizational survival works and how we can link the developments at the sub-organizational and organizational levels.

2) What Drove the LDP's Behavior?

Our research puzzle c) states the following: how can we explain the LDP's behavior, supporting the Big Bang while making decisions that drastically undermine MOF's presence in finance? What happened to the stable LDP - MOF alliance of the postwar era?

Let us reinterpret the above narrative from the LDP's view-point. While the LDP had to take responsibility as the main ruling party in the wildly unpopular Housing Loan package, it also faced tough competition from Shinshinto and the DPJ, its rivals, as well as from Sakigake and the Social Democrats, its coalition partners. The electoral competition with its rivals led the LDP to follow the program of its rivals regarding administrative reforms and systemic reforms of Japan. Sakigake and the Social Democrats pushed the ruling coalition's position towards more administrative reforms (or MOF reforms) by appealing to public opinion. Thus, the LDP faced a threat to its organizational survival and its position as a ruling power: the two were associated, as the last experience of loss of ruling power left a bitter impression on many of its lawmakers, who were resolved that such a thing would never happen again.[59] This was a new development, as the elections of 1993 transformed the collective perspective: the scope of possible scenarios was drastically widened to include the LDP's loss of power, which was a distant possibility prior to 1993.

The loss of public support in face of tough electoral competition rendered the LDP's organizational survival in jeopardy: accordingly, the LDP sought to re-coup public support, even if it meant that it would jeopardize its constituents in financial politics: financial industries in the financial reforms, and MOF in the administrative reforms. The ARPH and Party President Hashimoto were the two main sub-organizational actors who carried out this agenda.

First, let us see the ARPH's role. The LDP let the ARPH carry out the financial reforms, by-passing the PARC, an important pillar of bureaupluralism where the regulated industries were known to be influential. The financial sector's financial contributions were important to the party.[60] However, in the realization that drastic reforms hurtful to most of the industry would still improve the party's public image vis-à-vis its rivals, the ARPH, supported by party leaders, and not the PARC, took the initiative on the financial reforms. The same thing can be said about administrative reforms. Again, the ARPH acted as the spearhead for MOF's breakup, by-passing the PARC, which grouped politicians in support of MOF. MOF, the LDP ally in the pre-1993 world, did not fare well when the LDP faced the specter of electoral defeat. True, the LDP developed a grudge over MOF's attitude while it was in opposition in 1993-94. (Mabuchi 1997) However, the LDP was attempting to pass the Housing Loan package through the Diet at the same time as it was discussing the breakup of MOF: besides, MOF's influence upon public works and other abilities to assist the LDP lawmakers regarding their individual constituencies was left intact from the pre-1993 era. Not surprisingly, MOF had its allies within the LDP: Yosano and others tried to stall the breakup. However, as the Group of Eight of 18 September shows, the electoral concern ("we cannot fight elections") led the ARPH's position to be adopted as the LDP's party platform.

Next, how can Hashimoto's role be re-interpreted? As LDP President, he came to incorporate the issues developed by the rival parties, related to administrative reforms and other structural reforms. He was constantly under pressure from the rival parties and the media to deliver on his electoral promises, once he won the October 1996 elections. Moreover, Hashimoto's base within the LDP was weak: he had to rely on public support by carrying out the administrative reforms, if he was to maintain his position. (Tahara 1998) Thus, public support was essential not only for the LDP's continued rule but also his continued rule as Prime Minister as well.

A seemingly puzzling relationship between the LDP and MOF emerges through this process. As mentioned earlier, the ARPH worked closely with MOF's Sakakibara to establish the first sequence of the Big Bang, the foreign exchange reforms, while the ARPH drove the LDP into breaking up MOF. Both the ARPH and MOF developed a plan for financial reforms, independently from one another.[61] Once the plan (MOF's) was announced, the ARPH and MOF both worked to support it. Hashimoto worked closely with MOF on the Housing Loan Affairs, launched the Big Bang with its help, yet dealt the final blow to MOF reforms by deciding its breakup in December 1996. How can we understand MOF and the LDP's relationship?

Our claim — that the LDP sought to re-coup the public support in face of tough electoral competition which threatened its continued rule and organizational survival — enables us to make sense of this relationship between the LDP and MOF. The LDP went along with MOF on the Housing Loan Affairs, as its position as the dominant party in the ruling coalition required (just like in the pre-1993 days). The LDP brought about the Big Bang along with MOF, defying the financial industries, because deregulation attracted public support and its rivals were campaigning for it. However, the same logic led the LDP to go against MOF on administrative reforms: this issue was popular and its rivals were pushing it. The LDP's behavior was driven by efforts to recuperate the loss of public support in the Housing Loan Affairs in face of party competition.

What emerges here is a mixture of cooperation, competition, and conflict between MOF and the LDP, each acting according to the logic of organizational survival. Thus, the relationship between the LDP and MOF ought not to be treated as a simple alliance or enmity: it is more of a strategic interaction, involving cooperation, competition, and conflict, determined on an issue-on-issue basis.[62]

3) How Does the Logic of Organizational Survival Operates? How Can We Integrate the Sub-Organizational and Organizational Levels-of-Analysis?

While our analysis centers around such organizations as MOF and the LDP, the narrative of the events had to involve the significant individuals and groups of individuals such as Hashimoto, Shiozaki, Sakakibara, and the ARPH. Delving into the mechanism of how the logic of organizational survival operates will enable us to link the organizational and sub-organizational levels-of-analysis.

In reality, as the narrative suggests, there were internal fissures in MOF and the LDP, reflecting the two sets of interests that the political actors seek to enhance: the constituencies and the public. However, the logic of organizational survival gave the upper hand to the latter: the strategy of the organization as a whole, which developed as a result of internal struggle, reflected this concern for organizational survival, which was not merely shared by all members but was their top priority. The organizations were suffering the loss of public support and their survival was threatened, while the constituents were the focus of public criticism because of scandals and/or policy mistakes. The following are the polls conducted in February 1996: to the question, "The strength of MOF's power has become an issue. Do you think that organizational reforms such as the breakup of MOF should be done or not?", 65% responded "it is better to do organizational reforms" while 15% said they "do not think so". (Asahi Shimbun 28 February 1996) Newspaper editorials urging the breakup of MOF appeared one after another. The Asahi Shimbun, a leading newspaper daily, campaigned heavily towards this goal with sensational headlines such as "The laughter of MOF can be heard" and "Are you prostrating to MOF?". In the year 1996 alone, the newspaper issued at least nine editorials aiming specifically to pressure the political actors to break up the ministry.[63]

Given this situation, it is quite understandable that the individuals within the organization pushing to shift the emphasis on public support from constituencies interest won the "policy contest" within the organization. This process of integration of different views into one organizational strategy shows us how the logic of organizational survival operates, enabling our analysis to proceed from the sub-organizational level up to the organizational level.

As for MOF, there were those "reformers", who advocated drastic financial reforms and those "financial insiders", who pressed for cautious approaches. The split reflected the two concerns of political actors, public support and the constituencies' well-being. (This difference is likely to be supported by the individual incentive structures of the bureaucrats, while the lack of available data prevents us from making a conclusive statement.)[64] Once organizational survival became threatened, the reformers increased their strength. While the financial insiders, in charge of policy making under bureaupluralism, did not abandon their cautious approach until the fall of 1996 (when Hashimoto's initiative came up), the reformers had been drawing up plans for drastic financial reforms since early 1996. Hashimoto's decision to launch drastic reforms gave a decisive advantage for the reformers. However, the political leadership *per se* was not sufficient in driving MOF to "seize the moment", as a cautious approach ("bad debt problem first") could have been advocated because of uncertainty involved. However, the organizational breakup looming in the background made it impossible for MOF's financial insiders to contest the Prime Minister's initiative, backed by experts (the Ikeo Report), as organizational survival was a priority for the financial insiders as well.

The LDP's behavior concerning both financial reforms and administrative reforms can be explained by the logic of organizational survival. Within the LDP, on one hand, some (e.g. the ARPH and Kato) sought to increase public support for both financial reforms and administrative reforms: they pressed for drastic financial reforms and the breakup of MOF. On the other hand, there were those lawmakers (e.g. the PARC for both issues; Yosano and other MOF allies for MOF reforms) who were promoting the other sets of interests that the LDP had to consider: its constituents (the financial industries and/or MOF), who were the LDP's partners in the policy making mechanism of bureaupluralism. While the two parties were engaged in a tug-of-war in both issues, the ARPH had the initiative over the PARC, reflecting the support of the party leadership, who had to consider not only the rival parties' programs, but also the fact that a three-party coalition, with partners who were pushing for further reforms, was in place. The Group of Eight meeting of 18 September 1996 clearly shows how the internal fissure within the LDP on administrative reforms was resolved: the concerns regarding the coming elections were the decisive factor in the conclusion to break up MOF. The strategy to pursue public support through drastic administrative reforms won over the cautious alternative which would preserve the LDP's ties with MOF.

In sum, the logic of organizational survival decided who was the winning party in the internal split that occurred along the possible options, reflecting the two sets of interests that the organization needed to consider. In other words, the experience of MOF and the LDP regarding the financial and administrative reforms show how the logic of organizational survival integrates different positions within the organization into one organizational strategy. Within MOF, the "reformers" and the "financial insiders" diverged in their views; this split was resolved by Hashimoto's decisions and ultimately by the need for organizational survival. The Big Bang Initiative, which the "reformers" conceived and the Ministry as a whole fully embraced later, was an effort to re-coup the public trust lost by policy failures and scandals. Within the LDP, those who sought drastic reforms and those who were cautious about the financial and administrative reforms engaged in a tug-of-war: ultimately, the former position became the party strategy. This came out of concern for competition with other parties, and was thus stemming from a consideration for organizational survival.

4) Our Revised Story: Our Explanation

Our revised story —our explanation — is that the Big Bang was produced amidst the strategic interaction between MOF and the LDP, each acting according to the logic of organizational survival. The logic of organizational survival drove the integration process of organizational strategy for MOF and the LDP: when the two sets of interests, constituencies and public, which needed to be enhanced to promote organizational survival, gave rise to internal differences in the organization, the sub-organizational actor whose position sought to increase public support over the constituents' well-being got the upper hand. As the loss of public trust in the Housing Loan Affairs (and other policy failures and scandals for MOF) was what brought about the crisis, organizations sought to re-coup public trust by enhancing public interest over constituencies interest: the sub-organizational actors who won (MOF's reformers and the LDP's advocates for drastic reforms) in the policy contest within the organizations were, in fact, representing the logic of organizational survival.

Thus, the Big Bang represents a shift within MOF and the LDP towards public interest from constituencies interest. An interesting development was that because the policy making mechanism of bureaupluralism was designed to represent mainly the constituencies interest, the Big Bang Initiative did not go through the normal decision making procedure: the LDP ARPH by-passed the LDP PARC and its financial sub-divisions, and MOF was preparing drastic financial reforms without consulting the regulated industries through the deliberative councils. This event may suggest a change that may be transforming bureaupluralism, the institution in public policy making under the LDP's one-party dominance prior to 1993, as will be seen in the later chapters.

5.6 Comparison with Alternative Explanations

We now need to compare our explanation against alternative explanations to check its plausibility. The discussion in Chapter 2 led us to posit five rival explanations that would claim that the Big Bang was:

a) a pre-designed and coordinated initiative by a single bureaucracy (MOF or MITI)
b) the result of the domination of financial institutions ("insiders" or "outsiders")
c) the result of politicians overriding bureaucrats
d) the result of the non-financial firms and MITI gaining the upper hand of financial industries and MOF
e) an achievement by the LDP backbenchers promoting consumerism as a result of electoral reforms of 1994, introducing the single-member district

1) Bureaucratic Dominance? Political Dominance? (a, c)

First, the narrative suggests that the Big Bang initiative was not a pre-designed and coordinated movement by any bureaucracy. Despite MOF's large influence, without Hashimoto's decision to launch the initiative at that timing and scope, MOF's plan would not have emerged. As we will see in the next chapter, it would have been hard to overcome the regulated industries' objection without Hashimoto's political leadership: that MOF, the focus of public criticism, was the leader for drastic financial reforms might have dealt a fatal blow to this initiative at the implementation stage. On the other hand, if we look at the role played by MOF in the preparation and implementation of the Big Bang, there is no way that this can be understood as MITI's scheme (also see below). Thus, explanation a) is "out".

Then, is the Big Bang the result of political dominance over the bureaucrats? True, Hashimoto's political leadership mattered. However, as the narrative suggests, MOF was willing to carry out the plan which it has been discreetly preparing for quite some time:

thus, this explanation does not hold in the absence of MOF resistance. Thus, explanation c) is also "out".

Instead, we ought to characterize the process as an outcome of a strategic interaction of MOF and the LDP, involving cooperation, competition, and conflict, decided on an issue-on-issue basis. In order to approach this question, "Why was the Big Bang brought about?", asking why the actors behaved as they did would be more fruitful than seeking to detect the dominance of either bureaucrats or politicians.

2) Dominance of Financial Institutions? (b)

What about the possibility that the Big Bang was brought about as a result of the financial institutions' domination of financial politics? As we saw above, if we look into the incentives of MOF and the LDP, both political actors had reasons to engage in the promotion of all-out regulatory reforms, independent of the affected industry, that is, in the absence of exchange of social goods and services. Besides, who would be pushing for drastic financial reforms? From our discussion in Chapter 4, we know that most financial institutions had reasons to oppose the Big Bang, as it would jeopardize their prospects for survival. Thus, it was not through the large industrial organizations, such as the National Federation of Bankers' Associations, which included the city banks as well as long-term credit banks and trust banks, that such efforts would be made, unlike in the past. (e.g. the banking reforms of 1979-82, discussed in Chapter 6)

The powerful city banks were the few candidates who might have had incentives for pushing such financial reforms. Indeed, they worked hard through MOF's Banking Bureau to pursue their cause vis-à-vis the long-term credit banks as well as the securities industry. They also strove to pursue liberalization of the bond market through MITI.[65] However, if we consider the context of 1995-1996, it is clear that the powerful city banks were unable to ostensibly campaign for drastic financial reforms which would result to their benefits. The city banks, along MOF, were attracting a large amount of criticism from the public and the politicians, due to their roles in the Housing Loan Affairs. In this context, there was little possibility that the powerful city banks successfully lobbied to the state actors to launch the Big Bang reforms.

Among the newcomers to finance, nonbank financial institutions would have had a hard time campaigning for the Big Bang, as they were also constrained by the Housing Loan Affairs: the housing loan companies were also nonbank financial institutions. Indeed, later, when the issuance of corporate bonds was proposed to the Diet to carry out the Big Bang initiative, many LDP lawmakers initially opposed the measures because of the Housing Loan Affairs: they did not feel comfortable legislating beneficial measures to nonbanks.[66] Given this environment, the likelihood that nonbank financial institutions brought about the Big Bang through their campaign upon political actors is very small.

Then, is it that foreign financial institutions dominated financial politics? Foreign pressure by the U.S. government had increased the presence of foreign financial firms in Japan since the liberalization of the 1980s. However, there is not much in the process of the Big Bang that points to the impact of foreign pressure: while the insurance bilateral talks were going on prior to the Announcement of November 1996, there was little in the discussion (e.g. threat of a painful retaliation) that may have forced the Japanese political actors to launch drastic financial reforms at this timing.

Thus, the explanation c) that sees dominance of financial institutions ought to be rejected (unless there is evidence that new firms in the financial markets wielded unusual, yet unobservable influence). Admittedly, there is always a possibility that some kind of exchange of goods and services existed behind doors between some "winners" among the financial institutions (e.g. large city banks and/or foreign financial institutions) and the political actors who pursued the cause of drastic financial reforms. However, unless such evidence is uncovered, our explanation that points to the incentives of the political actors to pursue financial reforms, independently from the exchange of goods and services that might be provided from the economic winners, seems to be a better explanation.

3) A Bureaucratic Turf-War between MITI and MOF? MITI and Corporate Sector Taking Over Financial Sector and MOF? (d)

We now turn to explanation d), which would claim the possibility of the involvement of the corporate sector and MITI in financial politics. MITI had been involved in financial politics through its deliberative council on industrial finance. It had been working on financial liberalization since early in the process, as the representative of the corporate sector under bureaupluralism. Such topics as corporate bond issuance, securities commission, asset management of pension fund were the issues discussed at the LDP's ARPH as well as the government's panel on deregulation in 1995-96: MITI was very much involved in this process. Large non-financial firms as well as large city banks would come to MITI to speed up the liberalization. MITI provided a cover to firms who did not want to be singled out as advocates of financial reforms which would disrupt the current order.[67]

In this way, MITI certainly advanced the cause of financial reforms. However, there is a large discrepancy between the topics of financial reforms addressed by MITI and the Big Bang Initiative, which included a variety of measures such as foreign exchange reforms and the breakdown of the segmentation in finance while carefully avoiding matters outside MOF's jurisdiction such as public finance and the pension fund's asset management. If the initiative came from MITI, why would the Initiative look as such? The efforts by MOF to launch drastic financial reforms seem to have been well sheltered from MITI until the end; it does not appear that a negotiation took place between the two ministries.[68] We already saw that while MITI may have been influential in the Hashimoto administration in general, especially regarding the administrative reforms, the financial reforms seem to have been MOF's domain.[69]

Thus, it is unlikely that the Big Bang was a result of a bureaucratic turf war between MOF and MITI. As mentioned earlier, some MITI officials were influential in setting the course of administrative reforms, which included stripping financial administration away from MOF. However, it appears that the drive for financial reforms within MITI, carried out by the Industrial Finance Division of the Industrial Policy Bureau, was not linked with the efforts for administrative reforms, led by MITI's Secretariat and the Prime Minister's staff from MITI. According to a MITI official, the efforts for financial reforms within MITI did not involve its top echelon, being limited to *nemawashi* among politicians and scholars on the necessity of such reforms.[70]

Without MITI, we are left with the corporate sector as the possible candidate to campaign for drastic reforms. However, we do not find much evidence there that their industrial organizations campaigned effectively for such goals: this may be due to the inclusiveness of their industrial organizations. For example, the Federation of Economic Organizations (*Keidanren*), the major national business federation advocating liberalization, would often compromise with dissenters in its own rank, such as the financial institutions: according to a senior Federation official, financial institutions pushed the Federation to qualify its support for the Big Bang reforms. (Vogel 1999)

Again, as was the case for the "winners" among financial institutions, this does not entirely reject the possibility of an exchange of goods and services taking place behind closed doors between state actors and some individual firm or industrial associations. However, until the unlikely event that such evidence is uncovered, we may be confident in our explanation's ability to better account for the events in the Big Bang process.

4) Consumers' Victory Achieved by the LDP Backbenchers as a Result of 1994 Electoral Reforms? (e)

Finally, we need to contrast our explanation with an alternative, increasingly influential in the study of Japanese politics: the rational choice explanation focusing on the effect of electoral systems (hereafter, "electoral rational choice"). The explanation e) would hold that the electoral reforms of 1994, introducing the single-member district system (SMD), altered the incentives of the individual LDP lawmakers to represent more of the consumers' interests; the LDP lawmakers would push their party leaders towards consumer-friendly reforms. The bureaucracy, if involved at all, would correctly anticipate its political master's wishes and switch gears towards this goal accordingly. The implications of the 1994 electoral reforms to regulatory policy, according to Rosenbluth and Thies (1999), would be a turn toward consumer-based regulation, as the old regulatory practice, based on the close business-government ties, would come under more frequent and successful attacks from consumer groups, and parties associated with such policies would be punished at the polls. As we saw earlier, the Big Bang is an outcome consistent with this explanation's expectations: it brings benefits to the consumers by increasing their chance to manage their financial assets better.

However, we have four objections to this type of explanation. First, the effect of the 1994 electoral reforms was not clear in 1996, when the first Lower House elections under the new system took place. Based on various empirical works on the 1996 elections collected in his edited volume, political scientist Hideo Otake suggests that the basic characteristics of the Japanese elections under the multiple-member district system (MMD), in which the contests among individual candidates based on personalistic support networks take place, was largely intact despite the introduction of the SMD. He concludes that while the 1994 electoral reforms succeeded in reducing campaign funds, they largely failed in the more fundamental goal to render elections party- and issue-oriented. (Otake 1997b) That the 1996 elections were not issue-oriented may follow from our earlier point: all parties had the administrative reforms as part of their party platforms, reflecting the LDP's strategy to "encompass" its rivals' programs of administrative and structural reforms. Given the uniformity of the party platforms, the elections could not become anything but contests among individual candidates.

However, the above criticism may not undermine the electoral rational choice explanation: the effects of the 1994 electoral reforms may not have been observable in the 1996 elections because the LDP lawmakers expected the implications of the electoral reforms and acted accordingly. In other words, we may revise the explanation e) as follows: it may be that the LDP lawmakers, aware of the impact of the electoral reforms to elect consumer-friendly parties, adopted consumer-friendly platforms. (If they were not aware of this tendency of the electoral reforms to increase the likelihood for consumer-friendly lawmakers to be elected, how could they adopt consumers-friendly positions before the elections?)

Even if revised as such, this explanation does not seem to be supported by the empirical facts as it gives rise to a number of anomalies: this leads to our three remaining objections to the electoral rational choice explanation.

Our second objection is that the electoral reforms were but an accelerating factor, not a necessary condition for change of power, which drove the LDP's behavior. The LDP's preference to avoid the loss of election, or loss of power, at all costs is clear from such evidence as the Group of Eight Meeting of 18 September 1996, where such concerns as "we cannot fight the elections unless we break up MOF" were raised and dominated the party discussion to overcome other views. As seen earlier, the LDP lawmakers were resolved not to repeat their experience as the opposition in 1993-94. In this process, did it matter that the SMD was introduced?

To be sure, the introduction of the SMD may increase the chance that the LDP loses its ruling power, as it makes it impossible for the LDP to have multiple lawmakers elected from its strongholds, which provided a comfortable buffer for the LDP under the MMD. However, the introduction of the SMD was not a necessary condition for the change of power, as it was shown in 1993 that change of power could occur under the MMD: that some LDP lawmakers founded a new party, forming an eight-party coalition with other non-LDP parties, but not the introduction of the SMD, is the factor that led to the change of government.

While the introduction of the SMD may facilitate the change of power, as long as the change of power does not require electoral reforms, and as long as the prospect of loss of power is what drives the LDP lawmakers behavior, we can conclude that "change of power" is a more fundamental causal factor than "electoral reforms", an accelerating factor.

Accordingly, our contention is the following: it was not the introduction of SMD but the possibility of change of power that worried the LDP lawmakers and drove them to adopt the pro-reform electoral platforms. And where did that possibility of change of power come from? It was the experience of 1993 that showed that parties can align themselves to throw the LDP from power unless the LDP secures an absolute majority. This made the threat of replacement from other parties, including major rivals (such as Shinshinto and the DPJ) and smaller coalition partners (such as Sakigake and the SDP), more believable. Not only did the LDP face a direct threat of replacement from its major rivals, but also it was exposed to the danger of the breakup of the ruling coalition in the absence of an absolute majority. It is this newly found "possibility of change of power" from party realignment, or the dynamics of party competition, that drove the LDP to match the other rival parties' platforms for reforms. This interpretation seems to be corroborated by the views of the LDP ARPH members, mentioned earlier, that attribute the advance of reforms to the fact that the LDP was in a three-party coalition. (Ironically, such central members of the ARPH as Shiozaki and Mizuno were not driven by electoral concerns under the SMD electoral systems. Mizuno was set to retire because of his dislike of the SMD, and Shiozaki had to switch from the more powerful Lower House to the Upper House in an electoral deal with another LDP lawmaker.[71])

Our third objection to the electoral rational choice explanation is that it is unclear whether the common phenomenon of exchange of vote and favor between political and economic actors existed between the consumers and the LDP. Recall that explanation e) would hold that the implications of the 1994 electoral reforms to regulatory policy would be a turn toward consumer-based regulation, as consumer groups would successfully attack old regulatory practice and parties associated with such policies would be punished at the polls. Does this observation hold when contrasted against reality?[72] We contend that the assumed link between the voting public's behavior which select parties according to their policy regarding the consumers' interests, and the LDP's behavior, which select consumer-friendly policy in anticipation of the punishment at the polls in failure to do so, does not hold in our case, because it is doubtful whether the exchange of vote and favor between the consumers and the LDP existed during the period surrounding 1996 elections: first, the consumers were largely unaware of the issues; and second, such central issues of the elections as administrative reforms can hardly be characterized as consumer-friendly.

First, we question whether the consumers were aware of the financial reforms at all: if the consumers were not aware of the issues, how can they possibly affect the electoral outcomes? Our discussion in Chapter 4 leads us to ask the following: how are we to make sense of the fact that only one-ninth of the consumer public were aware of the benefit of the Big Bang reforms as of July 1997 (well after the November 1996 Initiative) if we hold that the LDP lawmakers, conscious of the effect of the electoral reforms, pushed for consumer-friendly reforms? Polls clearly showed that the consumers were largely unaware of the financial reforms and that they were by no means showing large support to the financial reforms. Then, was it that the LDP lawmakers, who certainly had the opportunities to inquire into what concerned the voters in their constituencies, were somehow making an erroneous inference about the consumer-friendly effect of electoral reforms?

Second, the consumer-friendly financial reforms were but a minor issue in the 1996 elections. While the idea of the Big Bang was included in the LDP's electoral platforms (as emphasized by Shiozaki of the LDP ARPH), it does not seem to have attracted much public notice: the central issues were administrative reforms, to which the consumers had a much more remote stake than in the case of financial reforms. Administrative reforms to re-organize the central government's agencies may result in the reduction of the government's expenses, and thus ultimately in lower taxes: however, the causal link is much more opaque than the benefits of financial reforms which increase consumers' choice and financial services' efficiency. Administrative reforms were popular, but not because of the perceived beneficial effects to the general public such as lowered taxes. The popular anti-bureaucracy agenda of the Democrats was not so much about the content of the policy carried out by the bureaucracy than the procedure of bureaucratic dominance. Its strategy to stress the division between professionals and amateurs in politics was one proven to be effective for a short time by the numerous short-lived booms of new parties in the past.[73] (Otake 1999) In such a situation, is it appropriate to explain the LDP's behavior to advocate administrative and other reforms as a consumer-friendly stance in expectation of winning the consumers' support?

In contrast, our explanation can explain both such consumer-friendly reforms and such reforms as administrative reforms which have distant relations with the consumers' interests. In our explanation, what matters is public support, which affects the dynamics of party competition: public support can be obtained of a program perceived to be a "good" program, regardless of whether it objectively improves the consumers' lot or not. We simply state that as long as the rival parties' platforms attracted public support, regardless of their link to the public's day-to-day life, the LDP would have matched the other parties' platforms to avoid the loss of power as the one in 1993. The financial reforms were just one part of the large agenda of administrative reforms and structural reorganization of Japan; the LDP pushed for reforms to increase the public support of the party. While reforms may or may not have a direct impact on the public's lot, reforms attracted public support: this was demonstrated by the Democrats, whose leader Kan attracted large public support for his agenda of administrative reforms (or his anti-bureaucracy agenda, as mentioned earlier). As reforms (of the central government and the "system") became the central issue in the 1996 elections, the LDP was attempting to prevent losing public support to its rivals by matching its platforms.

In short, it was not that the LDP expected the consumers' support in return for its consumer-friendly policy: whatever their expected effects on the public, reforms were popular then, so the LDP adopted them as policy out of competition with its rivals.

Our fourth and last reason to reject the electoral rational choice explanation is that it cannot adequately account for the bureaucracy's roles. From our narrative, we know that there was a fissure within MOF regarding the financial reforms: while some were advocating gradual approaches, others were pushing for drastic financial reforms. This explanation would draw the following picture. MOF would prepare two sets of approaches so as to cover the differences within the LDP. It may be that the latter got the upper hand within the organization, as it suited the wishes of its political master, the LDP: Hashimoto gave the directions, so the bureaucrats decided that this was the LDP's wishes and acted accordingly.

However, as we bring in the administrative reforms and MOF breakup, this electoral rational choice approach faces an insurmountable empirical anomaly: how can it account for MOF's fierce opposition to its organizational breakup? That the LDP's decisions to break up MOF, such as the Group of Eight meeting of September 1996 and Hashimoto's decision in December 1996, shocked MOF bureaucrats demonstrates that MOF was unable to correctly anticipate its masters' wishes at all. That MOF kept on struggling against the efforts of LDP members such as Shiozaki and Kato to break up the organization, mobilizing the support of its allies within the LDP defies the world of electoral rational choice in which "bureaucrats' anticipate its master's wishes."

The same thing may be also said about financial reforms. Was MOF adopting this strategy of gradualism on the surface and preparation for drastic reforms in the background, as a response to the LDP's wishes? Wouldn't our explanation — that attributes the two different strategies to the internal fissure within MOF, reflecting the two sets of interests that MOF caters to — better explain why MOF behaved this way?

In sum, we reject the electoral rational choice explanation for the following four reasons. First, the empirical data obtained from the elections of 1996 do not support the consumer-friendly implications of the electoral reforms. Allowing for the possibility that the LDP put on consumer-friendly behavior in anticipation of such implications (thus rendering the effects of electoral reforms unobservable), we still have three objections. The second reason is that the electoral reforms were but an accelerating factor, not a necessary condition for a change of power, which drove the LDP's behavior. That the LDP expected to increase support from the consumers because of a change in the electoral system would not be an accurate account of the situation. That the LDP expected to increase public support, is true, but this is because of the realization that they could lose power, which was not necessarily a result of the electoral reforms. Third, it is unclear whether the exchange of vote and favor existed for the consumers and the LDP. The consumers were largely unaware of the issues, and the expected effect of the central agenda of the elections, administrative reforms, was not the cause of public support for this agenda. Rather, the LDP chose to adopt an agenda ("reforms") without much consideration about its effects on the public: its rivals were advocating this popular proposal, thus the LDP decided to do the same thing to avoid losing the elections. Fourth, the bureaucracy's roles in the financial and administrative reforms cannot be adequately accounted for.

In this section, we contrasted our explanation against the alternative explanations — bureaucratic dominance, political dominance, financial institutions' dominance, a bureaucratic turf-war between MITI and MOF, an alliance between MITI and the non-financial corporate sector, non-financial corporate sector dominance, and electoral rational choice. We conclude that our explanation withstands the challenge of these alternative explanations.

5.7 Conclusion

In this chapter, we analyzed Phase I of the Big Bang (- November 1996), or the process of its emergence, utilizing an "analytic narrative" approach (Bates et al. 1998) that seeks to build a dialog between theory and data. We first derived a hypothesis from the two sets of interests that state actors enhance: when public support is lost, state actors would seek to recover it, in their pursuit of organizational survival. We embodied it into a preliminary account. Then, we provided the narrative of the interrelated events that took place in the political process. We revised our account accordingly, and obtained an explanation, to which alternative explanations were contrasted and rejected.

Our explanation is that the Big Bang was produced amidst the strategic interaction between MOF and the LDP, each acting according to the logic of organizational survival. The logic of organizational survival drove the integration process of organizational strategy for MOF and the LDP. When the two diverging sets of interests, those of the constituencies and the public, which needed to be enhanced to promote organizational survival, gave rise to internal differences in the organization which had suffered a loss of public support, the sub-organizational actor whose position sought to increase public support over the constituents' well-being got the upper hand. As the loss of public trust in the Housing Loan Affairs (and other policy failures and scandals, concerning MOF) was what brought this crisis, organizations sought to re-coup public trust by enhancing public interest over constituencies interest: the sub-organizational actors who won (MOF's reformers and the LDP's advocates for drastic reforms) in the policy contest within the organizations were, in fact, representing the logic of organizational survival.

Thus, the Big Bang represents a shift within MOF and the LDP towards public interest from constituencies interest. An interesting development was that because bureaupluralism mainly represented the constituents' interests, the Big Bang Initiative did not go through the normal decision making procedure: the LDP ARPH by-passed the LDP PARC and its subdivisions, and MOF was preparing drastic financial reforms without consulting the regulated industries through the deliberative councils. This event suggests that the politics of bureaupluralism in public policy making is undergoing a significant change: we will pursue this idea further in the later chapters.

Through comparing our explanation against alternatives, we concluded that the Big Bang was brought about by political winners, namely MOF and the LDP in cooperation, competition, and conflict, who had political gains to achieve by gaining public support, independently from the exchange of goods and services with its constituents. It is unlikely that such economic "winners" as powerful city banks, the corporate sector, the newcomers to finance, and the consumers[74] were influential in bringing about the Big Bang.

We have so far answered the research puzzles a) and c), offering our explanations on the behavior of MOF and the LDP: we have shown that concerns for public support not only mattered in the LDP, which faced elections, but also MOF, a bureaucratic agency. How did the public affect other actors, such as the financial industries?

In Chapter 6, we turn to research puzzle b), discussing the financial industries' influence on the Big Bang. While the influence of the financial industries in the introduction of the Big Bang was addressed above, we have yet to assess the efforts made by the financial industries to oppose this initiative. The financial institutions' influence is known to have been quite strong in the past, sometimes even surpassing MOF's might: why were they not able to forestall, or even reverse, the Big Bang?

In this chapter, we established that Hashimoto deserves credit over timing, pace (setting the deadline), and scope, that the LDP ARPH deserves additional credit for the timing, that MOF may have determined the scope and pace, and that MOF and the LDP ARPH could share the credit over the sequencing. How much influence did the financial industries exercise over the outcome? These concerns will be addressed in the next chapter, which delves into Phase II, or the period after November 1996 (that is, after the Initiative was announced by Hashimoto).

Chapter 6 The Financial Industries' Influence on the Financial Reforms

6.1 Introduction

This chapter deals with Phase II of the Big Bang, the process after November 1996, when the Initiative was announced by Prime Minister Hashimoto. It seeks to analyze the process in which the Initiative (laid out in a three-page announcement) became the actual plan as the Initiative navigated through the deliberative councils and the Diet.[1] In the last chapter, we saw how the Big Bang initiative was produced, showing that the process up to November 1996 was dominated by state actors — the LDP and MOF in particular — who sought political gains of their own, not by economic winners who might have benefited from the planned drastic financial reforms. We now turn our interest to the roles of the economic "losers" in the financial reforms. In Chapter 4, we determined that most financial institutions except some large city banks would end up being the losers in the Big Bang reforms, which would take away regulatory protection. In the past, however, the financial institutions had exercised a strong influence on the course of the financial reforms. (Rosenbluth 1989; Vogel 1996) This leads us to wonder why the financial industries were unable to shape the reforms to their benefits this time, as our research puzzle b) asks. We have two questions to answer:

1) To what extent were the financial institutions able to wield influence?
2) Why did it not result in significant modification (such as reversal)?

In response, this chapter is structured as follows. First, we will offer our reflection on two ways economic reforms can take place, in order to conceive the pattern of economic reforms we would expect under bureaupluralism. Next, a narrative of the events will follow in order to establish the degree of influence the financial industries had. Then, we will provide a brief overview of three cases of financial reforms in the recent past: the 1991-93 financial reforms, the 1992-94 insurance reforms, and the 1979-82 banking reforms. We will compare our case to these three cases, providing our evaluation.

6.2 Politics of Economic Reforms: Two Types

As in the last chapter, we begin our discussion from our two sets of interests, the "public interest" and the "constituencies interest". Political actors seek to enhance both to ensure survival. In this section, we will see how these sets of interests give rise to two types of economic reforms. (By "economic reforms", we loosely refer to the changes in economic regulations imposed by the government, including of the rules on the economic regulators themselves as these are expected to impact the economic regulations in various ways. We seek to distinguish "economic reforms" from "budgetary measures" [e.g. public works] that center around budgetary politics.) [2]

Reflecting the two sets of interests, there are two ways for economic reforms to take place in the political system. On one hand, corresponding to the constituencies interest, we have "interest group politics", in which the exchange of goods and services between organized economic interests (such as interest groups and firms) and political actors drives politics. Here, the flow of goods and services from the economic "winners" to the political actors would induce the latter to shape, propose, and carry out the economic reforms.

On the other hand, reflecting the public interest, economic reforms may be launched in pursuit of not only sectoral benefits but also a welfare increase for the whole economy. While this pattern does not exclude the possibility that the economic winners still influence the political process based on their provision of goods and services, it may also happen that political actors see benefits in advocating economic reforms independent of such transfer of resources. (We call such actors "political winners" in distinction from "economic winners".) For example, if the economic reforms are expected to benefit the national economy as a whole or the unorganized households, such measures may be politically attractive for politicians as well as bureaucrats, even though no economic actors may be inducing them to act in such a way through the exchange of goods and services. Political parties can boost public support, increasing their chance of winning electoral seats. Or, bureaucratic agencies can expect wider acceptance for their policy measures by the public and solidify their reputation within the society, increasing the chance of organizational survival.

In sum, there are two types of economic reforms.[3]

a) "Interest group politics"[4]: interest groups politics drive economic reforms, in which organized economic actors (including the consumer groups) induce the political actors through the provision of goods and services; and

b) "Public interest politics": political winners drive economic reforms, in which political actors who see political gains through the promotion of public interest (including the unorganized households) act independently of the economic organized interests.

In Chapter 3, we saw that bureaupluralism was a system in which the regulated industries have the upper hand when the two sets of interests collide: this is largely due to the policy making mechanism in which policy proposals would go through deliberative councils and the LDP PARC. Thus, we would expect the economic reforms to be the interest group politics type, if bureaupluralism was intact.[5]

However, in the last chapter, we saw that the public interest politics type took place in Phase I, the process of the emergence of the Big Bang: the LDP and MOF were seeking to re-coup public support by appealing to the public by promoting "good" economic reforms, independently from the industries. Toward this goal, those within the LDP and MOF by-passed the channels of bureaupluralism such as the deliberation council or the LDP PARC (and its subdivisions) and thus its "constituencies" (the financial industries) under bureaupluralism. However, we may not declare the death of bureaupluralism before we take into account what happened in Phase II: the Initiative went through the channels of bureaupluralism and the regulated industries had a say, after all. It is by observing how the Initiative was affected as it went through this process that we obtain a true image of what happened to bureaupluralism. Thus, we will provide below the narrative of the events, and then contrast our case against the past financial reforms in which bureaupluralism was the "rule of the game".

6.3 Narrative

Below, we give a narrative of the events during Phase II of the Big Bang, that is, the period after November 1996. This will be presented by three interrelated sets of events.

1) Deliberative councils (- June 1997)
2) Surrounding developments
3) Legislative process (March - June 1998)

<u>1) Deliberative Councils (November 1996 - June 1997)</u>

The Big Bang Initiative announced in November 1996 was a brief, three-page paper. It explained why the Big Bang was necessary (e.g. aging population, increased efficiency needed, and global competition), gave the goal of completing the reforms and vitalizing Tokyo on a par with New York and London as an international market by 2001, outlined the three basic principles of reforms — Free, Fair, and Global — while stressing the need for the resolution of the bad debt problem and the stabilization of the financial system, and provided a simple list of agenda on deregulation and liberalization to consider.[6] Hashimoto and his Finance Minister, Hiroshi Mitsuzuka, asked the related deliberative councils to start envisaging the detailed plans. The councils were to start deliberating on the measures immediately in their sub-divisions.(Asahi Shimbun 15 November 1996)

Five MOF councils were mainly involved: the Financial System Research Council (FSRC), in charge of banking; the Securities and Exchange Council (SEC); the Insurance Council (IC); the Business Accounting Council; and the Council on Foreign Exchange and Other Transactions.[7] Below, reflecting our main research interest — the politics of "winners and losers"— we will focus on the political process of the first three councils, where the conflict among banking, securities, and insurance industries mainly took place.[8] These three councils issued reports in June 1997, which, along with other reports, were integrated into the official announcement made by MOF on the financial reforms. As each issue contained in the Big Bang Plan was discussed in Chapter 4, we will not repeat its significance in detail. Below, we will provide a summary of the main agenda, the related industry's position on it, and the outcome of the reforms, mostly relying on the summaries of the proceedings of these councils made available by MOF and from journalistic sources. (MOF web page; Asahi Shimbun[9]; Kin'yu Zaisei Jijo[10])

a) Financial System Research Council (FSRC)

The FSRC was managed by the Banking Bureau of MOF. In the FSRC[11], there were five main agenda:

α) Liberalization of financial holding companies;
β) Relaxation of business restrictions on banks' financial subsidiaries and brother companies (under financial holding companies);
γ) Cross-entry through selling products outside banking (e.g. investment trust; insurance);
δ) Liberalization of corporate bonds issuance by commercial banks; and
ε) Liberalization of corporate bonds issuance by nonbanks.

The banking industry's position was to "accept" as a whole:

a) Aggressive toward liberalization, reflecting their greater chance to "win" (α, β, γ);
b) Defensive against other industries[12] (ε, also liberalization of securities products); and
c) Divided within banking (δ, also entry of city banks into trust business).

The result was that liberalization took place in all these issues. Thus, it was a victory in some issues (a), a setback in others (b), and a victory of the city banks over other "losers" within banking (c). However, the pace of the liberalization was often delayed by the resistance of the "losers" who resented the entry of the powerful large banks into their businesses: while the banking sector was able to increase its presence into securities by 1997-99, it would not be able to get into insurance until the end of the Big Bang, that is, 2001.[13] As for the bond issuance by ordinary banks, it was to be liberalized in the second half of 1999 (for the nonbank institutions, in FY 1998).[14]

b) Securities and Exchange Council (SEC)

The SEC was managed by the Securities Bureau of MOF. There were three main issues:

α) Investment objects (product liberalization of investment trust and asset management account);

β) Market (abolition of mandatory use of the securities exchange; stricter disclosure; tighter supervision); and

γ) Intermediaries (brokerage commission liberalization in two steps; diversification of the securities firms allowed; financial holding companies allowed; administrative control of entry control downgraded; and banks' securities subsidiaries' business restriction relaxed in two steps).

The industry's position was to "acquiesce" on the whole:

a) Pushing for liberalization on products (e.g. company-type investment trust);

b) Demanding the "one-set principle": hurtful liberalization on brokerage fee would be accepted as long as the other measures to develop market infrastructure (such as abolition of mandatory use of the securities exchange; liberalization of diversification; review of securities taxation) are introduced altogether;

c) Requesting soft-landing, or delay of the competition-enhancing measures to allow adjustment for the smaller firms in the business; and

d) Opposing the entry of banks into the business and the concept of "universal banks", out of concerns for banks' abuse of their business positions.

The result was the following. The securities industry got most of its wishes as product liberalization took place and the "one-set principle" was observed (a, b): the liberalization of the brokerage commission was coupled with the liberalization of business diversification of securities firms and the abolition of the mandatory trade through securities exchanges, while the Council, lacking jurisdiction over taxation matters, limited itself to "request" that securities taxation be revised. The opposition to the banking industry's intrusion into their business had mixed results (d): it did not stop the banks from coming in, however, the securities industry was able to obtain liberalization on some products that compete with banks' products (e.g. asset management account, which has settlement functions). The request for soft-landing was granted (c). The brokerage commission will be liberalized in two steps: first, for large transactions over 50 million yen, from April 1998; then, complete liberalization will take place by the end of 1999. The banks' entry would also be in two steps: their securities subsidiaries would have most business restrictions lifted in FY 1997, but the cream of the securities business, or businesses related to stocks, would only be allowed in the second half of FY1999.

c) Insurance Council (IC)

The IC was administered by the Insurance Department of MOF's Banking Bureau. This council was heavily dominated by two sets of actors within the insurance industry, the casualty and life insurance firms. There were four main agenda:

α) Liberalization of legalized cartel on casualty insurance premium;
β) Liberalization of shareholding companies for insurance firms;
γ) Cross-entry into and from insurance through subsidiaries; and
δ) Entry for banks into insurance through the sales of insurance products.

The industry's position was very simple, seeking to protect its own industry's benefits. It was to "oppose" on the whole:[15]

a) Against price liberalization (α);
b) Opposing banks' entry into insurance (γ, δ); and
c) Pushing for financial holding companies (β) and insurance companies' entry into other financial businesses(δ).

As for the results, it is not that the insurance industry got all of its wishes. The liberalization of insurance's entry into other fields materialized, while the financial holding companies were granted for corporations, but not for mutual companies, which was the legal form adopted by many life insurance companies(c). Price liberalization, fiercely opposed by casualty insurance, materialized (a); here, we have to note that the U.S.-Japan Insurance Talks were taking place in the background and an agreement was reached in

December 1996, where the Japanese government promised to liberalize the premium rates for casualty insurance.[16] (Asahi Shimbun 15 December 1996)

However, regarding the banks' entry into insurance, the insurance industry kept the degree of intrusion low, although the best scenario for them would have been to keep the banks entirely out of their fields (b).[17] The banks would only be able to enter in 2001 through subsidiaries, while other financial businesses' entry into insurance and insurance's entry into other fields would be allowed earlier. The banks would not be able to sell insurance products, except for a small set of insurance products related to bank loans that are also issued by a brother company or parent company; despite this very tight restriction, this would not happen until 2001.

2) Surrounding Developments

Three noteworthy events surrounded the policy debate of the Big Bang in Phase II.

a) Racketeering Scandals involving banks and securities firms (Spring 1997-)
b) Financial and economic crisis and the resignation of Hashimoto (November 1997 - July 1998)
c) MOF Wining and Dining Scandal resulting in arrest and resignation (Spring 1998)

a) Racketeering Scandals Involving Banks and Securities Firms (Spring 1997-)

A series of racketeering scandals shook the business world from 1997: the banking and securities industries suffered a severe blow because of their deep involvement. Racketeers specializing in shareholders' meetings, called *sokaiya*, have long been known to be influential in the Japanese corporate world. Corporate leaders, fearing the disruption of shareholders' meetings by such racketeers, would give them financial benefits in some forms. This practice was made punishable by the Corporate Law in 1982 to preserve equity among shareholders; however, the practice did not die away. According to one survey, 64% of the corporations felt themselves to be providing some kind of financial benefit to racketeers. (Asahi Shimbun 29 November 1997)

Although a number of large firms in various fields (including manufacturing and department stores) were discovered to have engaged in unlawful conducts, the blow to the financial industries was particularly heavy. In the spring of 1997, as a result of the investigation by the public prosecutors, the top management of Nomura and other top securities firms as well as of Daiichi Kangyo Bank (DKB), one of the top city banks, was arrested and indicted for succumbing to racketeering demands. MOF issued administrative orders banning the implicated firms from engaging in certain businesses for a period of time starting from July 1997. The administrative measures were expected to negatively affect the firms' businesses by undermining the services that could be provided to institutional investors in the case of Nomura Securities, or by constraining the ability to move forward in the Big Bang process of cross-entry and strategic alliances for a year for the DKB. (Kin'yu Zaisei Jijo 18 August 1997)

The racketeering scandals directly affected the businesses of the firms involved as well: governments as well as customers let their discontent known through their choice of firms. Many branches of the national and local governments excluded the involved securities firms from underwriting their bonds or chose to reduce transactions with the DKB. The consumer public dealt a visible blow to the firms involved in the scandals by their choice. The amount of deposits by individuals to the DKB went up only 7 billion yen while other top banks increased their amount by 300 to 500 billion yen in June 1997[18], and the figure for the DKB decreased by 200 billion yen in July 1997. The DKB went on to lose individual deposits from May until August 1997.[19] Finally, the top three securities' firms saw their profits shrink for FY1997: the loss of business due to the racketeering scandals was one of the major reasons. (Asahi Shimbun 4 September 1997; Kin'yu Zaisei Jijo 18 August 1997 and 4 May 1998)

That this racketeering scandal was taking place in the spring of 1997 had an impact on Phase II of the Big Bang: the securities industry, in particular, was heavily constrained in its ability to forcibly defend its turf against the encroachment of the banking industry. It is important to note that with its top management resigning in disgrace and being arrested, the securities industry, usually led by Nomura and other top firms, was in no position to wield a significant political influence.

b) Financial and Economic Crisis and the Resignation of Hashimoto (November 1997- July 1998)

The financial crisis, which was once thought to be under control with the passage of the Housing Loan and other financial packages in June 1996, rekindled with much more intensity. In April 1997, Nissan Life went under, becoming the first life insurance company to fail in the postwar era. A rescue operation for Nippon Credit Bank, the weakest among the three long-term credit banks, was introduced after a tumultuous negotiation between MOF and the financial industries in April 1997: financial institutions ranging from banks to life insurance companies were asked to provide their contribution to "save the financial system". From the fall of 1997, a financial crisis was in place. First, the ninth largest securities firm, San'yo Securities announced its failure in early November 1997. One of the major banks, or "money center banks" that the government had promised was "too big to fail", Hokkaido Takushoku Bank, went under in the middle of the month; one of the Big Four in securities, Yamaichi Securities, had to fold its business a week later.

Amidst this crisis, the LDP decided in mid-December 1997 to inject public funds into the financial system through the Deposit Insurance Corporation: the sum would be 10 trillion yen.[20] However, with the economic downturn, partly due to the fiscal contraction starting from April 1997, the situation turned into a credit crunch. Small firms in the economy suffered from tighter cash flow: they had trouble financing day-to-day needs because of "*kashishiburi*", a phenomenon in which the banks, conscious of capital requirements, were reluctant to make loans. On 22 December 1997, the Nikkei Stock Price Index plummeted to below 15000, for the first time in two years and five months. MOF and the LDP came up with the second set of plans on 24 December: MOF would allow banks to choose between two accounting standards (based on market value or acquisition value) so as to facilitate the banks' ability to meet the BIS capital/asset ratio[21]; the LDP came up with a scheme which would inject a maximum of 30 trillion yen[22] into the resolution of bank failure and also to operating banks in order to facilitate them to make loans. (Nihon Keizai Shimbun 1998)

The injection of public funds (in forms of a government guarantee ceiling of 17 trillion yen for resolution of bank failure and 13 trillion yen for capital base solidification) became law in February 1998, and by March 1998, 1.81 trillion yen was injected into twenty-one banks, including all of the eighteen largest banks.[23] (Kin'yu Zaisei Jijo 23 March 1998) While the conditions of repayment differed from one bank to another according to its financial health, and banks were forced to submit restructuring plans, most banks asked for the same amount (approximately 100 billion yen): this reflected the concerns that if some banks with damaged balance sheets were the only ones to ask for public money, the capital injection plan itself might cause the former ones to go under by stirring up public anxiety.

However, the market did not react as expected and the financial crisis went on, with the economy sliding down into negative growth. The ruling coalition and the government went on to draw a "total plan" for financial revitalization to resolve the bad debt problem between May and July 1998. Schemes to facilitate the transactions of bad loans and land were discussed, and a public bridge bank would be set up by public money (using the 13 trillion yen reserve cited above) to assume the businesses of failed banks.(Kin'yu Zaisei Jijo 13 July 1998) The Long-Term Credit Bank of Japan (LTCB) was facing a tough speculative attack from foreign investors from June 1998.[24] (Takeuchi 1999) The Upper House elections, held once every three years, were held in July 1998: amidst the economic and financial crisis, the LDP lost the majority, resulting in Prime Minister Hashimoto's resignation.[25]

c) MOF Wining and Dining Scandal Resulting in Arrest and Resignation (Spring 1998)

The racketeering scandals involving banks and securities firms, mentioned under a), led the public prosecutors to go after MOF officials: they were able to get hold of documents demonstrating the wining and dining that the financial industries were providing to MOF officials. This resulted in the arrest of five officials in March 1998, leading to the resignation of the Minister and the Administrative Vice-Minister, the top permanent official. In an unprecedented move, MOF eventually announced internal sanctions on 112 officials, including the retirement of two of its senior officials in April 1998.[26]

This incident dealt a final blow to MOF's political influence before its breakup and the creation of the Financial Supervisory Agency (FSA) in June 1998. Public trust in the bureaucracy became low: not only the competence but also the ethics of its officials were now definitely in doubt. In a public survey by Asahi Shimbun given in March 1998 in the aftermath of this scandal, 71% responded that they did not trust the bureaucrats, up from 65% in the midst of the MOF reforms in 1996 and 51% in 1994 as the Housing Loan Affairs began to unfold, the first time that such questions appeared in the surveys.[27] (Asahi Shimbun 15 May 1994, 12 December 1996, and 4 March 1998)

3) Legislative Process (March - June 1998)

Most of the policy proposals adopted by the deliberative councils in June 1997 were written into legislation by March 1998 and became laws in June 1998, while the foreign exchange reforms, the "forerunner", became law one year earlier in May 1997. The legislative process of the Big Bang was not a very exciting one: one lawmaker observed regarding the foreign exchange reforms that most of those lawmakers who passed the law did not understand the significance of the Big Bang. (Kaieda 1997)

It was not that the Big Bang was welcomed unanimously by the political world, especially as Japan crept into economic and financial crisis from 1997. For example, Seiroku Kajiyama, an influential LDP lawmaker, was arguing that U.S.-style free marketization, including the Big Bang, would only benefit foreign firms at the detriment of Japanese firms. Views toward postponing the Big Bang till later was gaining ground among politicians, critics, and journalists as well as the financial world. (Tahara 1998)

Nevertheless, the Big Bang legislation sailed through the Diet without much opposition. Despite the financial crisis, the package had public support: newspaper editorials were claiming that "the current crisis should not be made into a pretext to postpone or water down the financial reforms". (Asahi Shimbun 21 January 1998)

The scandals seem to have been material in this process. As the legislation was being submitted to the Diet in March 1998, the MOF Wining and Dining Scandals reached its peak with the arrests of its officials. The charges against them were that the officials gave favor to the financial industries regarding the authorization of new products and the schedule of financial inspection in exchange for wining and dining services.[28] (Asahi Shimbun 6 March 1998) This incident gave a final endorsement to an already popular view that the Convoy System (see Chapter 3), in which the financial industries and MOF closely cooperated with each other, needed to be reformed into a rule-based system (modeled after the United States) in which the regulators and the regulated maintain a distance from each other. As the wining and dining scandals were seen to be representing the pathology of the old system of financial administration, the Big Bang came to be perceived as a measure that needed to be introduced as early as possible. This trend was symbolized in an event in which MOF officials in charge of financial administration uniformly expressed their remorse for their involvement in the Wining and Dining Scandal to the Diet Committee deliberating on the Big Bang legislation, stressing that the proposed legislation would change the way of administration. (Asahi Shimbun 29 April 1998) Under such circumstances, the cost of such options as canceling or postponing the Big Bang would have been prohibitively high for any political actors.

6.4 Summary of the Narrative

Let us briefly summarize the narrative of the events given above so as to get a better grasp of the issues which will be later analyzed. The main issues of the Big Bang can be classified into two categories as shown below(see Chapter 4).

1) Liberalization and deregulation
(Enhanced competition and reduced governmental control)

- Price liberalization (brokerage fee; casualty insurance)
- Cross-entry (business restrictions of subsidies or firms proper; financial shareholding companies)
- Product liberalization (ABS, derivatives, investment trust)
- Reduction of entry control (securities)
- Reduction of foreign exchange control

2) Enhancement of market infrastructure
(Market development, fairness, and transparency)

- Market development (abolition of monopolies of securities exchanges; listed markets)
- Stricter disclosure (banking and securities; accounting standards)
- Tighter supervision

While the financial industries invariably pushed for the liberalization of financial shareholding companies, there were plenty of distributional conflicts regarding the issues under the first category. Such conflicts can be characterized as between the winners seeking to maximize their gains and the losers forestalling such developments. In particular, it was the large, city banks, the likely winners of the reforms ("accept"), against all the rest, although there was a difference in attitude among them (i.e. "acquiesce" for securities and "oppose" for insurance).

The conflicts took place in two dimensions: first, large banks against securities and insurance in the battle of the industries; second, within industries, the more powerful city banks against the long-term credit banks and trust banks in banking, and larger firms were the winners against smaller ones in securities and insurance. Within the FSRC, the first conflict took place in favor of the banking sector's entry towards securities and insurance, while the second conflict took place regarding the bond issuance of city banks (opposed by long-term credit banks) and the business restrictions of trust bank subsidiaries of city banks (which trust banks sought to limit). At the SEC, the securities firms sought to limit the intrusion of banks into their business fields; the insurance industry's primary concern at the IC was the fear of the banks' dominance of the whole economy based on the main bank system, which would translate into a dominance in their fields if their activities were allowed unfettered.

While the losers sought to fight the intrusion of the banking sector, their attitudes differed from one another: the securities acquiesced to the liberalization and sought to procure compensation, while insurance sought to oppose the measures. In the SEC, the liberalization of the brokerage fee was seen as inevitable, and the industry sought to achieve other beneficial reforms as well by successfully pushing for the "one-set principle". However, in the IC, liberalization was not a given: such grounds as "insurance is different from finance" or "we decided in the past that banks' entry into insurance would be well after the cross-entry between life and casualty insurance became solid" were frequently raised in support of arguments such as "the deadline (2001) given by the Prime Minister does not apply to insurance" and "banks' entry into insurance should be after 2001". (MOF web page[29])

The scope of the financial reforms were encompassing in that it included not only banking and securities, but also foreign exchange and accounting standards; however, most measures included in the Initiative were in fact under the aegis of MOF's financial sections. We may remind ourselves that such important issues regarding finance as financial taxation and public finance (i.e. the national postal savings system) were left outside the Big Bang.[30] Accordingly, in our political process of Phase II, the debated measures came neatly under the jurisdiction of MOF's three financial bureaus and its five councils, but not including the deliberative organs of MOF's Taxation Bureau (financial taxation) or the Ministry of Post and Telecommunications (Postal Savings).

The involvement of politicians on behalf of the regulated industries was not very significant in the whole process. True, there was some intervention in such fields as life insurance: the industry sought to forestall the banking's intrusion in their fields by relying on politicians (from the LDP and other parties).[31] (Asahi Shimbun 14 June 1997) While such interventions meant a great deal to the affected industries, their effects did not affect the larger picture of the reforms: in the above case of life insurance, what was achieved by political pressure was not to keep the banks out of the insurance market or to keep insurance out of the Big Bang deadline (2001) altogether, but to limit the insurance products banks can sell or to postpone the banks' entry until the end of the five-year reform period. It is not that there was an open defiance by the regulated industries and its political allies against Prime Minister Hashimoto or MOF on this matter. (We will later come back to this point, in comparison with the banking reforms of 1979-82.)

Nevertheless, it was not that bureaupluralism as a policy making process had died away. During Phase II, the Big Bang Initiative sailed through negotiations involving the regulated industries and experts in the deliberative councils, and the LDP's financial "tribesmen" had their say, officially as the Initiative went through the LDP PARC and its financial sub-divisions to become legislation, and informally through applying pressure to the bureaucracy. Throughout Phase II, MOF's three financial bureaus (Banking, Securities, and International Finance) were presiding over the bargaining process as its organizers. The content of the package as well as the policy making process — deliberative councils and the LDP sub-divisions of the PARC— matched MOF's three financial bureaus' jurisdiction.[32]

Indeed, the "losers" among the regulated industries wielded their influence most in setting the pace of the reforms. They were able to influence the conclusions in two ways: when and under what forms the specific measures of liberalization and deregulation would apply to their businesses. The securities were able to have their "soft landing" priority translated into a liberalization in two steps for such matters as brokerage commission and business restrictions placed on the securities' subsidiaries established by banks. The complete liberalization of brokerage commission would only materialize in 1998, and the banks' subsidiaries would have to wait until 1999 to come into securities in full strength. While securities had to swallow price liberalization and entry deregulation, they were more or less successful in their advocacy of "one-set principle" (with the exception of financial taxation, outside the jurisdiction of the three financial bureaus): such "bitter pills" were coupled with "sweeteners" such as the abolition of mandatory use of securities exchanges and the abolition of the ban on business diversification of securities firms. The insurance industry was even more successful in procrastinating the banks' entry into insurance: this would only happen in five years, that is, by 2001, for banks' subsidiaries, and banks proper would only be able to sell a very small set of products, again by 2001. This "hole" into the insurance business was characterized as very small by the media.

Yet, we must note that there was no reversal in Hashimoto's master plan: the basic plan laid out in the Initiative announced in November 1996 survived through the deliberative councils and the LDP PARC. The timing, "from now" and "by 2001", was upheld. The basic principles, "Free, Fair, and Global", and each category of measures under them, including "cross-entry liberalization, product control deregulation, liberalization of commissions, foreign exchange deregulation, stricter disclosure rules and tighter supervision, and accounting standards", many of which had distributional effects, were maintained. Despite the opposition of the regulated industries, especially the insurance industry, the Big Bang laws[33] included banking, securities, insurance, foreign exchange reforms, and accounting standards, as announced by the November 1996 Initiative: it is not that an important part, such as insurance, was dropped as a consequence of heavy industry opposition.

In sum, the regulated industries, most of which stood to "lose" from the reforms, were able to wield influence in affecting the "pace" of the reforms by delaying specific measures (e.g. banks' subsidiaries entry into insurance; the lifting of the business restrictions of banks' securities subsidiaries) perceived to be hurtful or by limiting the scope of particular measures (e.g. banks' sales of insurance products). As the Initiative was developed by the state actors (i.e., MOF and the LDP) without much involvement by the regulated industries during Phase I, the industries' influence was concentrated in Phase II through the process of bureaupluralism. However, neither the Big Bang Initiative itself was reversed, nor any important part of the Initiative dropped. Conceived by MOF and the LDP in cooperation, competition, and conflict during Phase I, the Initiative was carried through the process of bureaupluralism in Phase II: while the regulated industries affected the "pace" of the reforms, its basic framework, or the "timing" and "scope" (not to mention the "sequence"), was largely unaffected.

The remaining question is the following: Why weren't the reforms reversed? After all, the financial industries have been known in the past to wield strong political influence over regulatory reforms: what kept them from doing so this time? In order to answer these questions, we briefly survey the past financial reforms so as to compare our case against such cases, in hopes of obtaining answers through comparison.

6.5 Three Cases of Past Financial Reforms

In this section, we will briefly review three cases of financial reforms in the recent past for longitudinal comparisons.[34]

1) Financial reforms of 1991-93
2) Insurance reforms of 1992-94
3) Banking reforms of 1979-82

These cases are selected with the comparative methods in mind.[35] While a thorough comparison by John Stuart Mill's Method of Difference is impossible in this complex world, by relying on longitudinal comparison (or a comparison of similar cases across time), we are seeking to assimilate this method by trying to select the cases with the most commonalities, essentially sharing the set of actors involved, the political and economic settings, and the fields of reforms.[36] Our analysis is about the politics of the regulatory reforms in finance with particular focus on their distributional effects. Thus, we are interested in the past cases of financial reforms, which had many similarities with the Big Bang, yet with different results: we claim the Big Bang reforms to be "drastic / wide scope of reforms" as opposed to the "gradual / piecemeal reforms" of the past.

Cases 1) and 2) are chosen because these cases in the early 1990s represent the most recent efforts of major reforms under bureaupluralism with distributional effects in the fields of banking, securities, and insurance, which were also the areas of contention in the Big Bang. Our case is also one in which many among the industries were expected to be hurt by the reforms, and thus were likely to seek political remedies. Case 3), which shows the rare occasion of a political conflict between the banking industry and MOF involving the intervention of the LDP, may give us clues as to the political influence of the financial industries under bureaupluralism. By contrasting our case against these three, we may obtain a clearer view of the changes affecting the policy making process of bureaupluralism.[37]

1) Financial Reforms of 1991-93

The Big Bang was an effort to bring a conclusion to the de-segmentation of the financial system launched by the Financial Reforms of 1991-93. Thus, the issues were overlapping, despite the exclusive focus on banking and securities in the latter: the cross-entry between banking and securities, and within banking (regarding trust and long-term credit banks).

Following the Yen-Dollar Committee report issued in 1984, MOF's deliberation council on banking, the FSRC, started its discussion on the matter of financial system reform, or the de-segmentation of finance. The SEC, MOF's deliberation council on securities, was brought into the reforms from 1988 after the FSRC issued an interim report pressing for de-segmentation, reflecting the fact that MOF's Banking Bureau was aware that successful reforms could not be obtained without the participation of MOF's Securities Bureau. Intense discussion followed at the two councils between 1988 and 1991: the final reports came out in June 1991; and the measures were legislated in the spring of 1992, taking effect in April 1993.

The bargaining outcome between the industries was that the core business of the industry who faced new entry would be protected while the cross-entry would be allowed in the margins: the cross-entry between the industries would be allowed under the form of single-business subsidiaries (e.g. city banks would set up separate subsidiaries for trust business and securities business), although the new entrants would be only gradually allowed into the market with strict business restrictions. The losers would be the trust banks, the long-term credit banks, and the securities; the winners would be the city banks, as the more resourceful city banks would be able to enter the various financial businesses. While all sides had something to gain, the nature of the gains was different: while the losers' gains were temporary (e.g. delay in new entry and strict business restrictions attached to the newly established subsidiaries), the banks' victory —that they were able to enter into the securities business— was permanent. (Vogel 1996; Nishimura 1999)

In this case, we see a typical example of the policy making of "bureaupluralism" in operation: MOF's Banking and Securities Bureaus were clearly the organizers of the bargain among the regulated industries. The respective councils functioned as the arena where the interests of the regulated industry were expressed and mediated under MOF initiative. The principle, if any, was that of gradualism: a high ranking official in the Banking Bureau at that time confirms that, whatever the reasoning attached may be, the essence of the 1991-93 reforms' conclusion (the subsidiaries system) was "the alleviation of drastic change" and "the protection of the weak". (Nishimura 1999, 64) Largely through the affiliated deliberative council (FSRC - banking; SEC - securities), each industry presented a "heroic" (Vogel) lobbying effort to influence the outcome of "how and when" the cross-entry would occur so as to maximize its gains or minimize its losses. Some "losers" wielded great political influence: the long-term credit banks, led by the powerful Industrial Bank of Japan (IBJ), or the securities firms, led by its leader Nomura Securities, largely determined the course of the discussion at the deliberation councils through their influence on MOF.[38] (Nihon Keizai Shimbun 1992)

Some events happened to significantly affect the environment by the time the legislation reached the Diet in the spring of 1992, as in the case of the Big Bang (in parentheses are the events of 1996-98): the fall of the stock market (the depression and the financial crisis), the scandals involving banking and securities (the Housing Loan and other scandals), and the resulting organizational reforms of the MOF (MOF breakup).

The demise of the stock market weakened the banks and securities alike, and making it easier to coerce the reform plan for MOF; however, it made them less interested in the cross-entry in the first place as well. (Vogel 1996) As for the scandals, there have been numerous scandals involving large banks (such as the IBJ, Sanwa Bank, and Sumitomo Bank) related to the shady transactions made during the excess of the bubble economy of the 1980s. The securities had an even larger scandal: the Loss Compensation Scandal. In June 1991, it was reported that the top four securities firms were engaging in practices of compensating the losses suffered by their large corporate clients: while the practice by itself was strictly speaking not illegal[39], it triggered a public outrage because of the perceived inequality that existed between the large corporations and the individual investors, who did not enjoy such favorable treatment. The scandal heavily involving the securities industry muted the "most powerful group opposing meaningful reform". (Vogel 1996, 187) However, it also challenged MOF's financial administration and raised the possibility of organizational breakup. Following the scandal, Prime Minister Toshiki Kaifu charged an advisory panel on administrative reforms to develop a policy recommendation on reforming the financial administration. While such plans as to establish an independent commission (and thus breaking up MOF) emerged, MOF outmaneuvered its critics and succeeded in limiting the reforms to a creation of a commission in charge of securities regulation within MOF with a substantially enlarged staff.[40] (Vogel 1996)

2) Insurance Reforms of 1992-94

The insurance industry had been undergoing a separate reform process from the banking and securities industries: parallel to the reform process in these two areas, the insurance reforms had been discussed at the IC (Insurance Council) since 1989. The insurance industry, especially the large life insurance companies, pressed their long-held wishes to enter into other financial businesses such as trust and securities; however, the issue itself was largely kept at the sidelines from the main struggle between banking and securities. In April 1991, the Council issued an interim report advocating a wider scope of cross-entry including insurance; this report was reflected in the FSRC's final report of June 1991 on financial reforms. In line with banking and securities, MOF's Insurance Division of the Banking Bureau acted as the organizer of bargaining in the policy making process. With the help from the heads of the industrial associations, occupied by the Presidents of the largest firms in life and casualty insurance, the Insurance Division was able to coordinate the discussion within the industry, skillfully going past the division between the large and small firms as well as the rift between life and casualty insurance. (Nihon Keizai Shimbun 1992)

However, with the collapse of the bubble economy, in particular the downturn in the stock market and real estate value since 1991, the insurance industry, especially the life insurance industry whose portfolios heavily included stocks and real estates, lost its appetite for cross-entry.[41] In 1992, the IC issued its final report for a comprehensive reform, and the wholly revised Insurance Business Law came into effect in 1994. While the cross-entry between casualty and life insurance through subsidiaries was introduced (October 1996), measures towards cross-entry between insurance and other industries were not included. Such cross-entry involving non-insurance industries would be postponed until after the cross-entry within insurance took place.[42]

3) Banking Reforms of 1979-82

The Banking Law of 1982 comprehensively revised the Banking Law of 1927. According to Rosenbluth (1989), it contained two important measures: first, banks would be permitted to engage in dealing and retailing of government bonds, and second, banks would not face substantially stronger disclosure requirements. The two case studies provided by Rosenbluth show the working of bureaupluralism in its heyday.[43]

First, the issue regarding the banks' dealing and retailing of the government bonds was about the war between banking and securities. The banks became increasingly concerned about their government bonds holding in the late 1970s, which increased as a result of a ballooning government deficit and the Bank of Japan's reluctance to absorb the government bonds as arranged[44] for fear of stirring up inflation. Thus began the debate concerning the retailing and dealing of government bonds: the banks sought to enter this field, to the displeasure of the securities firms, which enjoyed regulatory protection. While such measures[45] as the creation of a quasi-auction market for government bonds were taken in response, the banks' demands were persistent, in realization that banks ought to move beyond traditional banking into securities and international business. The deliberative councils affiliated with each industry behaved as expected: the advisory panel on banking concluded in support of such measures, while the one on securities argued that banks' entry ought to be avoided. A deadlock between the two industries ensued, while MOF discreetly sought a resolution. The LDP chose not to intervene, caught in between two powerful industries which were both important supporters of the party. Finally, after much heated exchange between the industries, the compromise[46] struck by the Banking and Securities Bureaus in November 1980 basically became law in April 1981, and a neutral Committee of Three, approved by both industries and whose members were all retired MOF officials, would decide the timing and other details regarding the banks' entry into government bond retailing and dealing.

The second issue was the disclosure requirements. MOF sought to introduce tighter disclosure requirements over the opposition of the banking industry, to no avail due to the political intervention by the LDP. The proposed disclosure requirements developed from MOF's recurrent campaigns for "efficiency", or the efforts to consolidate the small financial institutions through merger to secure financial stability, strongly opposed by the small financial institutions themselves. The proposition made by MOF in 1980 was a combination of carrots and sticks: banks would face stricter disclosure rules and they would be forced to limit their loans to any single borrower for 25% of their assets; in return, they would be allowed to engage in government bonds trading and retailing. The banking industry, through heavy lobbying to the LDP which was dependent upon its financial contributions, successfully overturned the original legislation drafted by MOF, as the draft legislation was going through the LDP's policy apparatus. The LDP PARC's sub-divisions on finance redrafted much of the legislation in favor of the banking industry's position, and the banks were able to enjoy the "carrot" without the "stick".

6.6 Comparison

What can we obtain by comparing our case to the above three cases? Given our comparative strategy, we are interested in finding differences. There are four important ones, which lead us to the possible changes that took place in the Big Bang reforms.

First, the involvement by the regulated industries in the planning phase was clearly absent in the Big Bang. It was the norm for past reform plans to have been discussed carefully and thoroughly at the deliberative councils, where the views of the industry representatives as well as experts would be expressed, before the reform plans would be proposed, then turned into legislation by MOF. It took six years for the FSRC and three years for the SEC to come up with the final plan in the 1991-93 reforms; the IC took three years for 1992-1994 reforms; and the FSRC spent more than four years for 1979-1982 reforms.[47] In contrast, in the Big Bang, MOF and the LDP by-passed the industries and the deliberative councils in launching the reforms: it was not until *after* the Initiative, setting the overall framework of the reforms, was proposed that the deliberative councils were asked by the Prime Minister to concretize the proposal (see Chapter 5). In any case, the deliberation lasted less than a year: in November 1996 the Hashimoto Initiative was announced, and the MOF councils were issuing the final reports in banking, securities, and insurance in June 1997.

Second, the political leadership provided by Hashimoto over the Initiative renders the Big Bang markedly different from past reforms, which were clearly led by the bureaucracy. If political intervention existed in past reforms (as in 1991-93 and 1979-1982), it was on behalf of particular regulated industries seeking to thwart or realize certain reform measures, and there was no doubt about the fact that the reform initiative was under the control of the bureaucracy. While the Big Bang reform plan came largely from within MOF, once it was taken up by Prime Minister Hashimoto, it became a pillar of his Six Large Reforms, the central agenda of his government. From then on, it was mostly conceived as Hashimoto's program, not MOF's.

Third, the scope and pace of the reforms differ in the Big Bang: the Big Bang sought to combine banking, securities, and insurance as well as other fields, while the scope of the reforms in each past reform was limited in comparison. The pace of the reforms also differ: in past reforms, gradualism was the norm without much of a deadline for the reforms. While the Big Bang initiative did not entirely lose this trait of gradualism in Phase II, the measures contained in the Big Bang were not allowed to be dropped for this concern.

Fourth, MOF lost its standing as the "organizer" of the bargaining. Here, we may note an important similarity: the scandals played a large part in propelling the reforms in the Big Bang as well as the 1991-93 reforms. In the latter, scandals basically hurt the securities, forcing them to accept the cross-entry between banking and securities; they also hurt MOF to a lesser extent, resulting in its organizational reforms (that is, the creation of the SESC). In the Big Bang, MOF was badly hit by the scandals, resulting in its organizational breakup; while banking was the largest hit through the Housing Loan and other scandals, the securities were also heavily hurt by the racketeering scandals. Thus, we observe a similarity in the roles of the scandals as propellants of reforms: MOF and the regulated industries were forced to accept reforms when their political influence was hurt by the scandals.

Despite this similarity, there is a large difference between the Big Bang and the past cases. In the past, that MOF acted as the organizer of the "bargain" was not questioned; in the Big Bang, it was. That MOF initiated and led the reforms, mediating between the industries who supported or opposed them according to their interests, sometimes involving the intervention of the LDP, was an accepted matter of fact in past reforms. However, in the Big Bang, it was not. As discussed in Chapter 5, MOF was largely active in devising the strategy for the Big Bang. However, the Big Bang itself was presented not as part of MOF's campaign (unlike the "efficiency" campaign and the disclosure rules of 1978-82); nor were the reforms orderly presented by MOF through the deliberative councils. Instead, as our second point stated, it was presented as Prime Minister Hashimoto's Initiative, with marked efforts by MOF to efface its involvement in devising the reform plan.

6.7 Evaluation

How does the result of the comparison— absence of the regulated industries' involvement in planning, existence of political leadership, larger scope and quicker pace, and loss of MOF's standing as the "organizer" — help us understand why the regulated industries were unable to reverse the reforms?

Anticipating the opposition from the "losers", the bureaucrats and the politicians by-passed the regulated industries and the deliberative councils at the planning stage (Phase I). This, as explained in Chapter 5, came from the efforts by the LDP and MOF to secure their own organizational survival. The LDP chose to court public opinion over the preservation of its ties with MOF in the wake of the Housing Loan Affairs; it incorporated its rivals' electoral platforms of structural reforms, as it faced a believable threat of replacement. MOF faced an imminent threat of organizational breakup, and sought to re-coup public confidence hurt by the policy failures and scandals rather than preserving its traditional style of financial administration.

Because of this by-passing strategy by the bureaucrats and politicians, the regulated industries were only allowed to participate at Phase II: what mattered here was the Prime Minister's political leadership, as it altered the costs for the industries to successfully challenge and reverse the course of the Big Bang reforms. The past cases show that the regulated industries had been able to significantly alter, even reverse, the course of the reforms to suit their interests. The banking industry demonstrated its ability to reverse what was decided by MOF through heavy political lobbying to the LDP in 1979-82; that the securities industry possessed powerful political resources in the Diet was shown in 1979-82 as well as 1991-93. Likewise, in the Big Bang, it was not that the "losers" were unable to raise objections at all. Indeed, the life insurance companies, and the securities firms to a lesser extent, were able to delay the entry of the banks' subsidiaries in their businesses.

However, such efforts by the industries were only made at the level of particular measures of interest to the industries (e.g. entry of banks' subsidiaries into other fields) but not at a more comprehensive level with a goal to significantly alter (e.g. postponing the deadline, 2001, or dropping an area of reforms) the Big Bang Initiative. This warrants an explanation, as there were very few among the financial firms which stood to gain from the Big Bang: "for the large part of the financial world, the Big Bang was clearly an annoyance." (Tahara 1998, 216) Yet, no corporate leader of the financial sector interviewed by Nihon Keizai Shimbun (1997) — including city banks, long-term credit banks, trust banks, regional financial institutions, securities companies, and insurance firms— openly opposed the Prime Minister's Big Bang Initiative, which professed to vitalize the Tokyo market, while the "losers" expressed reservations regarding the specific measures included therein. (Chapter 4)

Why would the regulated industries' opposition be limited to particular measures? It was because the Big Bang was one of the main pillars of the Prime Minister's political agenda.[48] In November 1996, the industries suddenly faced a program, launched by the Prime Minister and embraced by the LDP (note that the Big Bang-type reforms were part of its electoral platforms because of the efforts made by the LDP ARPH). Thus, we can see that to campaign for the reversal of the Big Bang through the LDP became too costly, unlike in the case of 1979-82. One can see how the cost of choosing this option differs by the use of counterfactuals: imagine a world in which MOF would take credit and full charge over the reforms as in the past as the organizer of bureaupluralism, and contrast it to the real world, in which Prime Minister Hashimoto put his government at stake with this proposal, presented as his. While MOF's political influence was considerably lessened by the Housing Loan and other scandals in finance, and was thus potentially vulnerable to the industries' defiance through the LDP, one can easily see that the industries would have had a much harder chance trying to challenge the Prime Minister's main political program.[49]

To say the above is not to deny that there was an important variation as to how much change was brought about as a result of this political leadership: the industries and the bureaucracies mattered, especially in the area of insurance, where reforms seem to have been most effectively opposed. First, the attitudes among the industries towards liberalization (accept / acquiesce / oppose) varied. Because the banking industry as a whole was expected to be the winners against the other industries, it was quite expected that they would not object to the reforms ("accept"). However, there was a large difference between the securities and insurance industries' reactions to the reforms. While the two industries were in agreement in their rejection of banks' entry into their fields, the insurance industry was much more vocal in raising its opposition against the measures outlined by the Big Bang Initiative ("oppose"), while the securities sought to acquiesce to liberalization and procure maximum compensation ("acquiesce"). Second, the bureaucracy in charge of the reforms showed a variation: insurance showed a difference from the rest. While the Banking Bureau, hit by various scandals and policy failures, was vowing to depart from its traditional style of administration[50], and while the Securities Bureau was very eager to proceed with the Big Bang under its head Atsushi Nagano (an ardent advocate of reforms), the Insurance Department was reluctant to initiate drastic reforms that would jeopardize the status quo in the industry. During the U.S.-Japan Insurance Talks, there was even a scene in which Eisuke Sakakibara (the head of the International Finance Bureau and advocate of foreign exchange reforms) advised the Insurance Department to liberate itself from the industry's influence.[51] The industry, however, under the encouragement by the Department, went on to make unsuccessful political lobbying efforts to thwart the unwanted liberalization.(Asahi Shimbun 1997, 65-72) This reluctance may have been reflected in the discussion at the IC, slowing the pace of the liberalization in insurance.

Yet, even for insurance, such "nuisances" as the deadline of the year 2001 and the entry of banking within insurance could not be avoided. That it was part of the Prime Minister's main political agenda seems to have counted more than the concerted efforts by the bureaucrats and industries to slow down the reforms.[52] Thus, the fact that the Initiative was not bureaucracy-led but politically-led considerably raised the hurdles for the regulated industries to raise effective opposition at the comprehensive level.

However, it is not impossible to successfully oppose a policy proposal made by the Prime Minister: a coalition within or outside the LDP sometimes overrode the Prime Minister in the past. For example, regarding the tax reforms, the Prime Minister's drive for the introduction of indirect taxation failed many times in the 1970s and 1980s.

Such was not the case in the Big Bang, nevertheless. We stress that not only was the Initiative launched under the political leadership of Hashimoto, but also it enjoyed wide public support over the more gradual alternatives in the mold of past reforms: Hashimoto had just won the 1996 elections with a campaign pledge for reforms. If the reform plan was criticized, it was because the liberalization was not far-reaching or quick enough or because the scope of the reforms was limited, not because it jeopardized the stability of the financial order, as opponents to drastic reforms would have asserted. The efforts by the regulated industries to slow down the reforms were criticized as "egotism" and "disregard of the consumers" by the media.[53]

On top of all this came the scandals. In addition to the Housing Loan and other financial scandals dragging down the banking sector's political influence in 1996, as the deliberation at the MOF councils was going on, the heads of the DKB (Daiichi Kangyo Bank) and Nomura Securities were being investigated and eventually arrested for the racketeering scandals from March 1997 on. As the involvement of other top three securities firms became clear, the securities industry was in no position to wield great political influence had it wished to do so, as in the past. In this atmosphere[54], it would have been impossible to build a coalition among lawmakers, within or outside the LDP.[55]

Besides, apart from the dimension of political coalition-building, a campaign to reverse the reforms would also have posed risks to the profits (and hence the chance of survival) of those firms which dared to do so. The industries had good reasons to avoid being labeled "public enemy", especially for those banks and securities firms which were hurt by the waves of the scandals, as campaigning towards forestalling the reforms while the firms' directors were being arrested would have had prohibitive costs vis-à-vis the public. The Racketeering Scandals of 1997-98 demonstrated that the costs of the scandals were highly visible for the firms' businesses as the public was making their discontent known through their choice of firms: the DKB, Nomura Securities, and other firms involved saw their businesses severely affected.[56]

The scandals in finance reinforced the notion of inevitability of "no going back", thus raising the cost of gradual alternatives to the Big Bang, which was associated with the reform of financial administration, including the MOF reforms. In the wake of the racketeering scandals, the "Free, Fair, Global" principles of the Big Bang came to be professed by newspaper editorials as the necessary conditions for the revival of the obsolete Japanese market into a transparent, efficient one on a par with its European and American rivals. (Asahi Shimbun 21 May 1997) The MOF Wining and Dining Scandals further reinforced the need for drastic departure from the current way of financial administration: MOF reforms and the Big Bang were seen to go hand-in-hand. The logic would be that the elimination of discretion from financial administration, based on the "Free, Fair, Global" principles of the Big Bang, was necessary to prevent the recurrence of such scandals. (Asahi Shimbun 8 March 1998) In this environment, it would have been very hard for anyone to argue against the Big Bang without being characterized as an advocate for the preservation of the old financial system, the Convoy System, which came to be vilified with the eruption of scandals and discredited by the financial crisis.

6.8 Conclusion

In this chapter, we have sought to answer why the financial industries were unable to forestall the Big Bang as they did in the past, in response to research puzzle b). The puzzle was broken down into two questions:

1) To what extent were the financial institutions able to wield influence?
2) Why did it not result in significant modification (such as reversal)?

In response to question 1), we gave an overview of the course of the events. The regulated industries, most of which standing to "lose" from the reforms, were able to wield influence mostly in affecting the "pace" of the reforms by delaying and narrowing the specific measures. As the Initiative was discreetly developed by some state actors (i.e. MOF and the LDP) without much involvement by the regulated industries during Phase I, the industries' influence was concentrated in Phase II through the process of bureaupluralism. However, neither the Big Bang Initiative itself was reversed, nor any important part of the Initiative dropped: while the regulated industries affected the "pace" of the reforms, its basic framework, "timing" (i.e. immediately, until 2001) and "scope" (e.g. with or without insurance), were largely unaffected.

Next, turning to question 2), we provided a comparison with three recent cases of financial reforms involving banking, securities, and insurance: the strategy of the analysis was to provide a longitudinal comparison focusing on the identification of differences among similar cases. That the regulated industries were by-passed by those who conceived the Big Bang in the planning phase (Phase I) forced the regulated industries to deal with the Initiative, already made public (unlike in the past reforms where the plan would only emerge after a thorough discussion involving the industries), in Phase II. The industries were facing a policy proposal (for drastic reforms) which was one of the main pillars of the Hashimoto government and which enjoyed public support more than its gradual alternatives in the mold of past reforms. That the program was led by the Prime Minister (and head of the LDP) made it hard for the industries to campaign through the LDP unlike in the past; that the program was supported by the public over its alternatives made it very unlikely that any political coalition would be successfully garnered to oppose the Big Bang. The scandals that had hurt the banking and securities industries since 1995 prevented them from wielding any considerable political influence to forestall the reforms at the comprehensive level, as the risk of being labelled "public enemy" proved costly to their businesses as shown in the Racketeering Scandals. The various financial scandals propelled the Big Bang further, as it came to be associated with other reforms in finance (e.g. MOF reforms) in departure from the old Convoy System, now vilified by the scandals and discredited by the financial crisis.

Finally, let us turn back to the two types of economic reforms mentioned in this chapter, "interest group politics" and "public interest politics". This chapter shows that though the regulated industries wielded some influence over the "pace" of the reforms, the Big Bang reforms — as far as its more important "timing", "scope", and "sequence" were concerned— fit the category of "public interest politics" not only in Phase I (the planning phase before November 1996) — as argued in Chapter 5 — but also in Phase II (after November 1996) as well.

It was not the regulated industries' wishes but the state actors' calculations (i.e. the LDP and MOF) that won out in the end. Thus, we conclude that the Big Bang as a whole was a case of economic reforms where "public interest politics" overrode "interest group politics". In short, it was not the economic consideration of the regulated industries but the political consideration of the state actors that drove the Big Bang: the Big Bang was the political winners' achievement, not the result of economic winners' drive.

In the next chapter, we will offer a tentative generalization on the new developments in bureaupluralism, using the Financial Diet of the fall of 1998, a recent event in financial politics, to assess whether such developments observed in the Big Bang can be characterized as the evolution of bureaupluralism in financial politics of today.

Chapter 7 New Developments in Bureaupluralism in Financial Politics

7.1 Introduction

We now advance our inquiry into bureaupluralism, in answer to research puzzle d): what does the Big Bang case allow us to say about what happened to bureaupluralism? In this chapter, we begin by reformulating our findings in the last two chapters on the new developments in bureaupluralism. Then, as a reality check, we contrast our observations against the most recent efforts of reform in financial politics, the Financial Diet of 1998, in which a massive injection of public funds in the banking system, a plan to deal with bank failures through a bridge bank, and the complete breakup of financial policy making from fiscal power were enacted to resolve the bad loan crisis in banking. We then proceed to derive our main empirical contention regarding financial politics. In this chapter, we contend the following: *in the post-1993 world of coalition governments and changes of government, with the financial crisis involving performance failures and scandals, it is public support that determines political behavior in financial politics.* How our findings in financial politics can be integrated into this claim, and how it applies to each set of actors (politicians, bureaucrats, and regulated industries[1]) will be examined. Finally, we will contrast our explanation to alternatives, especially with the electoral rational choice explanation (see Chapter 5) that contends that the (voting) public matters, not unlike our claim.

7.2 Six Observations from the Big Bang

In Chapter 3, we defined bureaupluralism as "an institution of public policy making in which policies are produced through the inter- and intra- industrial bargaining presided over by the ministerial bureaus in charge, which engage in intra- and inter- ministerial bargaining within the government, with the occasional intervention by the LDP lawmakers on behalf of the industries". The bargaining of bureaupluralism is carried out through arenas such as deliberative councils and the LDP PARC and through closed doors negotiations among bureaucrats, industries (often acting through their industrial associations), and often times the LDP politicians. Bureaupluralism has been the norm of financial politics, as shown in our three cases of past reforms in Chapter 6, and it is certainly not extinct in financial politics: even the Big Bang was a product of bureaupluralism. However, the Big Bang, involving such fields as banking, securities, and insurance which gave rise to a wide range of distributional conflicts among these industries, emerged not in the mold of 1991-93 or 1979-82 — where the industries would engage in years of conflict through the deliberative councils with the help of their bureaucratic and political allies before the master plan of the reforms would come out — but first as a political initiative of the Prime Minister, overriding the regulated industries' wishes in a relatively short amount of time (taking seven months until the deliberative councils' final report). By dissecting this stark contrast, we are able to project *six* new, interrelated developments that took place in the stable policy making mechanism of bureaupluralism.

1) The Big Bang was a case of economic reforms carried out under "public interest politics" rather than "interest group politics". We repeat our main contention through Chapters 5 and 6: the Big Bang was carried out under the drive of state actors to procure public support rather than the drive of the industries' efforts to influence the reforms to its benefits through the exchange of goods and services with state actors.

2) MOF and the LDP began to develop an alternative mechanism of policy making to bureaupluralism, by-passing the LDP PARC and deliberative councils. In particular, reflecting the decline of MOF as the "organizer", there was a rise in policy making function in financial politics within the LDP, apart from the LDP PARC and MOF. In devising the Big Bang and MOF reforms, sub-organizational actors within MOF and the LDP by-passed the policy making mechanism of bureaupluralism, such as the deliberative councils or the LDP PARC, relying instead on such organizations as the WT (Working Team) within MOF and the LDP ARPH. Such sub-organizational actors came to command the behavior of their organization, as their positions were deemed by the members of their organizations to be most conducive to organizational survival (the ultimate goal shared by all members) in the environment of public animosity to their organizations in the wakes of the scandals since 1995.

While in some fields (such as taxation) the LDP PARC was known to wield a large influence over the substance of the measures, even in such cases, it was not that the LDP would come up with concrete plans: the details would be largely in the bureaucrats' hands (e.g. the Tax Bureau of MOF in taxation[2]). However, reflecting MOF's loss of standing as the "organizer", the LDP ARPH had been planning its version of the Big Bang, independently of MOF and the LDP PARC, with a detailed time schedule. As the reason for by-passing the PARC, an LDP lawmaker once remarked that the LDP PARC sub-divisions on finance were not interested in any reforms.[3]

3) The involvement of the regulated industries in the planning phase was kept minimal by the state actors, in anticipation of their opposition. It was not until the plan was publicly announced by the Prime Minister that the industries had a say, preventing them from crushing the plan before its presentation to the public.

4) The reform package was presented as one of the pillars of the main political program of the Prime Minister, attracting public support over its gradual alternatives, and thus highly raising the costs of opposition from the industries, ridden with scandals *themselves.* That it was a plan not only supported, but led, by the Prime Minister made it hard for the industries to raise effective opposition at the comprehensive level by forming a coalition within the LDP as in past reforms. That the proposal was more popular than its gradual alternatives further raised the cost of raising opposition, as the Convoy System in finance came to be vilified by the scandals and discredited by the financial crisis.

5) MOF lost its standing as the organizer of the bargains, due to its policy failures and scandals. An important rift exists between the 1991-93 reforms and the Big Bang: this time, MOF could not claim credit at all if the reform proposals were to be supported by the public. MOF increasingly lost political influence because of the Housing Loan, Daiwa, and other policy failures and scandals since 1995. It was not that MOF lost its standing in its entirety. The deliberative councils in Phase II were organized by MOF as in the past; besides, our discussion show that MOF was very much involved in devising the Hashimoto Initiative as a whole. However, we need to keep our comparative perspectives in mind. *As late as 1991-93, that MOF was the initiator and manager of the reforms was not only obvious, but also taken for granted under the stable system of bureaupluralism. If bureaupluralism were intact in the Big Bang, that MOF was behind the Initiative may not be noteworthy at all!!* MOF was facing a dilemma: while the financial reforms were launched to re-coup the trust from the public, it could not claim much credit for it, as its notoriety vis-à-vis the public would jeopardize the reforms by leaving them vulnerable to political objection. Thus, MOF repeatedly denied credit, and it instead sought to accredit Hashimoto, who deserved his share.[4] That MOF tried to efface itself behind the political initiative may mark an important departure from the past: the consensus position of MOF as the planner and organizer of the financial reforms had come to be questioned.

6) MOF and the LDP were cooperating, competing, and conflicting in financial policy making unlike in the past, where the LDP-MOF alliance was rather the norm. The LDP was willing to sacrifice its ties with MOF in coping with the electoral threats in the post-1993 world. In the Housing Loan Affairs, the LDP cooperated with MOF as in the past, as one of the ruling parties responsible for the policy proposals planned by the bureaucracy (as in the pre-1993 days of one-party dominance). In the Big Bang, the LDP ARPH competed with MOF in the planning of financial reforms: after the plan was launched by Hashimoto (the LDP President), LDP cooperated with MOF on this issue. In the MOF reforms, the LDP ARPH pursued MOF's breakup, in opposition to MOF and its LDP allies. This confusion may be explained by the LDP's pursuit of survival in the post-1993 world, in which coalition governments and constant threats of electoral replacement were the reality. The LDP chose to ally with MOF in some policy areas as it mostly used to in the past, but the coalition with the Social Democrats and Sakigake pushed the LDP towards MOF breakup. When the rival parties were campaigning for the popular agenda of reforms in the face of the October 1996 elections, the LDP chose to "incorporate" its rivals' platforms to pursue survival, sacrificing MOF's organizational integrity for this goal and thus potentially jeopardizing its ties with MOF, long nurtured with its close cooperation in such fields as public works. It must be said that this strategy worked: the LDP was rewarded with electoral victory in October 1996.

7.3 Reality Check — The Financial Diet of Fall 1998 —

Are these new developments unique to the Big Bang? Is this all but an ephemeral phenomenon? We do not yet know for sure: as far as financial reforms with distributive effects among the industries are concerned, the Big Bang is the most recent case. For the purpose of performing a reality check, however, we extend our scope of analysis to a minimal degree, still keeping as many commonalities as possible to preserve the effectiveness of our comparative analysis. The recent development in finance regarding the resolution of the bad debt problem in banking — the Financial Diet of the fall of 1998 — allows us to verify whether our findings are valid in financial politics after 1995. Not only is the bad debt problem in banking closely connected with the Big Bang (considerably overlapping with the MOF reforms as well) but it also enables us to contrast our observation obtained through the Big Bang with the relationship among MOF, the LDP, and the financial industries in the post-1993 world. This interplay of actors was made even more complex with the addition of the opposition parties (the Democrats, the Heiwa-Kaikaku, and the Liberals) because of the loss of the LDP majority in the Upper House since July 1998: without their cooperation, the reform bill would not have passed the Diet.[5]

In 1998, measures came out one after another to cope with the financial crisis. The measures to inject up to 30 trillion yen[6] of public funds into the banking system was enacted in February 1998, and around 1.8 trillion yen was accordingly invested in the large banks to strengthen their capital base in March 1998. The three-party ruling coalition (the LDP, the SDPJ and the Sakigake Party) and the government set up the Committee for the Promotion of the Revitalization of Finance, under which the government and the LDP would work on "total plans" that would get rid of the bad debt problem, including the slump of the real estate market at its roots. While the content of the total plans[7] — including a scheme to accelerate the disposition of the real estate in collateral for the bad loans, and a bridge bank plan[8]— was made public in June and July 1998, the financial crisis did not subside over the summer of 1998. The LDP lost the Upper House elections of July 1998, Hashimoto resigned, and Keizo Obuchi, as a result of a three-way race, was elected LDP President and succeeded Hashimoto as Prime Minister. (See Chapter 6.)

The Diet Temporary Session[9] of the fall of 1998 was often called the Financial Diet, for much of the session centered around the resolution of the imminent financial crisis. Based on the "total plans" devised over the summer, the government submitted six bills to the Diet in August 1998. The content included bills related to the acceleration of the disposal of real estate, the most important source of the bad loans, and bills introducing the bridge bank plan.

In this section, we will give a narrative of the political process of the Financial Diet, dividing into two stages, focusing on the measures occupying the center stage of policy discussions.

1) Re-vitalization (August- September 1996)
2) Re-capitalization (October 1996)

Then, we will provide a "reality check" in which we contrast our observation from the past two chapters against the experience of the Financial Diet.

1) Re-vitalization (August-September 1998)

This stage was dominated by the opposition (the Democrats, the Liberals, and Heiwa-Kaikaku[10]) and the LDP Young Turks (see below): the central issue was over the policy proposal to replace the February 1996 "re-capitalization" scheme (a scheme that injects public funds to operating banks) with a "re-vitalization" scheme (a scheme that injects public funds to banks near failure by forcing its shutdown).

The opposition jointly submitted a counter-proposal in September 1996. The bills submitted by the opposition included the following measures:[11]

a) The finalization of the MOF reforms: the creation of the Financial Revitalization Committee (FRC) as an independent committee with a Cabinet Minister as its head[12], assuming full control over financial policymaking until 2001[13], subsuming the FSA (created in June 1998) and MOF's financial planning powers;

b) The introduction of schemes for legal liquidation of failed banks, including the system of financial administrators with special power over the process, and temporary nationalization in cases of danger of serious damage to the financial system, while abolishing the plan[14] (created in February 1998) for the injection of public funds into operating banks; and

c) The establishment of the Resolution and Collection Organization (RCO), modeled after the Resolution and Trust Corporation established amidst the U.S. Savings and Loan Crisis in the 1980s, which would purchase non-performing loans from the failed institutions.[15]

A month of intense negotiations at the Diet ensued between the LDP and the opposition. One of the main issues was the Long-Term Credit Bank of Japan (LTCB), which was nearing failure, with its stock price approaching near zero as a result of a severe speculative attack.[16] The opposition sought forced nationalization, and the LDP endorsed re-capitalization, avoiding its shutdown. Another was the creation of the FRC, which would finalize the separation of financial powers from MOF, to which the LDP was torn between those who were willing to accept and others who opposed, as in the earlier process of the MOF reforms (see Chapter 5). The LDP was facing a time constraint imposed by diplomatic concerns: the Prime Minister could not visit the United States without a deal, his visit being scheduled on September 20, 1998. The LDP could have forced its way in the Lower House, but it would not have the bills passed in the Upper House: thus, it needed at least a deal with part of the opposition. (Kin'yu Zaisei Jijo 21 September 1998)

The intense negotiation between the LDP and the opposition, especially the Democrats, was at the center of the policy debate. The involvement of MOF became increasingly smaller after August 1998.[17] Within the LDP, a number of junior lawmakers with expertise in finance, including Yasuhisa Shiozaki (see Chapter 5)[18] and Nobuteru Ishihara[19], began to take the initiative, handling the negotiations with the Democratic Party, independently from the party decision making bodies such as the PARC and its sub-divisions. In the heat of the debate, these Young Turks would even openly confront influential party leaders such as the heads of PARC and the Diet Affairs Committee.[20] Shiozaki, one of the main participants in this process, later credited the loss of the LDP majority in the Upper House elections as an important factor which made this possible.[21] On the Democratic Party's side, young lawmakers with legal and/or financial expertise (including Yukio Edano, Yoshio Sengoku, and Motohisa Ikeda) drafted their own counter proposal without the help of the bureaucratic agencies (such as MOF and the Cabinet Legislation Bureau), resulting in a completely independent enactment process from the bureaucracy. (Amyx 2000)

The LDP under its leader, Prime Minister Obuchi, decided to "fully swallow" (*marunomi*), or fully accept, the opposition's plans, while some among the opposition agreed to spare the LTCB from forced nationalization .[22] A deal was made in the meeting of the heads of the LDP, the Democrats, and Heiwa-Kaikaku on September 18, 1998, two days before Obuchi's scheduled U.S. visit.[23]

2) Re-capitalization (October 1998)

Before Obuchi's U.S. visit, things looked as if the opposition and the LDP Young Turks had their way over the LDP main stream on financial issues, or the "tribesmen" gathered around the LDP PARC and its financial sub-divisions: the re-vitalization scheme, or the forced nationalization scheme, seemed destined to replace the re-capitalization scheme of February 1998. However, the economic environment surrounding the Japanese financial system has changed in two important ways during September and October 1998, significantly affecting the policy debate.

First, the Asian financial crisis since 1997 had become a global financial crisis by then: Russia over the summer of 1998, and then Brazil and other nations in Latin America were now under financial crisis. In the United States, a major hedge fund nearly collapsed, only to be rescued by a major rescue package organized by the Federal Reserve Bank of New York in September 1998. Given this crisis situation, the United States shifted its policy stance concerning Japanese finance from "public funds injection only with strict conditions attached" to "public funds injection at all costs to save the global financial system from collapse": this shift in policy stance was told to Prime Minister Obuchi by the U.S. government during his September visit. The Group of Seven (G7) issued a joint statement on 4 October 1998, strongly pressing for an injection of public funds *prior to* bank failures. Second, on 5 October 1998, the Nikkei stock price index dived down past the 13000 mark, and the stock price of many large city banks came down to the vicinity of 100 yen: the financial system was near collapse. Given this crisis situation, many people, including leading economic figures, campaigned for the introduction of the pre-failure injection of public funds, or the re-capitalization scheme.[24] (Sakakibara 2000, Chapter 4)

These environmental changes — the shift in the U.S. stance and the deepening of the crisis — may have had a strong impact on the political debate. The LDP financial main stream (led by such lawmakers as Yukihiko Ikeda) regained control over the policy debate from the LDP Young Turks. Heiwa-Kaikaku switched sides in the beginning of October 1998 and so did the Liberals, breaking down the unified opposition front against the LDP. In this process, MOF regained its influence, although its presence was kept invisible, due to severe public criticism lingering as a result of its wining and dining scandals.[25]

As a result, the re-capitalization plan passed the Diet on 16 October 1998, following the re-vitalization scheme that passed on 12 October. The following sets of bills emerged:

a) The re-vitalization bills, which were essentially the opposition's proposal (see above) with some modifications[26], with an addition of an 18 trillion yen ceiling on government guarantee (making the total of public funds for this purpose up to 35 trillion yen); and

b) The early strengthening bills, a bank re-capitalization plan based on the LDP proposal, which included the re-capitalization by acquisition of common and preferred stocks[27] by the RCO based on applications filed by under-capitalized banks, and the establishment of a government guarantee ceiling of 25 trillion yen for this purpose.

3) Reality Check

The narrative above should suffice as a sketch of the course of the events. We now posit our observations about the new developments in bureaupluralism against the narrative.

1) The Big Bang was a case of economic reforms carried out under "public interest politics" rather than "interest group politics".
3) The involvement of the regulated industries in the planning phase was kept minimal by the state actors, in anticipation of their opposition.

Very little in the Financial Diet process points to the regulated industries' influence. The LTCB, whose survival was in the politicians' hands, did not seem to have had much say in the process, although we would expect firms in distress to do whatever is necessary to prevent their ruin. The banking industry was by no means in control of the heated political debate among the opposition, the LDP Young Turks, and the LDP financial main stream. Instead, we see the LDP and the opposition seeking to enhance their standings as the ones who resolved the financial crisis.

2) MOF and the LDP began to develop an alternative mechanism of policy making to bureaupluralism, by-passing the LDP PARC and the deliberative councils. In particular, reflecting the decline of MOF as the "organizer", there was a rise in policy making function in financial politics within the LDP, apart from the LDP PARC and MOF.

The development of an alternative mechanism of policy making other than the LDP PARC and the deliberative councils is notable in this process. The newly established *ad hoc* committees in the LDP and the government gave birth to the "total plans".[28] In September 1998, the involvement of the PARC became lessened as the negotiations went on, as the Young Turks with expertise in finance took the initiative in the negotiation with the Democrats. The deliberative councils were nowhere to be seen: MOF involvement, if any, was minimized during the first stage ("re-vitalization"), and its presence in the second stage ("re-capitalization") was kept very low, unlike in the past ("whisper").

4) The reform package was presented as one of the pillars of the main political program of the Prime Minister, attracting public support over its gradual alternatives, and thus highly raising the costs of opposition from the industries, ridden with scandals themselves.

The financial legislation was the main program for the new Obuchi government; however, this did not prevent the opposition from raising a counter-proposal, which seemed to have enjoyed the support from the public and the market.[29] This points to the obvious reality that a political program presented by the Prime Minister may raise obstacles to intra-party opposition (within the LDP), but does not prevent the opposition from raising objections. *What matters more in the Big Bang or in the Financial Diet alike, is not so much that the leadership of the Prime Minister was expressed than there was public support for whatever measures presented.*

5) MOF lost its standing as the organizer of the bargains, due to its policy failures and scandals. An important rift exists between the 1991-93 reforms and the Big Bang: this time, MOF could not claim credit at all if the reform proposals were to be supported by the public.
6) MOF and the LDP were cooperating, competing, and conflicting in financial policy making, unlike in the past where the alliance was rather the norm. The LDP was willing to sacrifice its ties with MOF in coping with the electoral threats of the post-1993 world.

Finally, MOF did not act as the organizer of financial politics during the Financial Diet of 1998. As a result of the deepening financial crisis and the Wining and Dining Scandals in early 1998, which involved arrests for bribery, MOF had almost lost control over the discussion on financial policy making: in stark contrast to the process of MOF reforms in 1996, it had very little control over the establishment of the FRC, which would seal its organizational breakup.

However, it is not that MOF completely lost grip over the financial policy making. As Sakakibara (2000) implies, MOF may have had some roles in influencing the policy discussion at the G7 as well as the shift in U.S. policy; in the second stage, it worked with the LDP financial mainstream, while keeping a low profile. Nevertheless, even such retained influence was exercised through channels other than the traditional channels (e.g. the Banking Bureau and its deliberative councils) of bureaupluralism. Moreover, as in the Big Bang, MOF retreated from the front of financial policy making: its strategy of keeping a low profile sharply differs from the policy making of bureaupluralism (e.g. 1991-93) in which that MOF was in charge was "taken for granted".

Although part of the LDP (e.g. the head of the PARC[30]) was not keen on the creation of the FRC (and the definitive breakup of MOF), the Young Turks within the LDP were willing to cooperate with the Democrats, who were strong advocates for the breakup. The LDP Young Turks and the Democrats were clearly competing with MOF in regard to financial policy making, and they were confronting MOF on the creation of the FRC and other measures (such as the one regarding the LTCB). The Democrats were consciously by-passing MOF in their planning of a reform package.[31] The Young Turks in the LDP were cooperating with MOF during the summer; however, they became increasingly alienated from MOF, and during the first stage of the Financial Diet, MOF had been more and more excluded from the policy process.

Prime Minister Obuchi decided to "fully swallow" the opposition's plans, including the creation of the FRC: this is exactly according to the formula of the "incorporation" of the agenda of reforms of the Liberals and Democrats before the 1996 elections. In another instance in January 1998, a leader of Sakigake deplored the flexibility of the LDP regarding the issue of the MOF breakup, barring the option for his party (a junior coalition partner) to distinguish itself from the LDP: "the LDP would do anything to preserve its rule. How can one confront such a party?" The LDP is characterized as a "mollusk" from its critics for its large willingness to compromise policy matters so as to keep the ruling power.(Asahi Shimbun 28 February 1998)

In the Financial Diet, the strategy of "fully swallowing" seems to have worked once again. The Democrats, while having their plans successfully adopted as part of the financial revitalization scheme despite their standing as the opposition, failed to cash in their credits. This may be partly due to the fact that the Democrats lost control over the process in October 1998, as suggested by our narrative: this is reflected by the voting behavior of the Democrats, who voted for the first set of bills (re-vitalization), while opposing the second ones (re-capitalization) when the bills were passed in October 1998. Later, their head, Naoto Kan, would admit that his strategy in the Financial Diet of "responsible opposition", which would cooperate with the ruling government when in need, did not materialize a boost in his party's public support. Obuchi cruised in his office with approval rates rising over time, as the economic and financial crisis receded. The legacy of the Financial Diet was that the LDP, seeking to avoid the embarrassment of another total concession (as the one made in September 1998), opted to build a solid coalition: it reached to the Liberals, forming a coalition government in January 1999. (This coalition was extended to include the Komeito [Heiwa-Kaikaku] later in the year.)

7.4 New Developments in Bureaupluralism in Financial Politics

The above shows that the observations about new developments in bureaupluralism obtained through the Big Bang held, when contrasted with the experience of the Financial Diet. Thus, we claim that the changes were neither unique nor ephemeral: it is a new trend in financial politics since 1995. Below, we offer a more generalized version of the changes in bureaupluralism in financial politics, in light of the reality of the Financial Diet of 1998.

a) "Public interest politics" is now dominant in financial politics over "interest group politics". Political actors seek to institute reforms that suit the public interest in their quest for public support. The regulated industries' influence on the political actors and the reforms' outcomes are minimized compared to the past, as they are increasingly put on the sidelines in the planning of economic reforms, largely due to the following point (b).

b) Alternative policy making processes to bureaupluralism have been developed: the LDP PARC and the deliberative councils have become lessened in importance in their role of being the forums in which the substance of the policy proposals would be decided. It is not that such organs of bureaupluralism ceased to function: the LDP PARC is still a decision-making body through which all measures have to pass to obtain party approval, and MOF runs its deliberative councils to devise plans regarding the future of finance as of now. However, many *ad hoc* arrangements have sprung up to displace such organizations as the arenas in which the substance of the reforms is decided: the LDP ARPH, the three-party coalition's WP on MOF reforms, MOF's WT on the Big Bang, the committees in the LDP and the government on the "total plans", and the LDP Young Turks in the Financial Diet all testify that the policy making process of bureaupluralism has lessened in importance in financial politics.

c) MOF lost its standing as the organizer of bureaupluralism as a result of a series of policy failures and scandals. MOF was involved in a variety of policy failures and scandals, losing political influence as these events unraveled. In the Big Bang and the second stage of the Financial Diet, it could not claim the credit for its role of planner. In the first stage of the Financial Diet, its involvement in the policy planning process became minimal.

d) Political initiatives displaced bureaucratic ones in financial politics. This point follows from the above point: the vacuum created by the departure of the bureaucracy was filled by the politicians. Hashimoto's political leadership and MOF's self-effacement, contrasted to the 1991-93 reforms organized by MOF, shows the displacement of MOF by political leaders as the "organizer" of reform initiatives, while, in fact, MOF was still largely responsible for the content of the reforms. This trend was furthered especially in the first stage of the Financial Diet of 1998, where MOF was kept on the sidelines: the negotiations between the LDP and the opposition were what determined the content of the reforms.

e) MOF and the LDP are now in a strategic relationship with each other: they cooperate, compete, and conflict, according to the dictates of the logic of organizational survival. The LDP would cooperate with MOF on some issues as in the past (e.g. Housing Loan), while competing (e.g. the Big Bang planning; the first stage of the Financial Diet) or even conflicting with it (e.g. the MOF reforms). There is no static relationship between the two political actors, who act to increase their own chance of survival.

Table 7.1 Observations about the New Developments in Financial Politics

a) "Public interest politics" is now dominant in financial politics over "interest group politics".

b) Alternative policy making processes to bureaupluralism has been developed: the LDP PARC and the deliberative councils have become lessened in importance in their role of being the forums in which the substance of the policy proposals are decided.

c) MOF lost its standing as the organizer of bureaupluralism as a result of a series of policy failures and scandals.

d) Political initiatives displaced bureaucratic ones in financial politics.

e) MOF and the LDP are now in a strategic relationship with each other: they cooperate, compete, and conflict, according to the dictates of the logic of organizational survival.

7.5 Our Empirical Claim: Public Support as a Determinant of Financial Politics

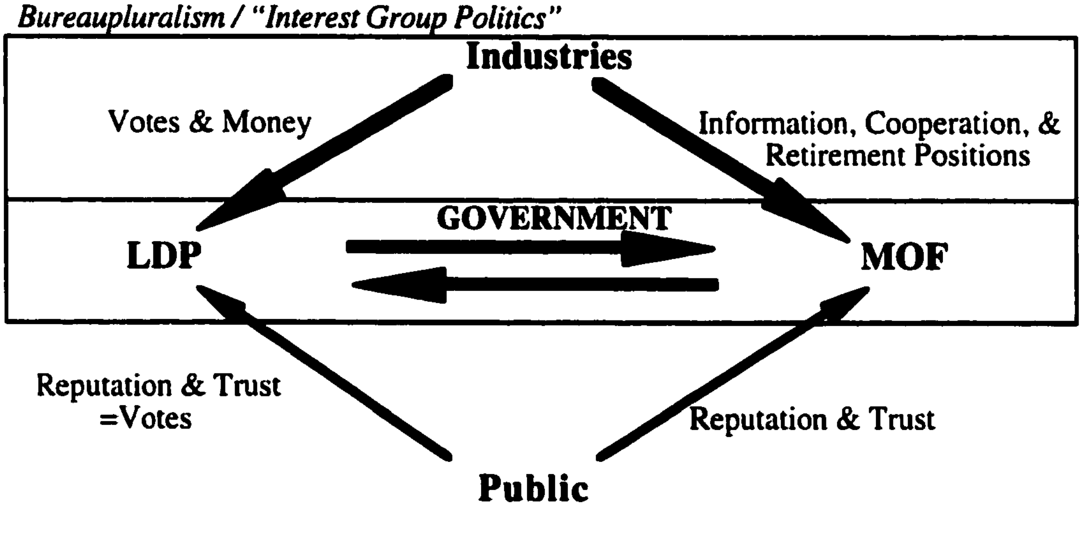
The observations about the new developments in bureaupluralism (Table 7.1) lead us to the following claim: ***in the post-1993 world of coalition governments and changes of government, with the financial crisis involving performance failures and scandals, it is public support that determines political behavior in financial politics.***

Below, we explain how this claim holds in two ways. First, we will demonstrate how the above observations can be integrated into this empirical conclusion. Second, we will examine how it holds among three sets of political actors: the political parties, the bureaucracies, and the regulated industries. (Figure 7.1 gives a visualization of the changes that happened to bureaupluralism in financial politics, as explored in this section).

Fig. 7.1 Politics of Financial Reforms: Before and After
A Diagram of Political Input into the Government

Notes:
Economic reforms are produced from the Government as "output".
Arrows: political influence (from A to B), thickness depicting strength.

1) Financial Politics Under Bureaupluralism (until the 1991-93 reforms)



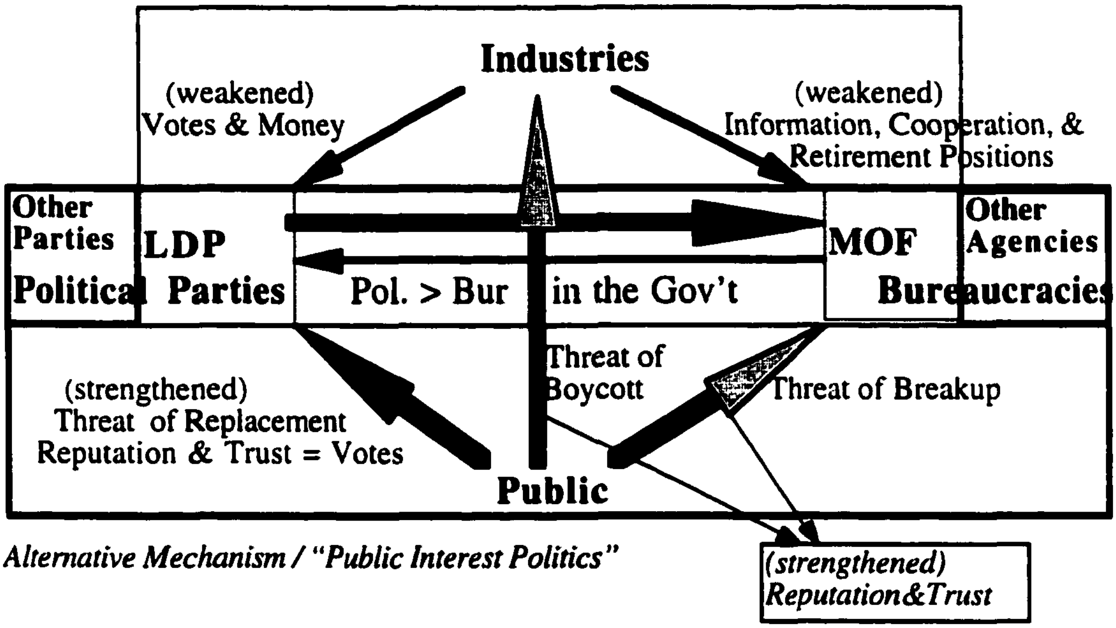
Government = LDP + MOF
Bureaupluralism/ Interest Group Politics = LDP + MOF + Industries

2) New Developments in Financial Politics (1995 -)

Changes:

1) Post-1993 world: coalition governments and changes of government possible
2) Failures: performance failures (financial crisis) and scandals

Bureaupluralism / "Interest Group Politics"



Alternative Mechanism / "Public Interest Politics"

Resulting Changes:

α. Political Parties displace Bureaucracies

β. The Government (= state actors) includes more actors

Government under Bureaupluralism = LDP + MOF
<u>Government in the new world = LDP + Other Parties + MOF + Other Agencies</u>

γ. Increased Inclusiveness of the decision making process

Bureaupluralism/ Interest Group Politics
= LDP + MOF + Industries
<u>Alternative Mechanism/ Public Interest Politics</u>
<u>= LDP + Other Parties + MOF + Other Agencies + Public</u>

1) How Does the Analytical Claim Relate to the Observations?

In the post-1993 world of coalition government and change of governments, the LDP faced a believable threat of replacement from its rivals. We add to this environment a series of performance failures (policy failures for MOF; bad performance for financial industries) and scandals in finance since 1995, which culminated into a financial crisis in 1997 (a performance failure for all actors).

MOF was discredited as the legitimate "organizer" of financial policy making in the public's eyes (c[32]). This led the politicians to displace the bureaucrats as the policy makers of the economic reforms (d). The LDP acted strategically towards MOF in the post-1993 world where change of government is a reality. While having close ties with MOF still has electoral benefits (e.g. public works), the LDP had a higher priority, to fend off its rival parties, which sought to cash in on the notoriety that the LDP and MOF earned for themselves in the Housing Loan Affairs. The process of weighing these two conflicting goals expressed itself in the form of internal rift within the LDP. However, as expected by the logic of survival ("we cannot fight the elections without the MOF break-up"[33]), those seeking to maximize public support won out, in the environment of heavy public criticism against MOF (e).

The regulated industries also attracted wide public criticism over the scandals and the failure of its institutions, largely a result of questionable conduct during the bubble economy. Their political influence waned, increasing the importance of the other source of political support than industries, the public (a).

That the public increased in importance vis-à-vis the regulated industries had important effects on the decision to adopt the Big Bang for the LDP as well as MOF. The LDP faced platforms of drastic reforms, including massive deregulation, from its electoral rivals, while the financial industries were also making important financial contributions to the party. These two conflicting goals resulted in an internal rift within the party; however, the believable threat of electoral replacement in the post-1993 world made the party adopt the popular agenda of "reforms" (via "incorporation"). This trend was even strengthened during the Financial Diet, where the LDP would "fully swallow" the popular opposition platform. As for MOF, it faced the outraged public, turning against its organizational survival, its ultimate priority. MOF had two sets of concerns vis-à-vis the regulated industries. The regulated industries provided such benefits as information, cooperation, and retirement positions to MOF. However, drastic reforms to revitalize the financial market which would create many "losers" among the regulated industries seemed a necessity to improve the Japanese economy. MOF chose the latter over the former concern: these two conflicting goals appeared in the form of internal rift within the bureaucracy. Again, in the environment where MOF had to fear for its survival because of heavy public criticism, the considerations for the "public interest" won out over those for the regulated industries.

In the above, we identified three incidents in which two sets of interests collided with each other: the LDP's strategy towards MOF, the LDP's strategy towards the regulated industries, and MOF's strategy towards the regulated industries. In all three aspects, an internal rift appeared in the organization and was resolved by the victory of the side which sought to make it the priority to increase public support, deemed essential for organizational survival. This process is one in which we see the logic of organizational survival operating under the environment where the political actors act to re-coup the earlier loss of public support, which is another way to express the dominance of "public interest politics" over the "constituencies", or "interest group politics" (a).[34]

The rise of alternative policy making mechanisms to bureaupluralism expresses what we mentioned so far (b): MOF being discredited as the "organizer" and displaced by the politicians; the public displacing the regulated industries as the source of political influence; and the process of internal struggle in the organization, in which the "public interest" won over the interests of the bureaucracy and the regulated industries. The deliberative councils were no longer the arenas where MOF would preside over the bargaining of the regulated industries. While MOF was displaced by the politicians in financial policy making, the LDP PARC of bureaupluralism was not the one to take the initiative. Instead, in the LDP's internal struggle, the PARC was the advocate of the interests of the regulated industries (and of MOF in the MOF reforms): it was the other sub-actors (such as the LDP ARPH and the Young Turks) who eventually got the upper hand with the more popular agenda of reforms.

Below, we construct a simple typology between bureaupluralism and the "alternative" mechanism of policy making, the various *ad hoc* arrangements that emerged in financial politics since 1996, for the purpose of illuminating the changes that occurred. (One caveat: it is not that a single set of policy making mechanisms replacing bureaupluralism emerged as the "alternative". However, for the purpose of illuminating the fact that bureaupluralism is no longer the only "rule of the game", we group together the various *ad hoc* arrangements that sprung up outside of bureaupluralism and label them as "alternative".)

The two systems draw a sharp contrast regarding the actors included. Bureaupluralism (see Chapter 3) had MOF at its core as the organizer of the bargaining among the regulated industries; the LDP would be occasionally involved to resolve the conflicts between the industries and the bureaucracy. The public was not without influence on the bureaucracy through "reputation" and on the politicians through their votes. However, we posit that it was not included in the policy making process of bureaupluralism for the following reasons. The LDP did not face much threat of electoral replacement, the bureaucracy's role as the "organizer" was taken for granted, and the industries were guaranteed entry into the policy making process through the deliberative councils and the LDP PARC, where the consumer public cannot be said to have been well represented. "Bureaupluralism" thus includes {the LDP; MOF; the industries}; under this system, the government, from which the economic reforms are produced, consists of {the LDP; MOF}. Reflecting the actors included, economic reforms under bureaupluralism tends to be "interest group politics" over "public interest politics", referring to our typology of economic reforms (see Chapter 6).

In "alternative", the public is included while the regulated industries are not. The public wields considerable influence on the LDP, which faces a believable threat of electoral replacement. MOF, which faces a threat of breakup due to loss of public trust, actively pursues public support. The regulated industries, hit with the scandals and financial crisis, also face the threat of boycott (e.g. the Racketeering Scandals). The deliberative councils and the PARC lose prominence as the policy making forums, reducing the relative importance of the regulated industries' political influence. Politicians and bureaucrats are in pursuit of public support rather than seeking to please the industries. The government includes the non-LDP parties ("other parties"). Because the replacement of the LDP is a reality, the non-LDP parties now affect the output (economic reforms) directly (e.g. Sakigake in the MOF reforms or the Democratic Party in the Financial Diet) or indirectly (e.g. the LDP "incorporating" its rivals' platforms) either in coalition or in opposition. We may add the increased presence of non-MOF agencies in financial politics (that of MITI in the Big Bang and the "total plans"; the FSA created in 1998 sharing policy making power with MOF as well as having financial supervisory power). Thus, "alternative" includes {the LDP; Other Parties; MOF; Other Agencies; the Public}; the government is now composed as {the LDP, Other Parties, MOF, Other Agencies}. With the rise of "alternative", "public interest politics" dominate in financial politics over "interest group politics", while within the government, the political parties' displace the bureaucratic agencies as actors taking the initiative.

It is important to note that bureaupluralism has not died away in the new world: after all, in Phase II of the Big Bang, bureaupluralism showed its presence. (As of 2000, the deliberative councils and the PARC continue to function as decision making bodies.[35]) Thus, it is more appropriate to visualize this new trend as *an addition of alternative mechanisms of policy making, not a replacement.* In other words, the changes that happened are best characterized as a situation in which bureaupluralism is not the only "rule of the game" in producing economic reforms. The new world is one in which "bureaupluralism" and "alternative" overlap.

<u>2) How Does the Analytical Claim Hold for Each Set of Actors?</u>

Next, how does our claim—that public support matters — hold for the other three sets of actors, politicians, bureaucrats, and industries? As for the politicians, to say that public support matters is not to deny the importance of political leadership. Hashimoto's leadership in the Big Bang prevented the regulated industries from building an opposing coalition within the LDP, a strategy that worked in the 1979-82 banking reforms against MOF. However, a proposal by the Prime Minister (and the LDP President) would not prevent the opposition from outside the LDP (as shown in the Financial Diet). Thus, we submit that the more crucial causal factor here is not so much the Prime Minister's presence than the fact that his proposal was far more popular than the other alternatives.

This claim is supported by the LDP's behavior, which was driven by the logic of organizational survival in 1996 and in the Financial Diet. Facing a believable threat of electoral replacement with the loss of public support (i.e. in the wake of the Housing Loan Affairs in 1996; the defeat in the Upper House in 1998), it chose to increase public support by two means, that is, by "fully swallowing" its rivals' policies and by sacrificing its ties with MOF, as MOF became a liability with its drastic loss of public trust.

It may not be surprising that our claim holds for political parties. After all, they regularly face elections, where public support directly determines their organizational survival, while the reality of the post-1993 world (i.e. coalition governments and changes of government) cannot be discounted as a factor that drastically increased the chance of electoral replacement.

How about the other actors, the bureaucracy and the regulated industries? *We contend that public support acts as a parameter for the bureaucracy and the regulated* *industries.* By "parameter", we stress the fact that the influence exercised by the public upon the behavior of the actors is by no means direct: it is not that the public as "actor" damages the bureaucracy or regulated industries by mass protest or other forms of direct action. (It remains a possibility in theory: recall the mass demonstration of the 1960s.) As is commonly observed, the Japanese public or consumers are far from being organized. (Vogel 1999) However, as unorganized they may be, under certain conditions, they may influence the behavior of other actors because the latter have good reasons to seek public support.

The political calculations of the actors are affected by the consideration of how the public might react to one's behavior. Admittedly, the public's attention span is short in time and narrow in range.[36] Its effectiveness is a function of the intensity with which its attention is devoted to a particular field (e.g. financial politics) or an actor (e.g. MOF; the banking industry).[37]

In our case — the financial politics of the late 1990s — the public was highly responsive to financial politics in the wakes of the scandals, the performance failures, and the financial crisis with numerous failures of financial institutions: the bureaucracy and the industries attracted heavy public criticism. Let us see below how the loss of public trust worked to affect the political behavior of these two sets of actors.

Public trust in MOF was increasingly undermined from two directions: competence and ethics. First, its competence came to be doubted in the wakes of the policy failures and the financial crisis, where many financial institutions failed despite its repeated promises that the worst was over and some banks were "too big to fail". Second, the scandals, most of all the Wining and Dining Scandals, raised questions as to the ethics and integrity of the bureaucratic agency. In this environment, where public trust in its organization was lost in both aspects, the organization faced a believable threat of breakup. Once discussions were raised (in early 1996), MOF immediately began its efforts to re-coup the lost public trust through its WT, by-passing the mechanism of bureaupluralism. This effort collided with concerns for the regulated industries, the dominant consideration in past reforms under bureaupluralism (i.e. 1991-93; 1979-82), resulting in an internal difference within the organization. However, the former side which sought to boost public support emerged as the winner under the threat of breakup, which was the least preferred scenario for both sides: this process shows how the logic of organizational survival operated.[38]

The regulated industries were severely affected by the scandals and financial crisis, while they may appear not to have suffered much from the public's reaction. The scandals involving the banking and securities industries culminated in the arrests of its employees, outraging the public.[39] The financial crisis, partly the result of the scandals and the questionable conduct during the bubble years, focused the public's attention on financial politics, as financial institutions failed one after another. The banking industry, in particular, had three factors that incensed the public's fury. First, the banking industry was slow to commit itself to restructuring until 1996, maintaining a relatively high level of salary while the recession in the economy negatively affected other sectors' workers.[40] Second, the years of low interest rate of the 1990s, adopted as a stimulus to the lagging economy and partly functioning to lessen the burden of the banking sector paralyzed in the bad debt problem, meant a low level of deposit rates for the household, generating a strong sense of dissatisfaction. Third, in addition, public funds were injected in the Housing Loan package as well as in the two banking plans of 1998 (February 1998 and the Financial Diet), giving the public a legitimate cause to scrutinize the banking sector.

In sum, the Convoy System in finance came to be vilified by the scandals and discredited by the performance failures that culminated in the financial crisis, leading the public to focus their attention on financial politics. This indirectly affected the regulated industries' political behavior in two ways. First, the cost for the regulated industries to openly object to the reform of the financial system in general, of which the Big Bang was part, became increasingly prohibitive. Second, the public demonstrated their power to directly affect the businesses of those under heavy public criticism in the Racketeering

Scandals: while the blow was not fatal to the industries, this incident demonstrates the fact that the public posed a believable threat of "boycott", as the cost of becoming a "public enemy" may be prohibitively high in the post-deregulation world where survival becomes an increasing concern for the regulated industries. In Chapter 6, we mentioned a comment made by a president of a lower-tier city bank that those opposed could not offer a "just cause" (*taigi meibun*) that could effectively counter that of the Big Bang. (Tahara 1998, 217) This supports our claim that the public acted as a *parameter* of the regulated industries' actions. The considerations for the "just cause", an implicit reference to public support, made the industries refrain from boldly pursuing their own interests: the public thus indirectly functioned to raise the cost for the regulated industries to forestall the economic reforms for their own benefits.

7.6 Comparison with Alternative Explanations

In Chapter 5, we contrasted our explanation on the emergence of the Big Bang which attributes the main cause to the strategic interaction of MOF and the LDP, each operating under the logic of organizational survival, with five alternative explanations identified in Chapter 2. Now, we have our main contention about financial politics since 1995 —that the public matters as a determinant of reforms —, which we contrast with the alternative explanations, especially with electoral rational choice, as this explanation would share our emphasis on the public's role, though from a different reasoning.

Among the alternative explanations identified in Chapter 2, the analysis provided in Part II so far clearly rejects "bureaucratic dominance" (i.e. a coordinated scheme of MOF or MITI), "interest group dominance" (i.e. the dominance of the financial industries or other industries), and "political dominance" (i.e. a victory of politicians over bureaucrats' resistance), as well as the "counter-coalition of the corporate sector and MITI" hypothesis. The role of Hashimoto, the LDP ARPH, and other political actors, or MOF's internal rift between "public interest" and "constituencies interest" would all be lost in explanations that see political or bureaucratic dominance. Most of the financial industries saw their interests hurt by the Big Bang; our analysis in Chapters 5 and 6 tell us that neither the financial industries nor the other economic "winners" were dominant in the political process, where "interest group politics", based on exchange of goods and services between political actors (politicians and bureaucrats) and the industries, was subdued by "public interest politics". That MOF had been discreetly planning the initiative from early 1996 on without much coordination with MITI makes it impossible to adopt the "corporate sector - MITI coalition" hypothesis.

"Electoral rational choice" shares our theoretical emphasis on the public. Electoral rational choice has the following causal argument, built upon the principal-agent theory. Basically, the public controls the LDP backbenchers through the elections, the LDP backbenchers control the LDP leaders through the party caucus, and the LDP leaders control the bureaucracy by their ultimate veto power. (Ramseyer and Rosenbluth 1993) We agree with electoral rational choice in dismissing such arguments as "the public is unorganized, and thus immaterial", as whether the public is organized or not is not at issue here. The public votes in the electoral rational choice, exercising control over the politicians. In our explanation, the public not only votes but also exercises influence as the bureaucracy and the industries have incentives to seek public support as well. How, then, do we claim that our contention distinguishes itself from electoral rational choice? We answer this question from two directions.

First, we iterate our third point of objection made in Chapter 5: it is unclear whether the exchange of votes and favors between political and economic actors existed between the consumers and the LDP as electoral rational choice would characterize. We contend that the assumed link between the voting public's behavior which selects parties according to their policy regarding the consumers' interests, and the LDP's behavior, which selects consumer-friendly policy in anticipation of the punishment at the polls (in case of failures to do so), does not hold in our case. We saw in Chapter 4 that the consumers were largely unaware of the benefit of the Big Bang, and the central issues of the elections such as administrative reforms can hardly be characterized as consumer-friendly. How could the LDP lawmakers adopt a pro-consumers' stance in 1996 "anticipating consumers' support", while merely one-ninth of the public was aware of the benefits of the Big Bang in 1997? Besides, the consumer-friendly financial reforms were but a minor issue in the 1996 elections, which were fought about administrative reforms, to which the consumers had a much more remote stake than in the case of financial reforms. After all, the causal link between administrative reforms and its benefits (such as lower taxes) is much more opaque than that of regulatory reforms (resulting in lower prices for services). Administrative reforms were popular, but not because of the perceived beneficial effects to the general public such as lowered taxes. The popular anti-bureaucracy agenda of the Democrats was not so much about the content of the policy carried out by the bureaucracy than about the procedure of bureaucratic dominance. In such a situation, is it appropriate to explain the LDP's behavior to advocate administrative and other reforms as a consumer-friendly stance in expectation of winning the consumers' support?

In contrast, our explanation can explain both such consumer-friendly reforms and such reforms as administrative reforms which have distant relations with the consumers' interests. In our explanation, what matters is public support, which affects the dynamics of party competition, determined not necessarily by the objective benefits to the voting public. Public support can be obtained for a program perceived to be "good", regardless of whether it objectively improves the consumers' lot or not (unlike electoral rational choice). We simply state that as long as the rival parties' platforms attracted public support, regardless of their causal link to the improvement of public welfare, the LDP would have matched the other parties' platforms to avoid their tragic loss of power of 1993. The financial reforms were just one part of the large agenda of administrative reforms and structural reorganization of Japan; the LDP pushed for reforms to enhance public support for the party. While reforms may or may not have a direct impact on the public's lot, reforms attracted public support: this was demonstrated by the Democrats, whose leader Kan attracted large public support for his anti-bureaucracy agenda. As reforms (of the central government and the "system") became the central issue in the 1996 elections, the LDP was attempting to prevent losing public support to its rivals by matching its platforms.

In short, it was not that the LDP expected the consumers' support in return for its consumer-friendly policy: whatever their expected effects on the public, reforms were popular then, so the LDP adopted them as policy out of competition with its rivals.

Our second way to distinguish our explanation from electoral rational choice would be through the comparison on the causal factors which drove the changes (that is, the surge in consumer public interests through drastic deregulation) in the Big Bang. Judging from Rosenbluth and Thies (1999), in electoral rational choice, electoral reforms would be the candidate as the main causal factor in the Big Bang case. In our explanation (in section 7.5), we have identified two changes (or causal input): the change of government in 1993 and "failures", or performance failures and scandals. Given such changes, we showed how the public's influence has been strengthened over the behavior of the politicians, bureaucrats, and industries. Thus, we ought to ask the following: is it "the change of electoral system" (as in electoral rational choice) or "change of government in 1993 and performance failures and scandals" (as in our explanation) that drove the Big Bang, which both would judge to be "the surge of public interest"?

We contend that our explanation is better than the explanation identifying changes with the electoral reforms in two aspects. First, the Big Bang would be lumped together with the Housing Loan Affairs, if we saw the electoral reforms to be producing victories for the voting public, pushing the LDP towards a pro-consumer stance. The Housing Loan Affairs would be a process in which "the LDP ultimately forced the banks to absorb huge losses rather than require taxpayers to bail out their mortgage-lending subsidiaries", according to an electoral rational choice interpretation (Rosenbluth and Thies 1999) It is hard to believe that there was *any* person (besides a few scholars of political science) who believed that this was the public's victory at the banks' expense in Japan of 1996. Is the characterization that "the banking sector was obliged to foot the entire bill" correct? (What happened to the injection of 685 billion yen of public funds, *the most important issue of all?*) Was the whole issue about "successfully forcing the banks to absorb huge losses", instead of "injecting 685 billion yen of taxpayers' money"? Why could we expect other alternatives for banks than absorbing huge losses?[41] Why didn't the LDP accept contribution from banking in 1996? Is it because of heavy public criticism against banks? Or, is it because the LDP was feeling financially secure and did not need the banks' campaign contribution more than agricultural votes? (Then, why would the LDP demand banking money again in 1999, well after the electoral reforms?[42]) In face of the numerous anomalies, we are forced to reject this explanation about the Housing Loan. Given the link between the Big Bang and the MOF reforms, and the Housing Loan affairs — where the former was conceived in early 1996 by MOF (Big Bang) and the LDP (MOF reforms), each facing a public outrage against the Housing Loan affairs —, it follows that this explanatory framework is inadequate for the Big Bang as well.

Second and more importantly, it is not because of electoral reforms but because of the change of government in 1993, accompanied with the loss of public trust in the Housing Loan affairs, that the LDP lawmakers faced a believable threat of electoral replacement in 1996. True, the change of government took place as a result of a failed attempt to introduce electoral reforms. However, the Lower House elections of 1993 were carried out under the old electoral system of multiple-member district (MMD), proving that change of rule was possible in that system. The changes in electoral rules may have a long-run effect upon the legislators' behavior, but as far as the 1996 elections are concerned, empirical evidence shows that not much had changed other than the decrease in campaign spending.(Otake 1997b) The experience of a change of government is more significant than the shift in the electoral system in affecting the politicians' behavior, if we are to compare the consumption tax case of 1989 with the Housing Loan Affairs, as Rosenbluth and Thies (1999) do. The experience of the LDP's loss of power in 1993, and its entailing experience of frustration of being in the opposition, was shared among the politicians in the LDP, raising their concerns for survival. While the electoral systems differ in the two worlds of 1989 and 1996, how this difference would affect the elections was far from being certain in 1996 (the first election being held in October 1996). Instead, the worlds of 1989 and 1996, while sharing the loss of public support, must have looked quite different to the eyes of the LDP politicians, where the loss of power was not a probable scenario in the former (supported by the past record of the continuation of one-party dominance over thirty years), while the experience of 1993 taught them that such a thing could happen. If we adopt our explanation — that once a change of rule happens after thirty-eight years of non-change, it remains a possible scenario, and thus it materializes a change in the shared expectations about "how the world works": an "institutional change" in politics (see Chapter 8) —, the fear of replacement of the LDP lawmakers would be much more clearly explained.

7.7 Conclusion

In this chapter, we sought to answer our research puzzle d), namely, the question "What happened to bureaupluralism?" We derived the general observations from the Big Bang case, then contrasted it against the experience of the Financial Diet of the fall of 1998, the most recent reforms in financial politics. As a result, five trends — the rise of alternative policy making mechanisms other than bureaupluralism, the rise of "public interest politics", the loss of MOF's position as the organizer of bureaupluralism, the displacement of bureaucratic initiatives by political ones, and the new strategic relationship between the LDP and MOF according to the logic of organizational survival — were identified as the new developments in bureaupluralism in financial politics. This led us to our main contention about financial politics since 1995 — that the public matters as a determinant of reforms in financial politics in the world of changes of government and financial crisis.

We supported this claim in two ways. First, we demonstrated the link between the observations about bureaupluralism and this analytical claim, by constructing a contrast between the policy making mechanisms of "bureaupluralism" and "alternative" . While the former includes {the LDP; MOF; the Industries} in the decision making process, with {the LDP; MOF} as governmental actors, the "alternative"— the diverse, *ad hoc* arrangements in the post-1993 world of coalition governments and changes of government, and of "public interest politics"— includes the public with the exclusion of "Industries" (and "MOF" at times), while the governmental actors now include "other parties" and "other agencies" as well. Second, we saw how the claim held for each set of actors: the political parties, the bureaucracies, and the regulated industries. After demonstrating that this claim directly accounted for the LDP's pursuit of survival in the post-1993 world where electoral replacement is the reality, we showed that public support acts as a *parameter* for the bureaucracy and the regulated industries. By parameter, we mean that the unorganized public indirectly affects the behavior of actors by altering the costs of their actions. The bureaucracy as well as the regulated industries had good reasons to seek the public support, even independently of political control.

Bureaupluralism has not died away in the new world in Phase II of the Big Bang as well as in today's financial politics. Thus, it is more appropriate to visualize this new trend as *an addition of alternative mechanisms of policy making, not a replacement.* In other words, the changes that happened are best characterized as a situation in which bureaupluralism is not the only "rule of the game" in producing economic reforms. The new world is one in which "bureaupluralism" and "alternative" overlap.

We then proceeded to compare our explanation — that public matters — against alternatives identified in Chapter 2. Because "bureaucratic dominance", "political dominance", or "interest group dominance" were clearly rejected from our analysis in the past chapters, we focused on "electoral rational choice", which shares our theoretical emphasis on the public from different reasons.

We rejected this explanation on two grounds. First, that the consumers were largely unaware of the benefit of the Big Bang in 1997 and that the elections of 1996 were hardly fought over the deregulation led us to question the assumed link between the exchange of votes and pro-consumer policy between the consumers and the LDP. It was not that the LDP expected the consumers' support in return for its consumer-friendly policy. Instead, our explanation focuses on the dynamics of competition among political parties over "public support", which does not necessarily reflect whether the measures would improve the public's welfare or not. Whatever their expected effects on the public, the opposition's agenda of reforms were popular then, so the LDP adopted them as policy to match its rivals.

Second, we distinguished our explanation from electoral rational choice by contrasting how the changes in the Big Bang, which both explanations would characterize as the surge of public interest with pro-consumer deregulation, were brought about. While electoral rational choice would identify "electoral reforms" as the cause for changes, we contend that "the change of government in 1993, and performance failures and scandals" are more adequate for two reasons. First, if we were to adopt electoral rational choice, we would lump the Housing Loan Affairs and the Big Bang together as the achievement of electoral reforms. However, the empirical evidence overwhelmingly suggests that the Housing Loan Affairs hardly matches electoral rational choice's interpretation (e.g. "the public's victory with the LDP forcing banks to absorb huge losses"), questioning its explanatory ability about the Big Bang, which we demonstrated to be deeply related to the Housing Loan Affairs. Second, the reason why the LDP faced an increased threat of electoral replacement in 1996 would be better attributed to the experience of the change of government in 1993, which changed the shared expectations in the political world (institutional change: see Chapter 8), than to the electoral reforms of 1994, whose expected results were far from being clear to the LDP in 1996 and whose actual results do not show much significant change in the elections. The fact that the LDP faced an increased threat can be better understood once we see how the loss of public trust by the Housing Loan Affairs and the change of rule in 1993 affected the behavior of the LDP politicians, than by trying to look for the scant empirical evidence supporting the quick (and doubtful) effects of the 1994 electoral reforms.

In the next chapter, we will situate the Big Bang in the larger context. What drove the changes in financial politics? We introduced two causal factors of change, "the change of government in 1993" and "performance failures and scandals". Where do they come from? We will address these questions by making use of our framework of institutional change, introduced in Chapter 3.

Part III Making Sense of the Changes (Chapters 8-9)

We turn to the concluding part, which makes sense of the analysis of financial politics provided in Part II, making use of the frameworks provided in Part I.

Chapter 8 provides a causal framework of the Big Bang and financial politics since 1995 by linking these developments to the environment. Our framework of institutional change (introduced in Chapter 3) will enable us to understand how the two causal factors of change in financial politics that we identified in Part II — "change of government" and "failures (performance failures and scandals)"— came to emerge. Our analysis leads us to offer the main grounds for our contention that "change", but not "continuity", is what characterizes Japanese politics of the 1990s: the Financial Convoy has broken down, and bureaupluralism in public policy making is in decay. We will close the chapter with a prediction on the future of bureaupluralism, as this issue will be key in obtaining a better picture of the Japanese political economy of the future.

Chapter 9 concludes our analysis. We will summarize our findings, establishing that Japanese politics has been changing since 1995. As an effort to expand the scope of the research and connect to other researches, we will discuss reforms in other issue-areas in the Japanese political economy, offering a tentative two-level model of economic reforms. We will also explore the policy implications of our analysis. The chapter will close by identifying issues that need to be pursued further.

Chapter 8 Institutional Change in the Japanese Political Economy: The Breakdown of the Financial Convoy and the Decay of Bureaupluralism

8.1 Introduction

In Part II, we have presented our views that see significant change taking place in Japanese finance. The massive deregulation since 1996 and the resulting flood of merger and strategic alliances in finance endorse our point. However, finance in Japan has always been drastically changing since the 1960s: there have been so many significant events — to name a few, the lift of the ban on inward foreign direct investment in 1964, the creation of the government bond market in the late 1970s, the liberalization of current account capital transactions in 1980, and the liberalization of deposit rates and the corporate bond market since the mid-1980s — that "if you take any period of ten years, you have two totally different worlds", according to economist Yukio Noguchi. In his view, it is technological innovation that fundamentally drives the changes in finance, and the regulatory reforms are but random events that ought to be dealt with by a stochastic model.[1]

Indeed, things change fast in the world of finance due to technological innovation, and the Big Bang may be another significant event along with many others in finance of the past thirty years. Globalization driven by technological progress has been significant in the world of finance, as exemplified by the drastic increase in the international capital flow largely made possible by advances in computer technology. Thus, one could argue that such environmental changes as technological innovation and/or globalization were crucial in triggering deregulation in domestic finance (as in Japan) through such influential phenomena as the development of the Euro-market that undermined the effectiveness of domestic regulation.

Despite the above, we claim that the choices about the timing (mid-1980s, early 1990s, mid-1990s, or later) and the pace and scope (drastic/gradual; wide scope/piecemeal) of the reforms make a large difference to the Japanese nation, thus rendering them worthy of analysis. In particular, whether the Japanese economy will have an efficient financial sector in the 2020s — at the beginning of the inevitable demographic crisis with the massive retirement of the baby-boomers coupled with today's steadily declining birth rate — is likely to be determined by the choices made years earlier. Even though technological advance may make financial reforms inevitable in the long run, when and how such reforms are carried out is largely a matter of domestic political economy.

However, our analysis of domestic finance and public policy making cannot be satisfactory if it does not delve into the causes of changes that we claim are taking place: our analysis has yet to show how changes occur. Such causal factors we identified as "change of government" and "performance failures and scandals" have been introduced exogenously; we now proceed to incorporate them in our analytical framework. In this chapter, we relate our story in Part II to the larger picture, or the development in the environment in which the Big Bang and other efforts of financial reforms have been taking place. How can we reconcile these two plausible views of "environmental changes (e.g. technological innovation and globalization) ultimately drive the changes" and "domestic political economy determines the timing and form of the changes"? In short, we ask the following sets of questions:

1) How can we situate the Big Bang within finance and the political economy in general? How can we link our story of domestic political economy with environmental changes (e.g. technological innovation and globalization)?

2) What causes changes in our story, and how do they happen?

In response, we rely on the theoretical framework of institutional change that we developed in Chapter 3. We first summarize our earlier discussion of institutions and institutional change, and of the prevailing institutions in financial politics. We proceed to identify the causal links between the environment, the domestic political economy, and the world of finance. Next, we will relate the Big Bang to the other changes in finance. Based on the above, we will identify two "institutional changes" in the Japanese political economy. We will show that the Convoy System in finance (hereafter the Convoy) has broken down in Japan over the 1990s, while bureaupluralism in public policy making is decaying. We close with a prediction on the future of bureaupluralism, based on our causal framework.

8.2 Summary of Our Framework of Institutional Change and the Prevailing Institutions in Financial Politics

In our definition, following Aoki (forthcoming), institutions are *"shared, stable, summarized expectations about how the world works, which may not be unique"*. Institutions are "shared expectations" about the state of the world, coming to be taken for granted due to the "stable" reproduction over time. Institutions convey "summarized" information to subjectively rational actors engaging in strategic behavior. "How the world works" signifies the rules that inform the actors about the consequences of one's action under the strategic interaction of actors. "Which may not be unique" represents the possibility of multiple equilibria. An institution is based on a feedback between the objective and subjective worlds. An institution is a) an equilibrium that arises from the repeated, strategic interaction of actors in the objective world, as well as b) a summary representation of such an equilibrium that is collectively shared by actors as subjective beliefs: a feedback mechanism between the two makes institutions self-sustaining.

We developed a theoretical framework of institutional change that addresses the politics, or the distributional conflicts, involved in the process of change. Institutional change is essentially a shift in shared perceptions about "how the world works" through a collective learning process based on an evolutionary selection mechanism of strategies derived from the actors' subjective beliefs about "how the world works". It is caused by the gap between the faster pace of environmental changes (including the institutional environment) and the slower pace of adaptation in domestic political and economic institutions. This gap appears in the form of "failures", or "performance failures" and "scandals", which lead actors to question the "taken for granted" aspect of the institutions. "Nature" — environmental changes in technology or the institutional environment— eventually determines the outcome of the competition of the institutions by rewarding various strategies of actors: successful strategies will increase their share in the population. Yet, the political struggle takes place between those actors who see the process as "resilience" of the institutions and/or have stakes in preserving the status quo on one hand, and those actors who, on the other hand, see that "change" is taking place and/or see enhanced interests in the new institutions: the distributional concerns of the institutional change comes in only when the old and new institutions are not Pareto-rankable. This political struggle is facilitated by symbols derived from such sources as history, foreign practice, ideology, and leadership. In the process, how the "conservatives" are displaced by "reformers" may be either "counter-coalition" (from outside) or "defection" (from within). When a critical mass of the agents shift their views about "how the world works" and the new institutions become "taken for granted", we call it "institutional change". Institutional complementarity often makes institutional change in one institutional field difficult; however, once such change happens in one institution, it is likely that the institutions in its environment will be forced to be re-assessed by the actors, thus starting a chain reaction of change. We defined "decay" to be a situation in which the shared expectations about "how the world works" come to be increasingly questioned by "mavericks", due to the appearance of "failures". However, the process of institutional change may always be halted, as "nature" may signal a return to the "status quo" or the "conservatives" may crush the "mavericks" in a political struggle: in such cases, we observe another instance of "institutional resilience", in which the institution demonstrates its robustness against minor deviations.

Then, we identified two prevailing institutions in Japanese financial politics before 1995: bureaupluralism in public policy making, and the Convoy System in finance. Our inquiry into the institutions analyzed the players, the formal rules, and the informal interaction patterns, ultimately reaching the shared expectations that sustained the institutions at their core. Bureaupluralism in the Japanese political economy was an institution in public policy making which held across sectors under the LDP one-party dominance before 1993. In this institution, policies are produced through the inter- and intra- industrial bargaining presided over by the ministerial bureaus in charge, which engage in intra- and inter- ministerial bargaining within the government, with the occasional intervention by the LDP lawmakers on behalf of the industries. The bargaining is carried out in arenas such as deliberative councils and the LDP PARC, as well as through negotiations behind closed doors. After surveying the policy tools available to the government and the way the policy making process operated, we showed how politicians, bureaucrats, and industries were intricately linked by a relationship of interdependence, while the public was largely outside of the policy making process. Bureaupluralism was a stable interaction pattern of politicians, bureaucrats, and the industries, based on the informal interaction of the same actors over time, guaranteed and reinforced by formal rules: the whole institution depended on shared expectations of continuity.

The Financial Convoy was another institution that arose in finance amidst the interaction of financial actors and state actors. The actors were always the same: the LDP was in power, MOF was the exclusive "organizer" of the bargaining process according to legal statutes, and entry and exit were *de facto* restricted, if not eliminated, by the formal rules and other informal constraints providing for the segmentation of finance. Their interaction pattern was largely informal, supported by such features of bureaupluralism as "informal administrative tools", "wining and dining", and *amakudari*: the policy making bodies were the deliberative councils under MOF, and the LDP PARC (in particular, its financial sub-divisions). The system was based on segmentation of finance as well as the surrounding institutions such as the main bank system, the financial *keiretsu*, and cross-shareholding. Essentially, no financial institutions were allowed to fail, and the state provided an implicit guarantee to sustain the "myth of no failure". The larger and more competitive firms were deterred from materializing their advantage; their compliance was secured by the regulatory rent and sanctions, or reward and punishment by the regulator. "Continuity" was key to the well-functioning of the Convoy: with future rounds to play, actors would be strongly deterred from deviating from the prescribed strategies under the Convoy. The "organizing principles" of the Convoy as the prevailing institution in finance was "cooperation and stability". Financial stability, or the stability of the financial order, was the goal of financial administration as well as the financial industries. This also fit the interest of the non-financial firms, which would enjoy stable access to finance: under the conditions that held under the high growth period, the repressed interest rates would guarantee cheap capital, even with an underdeveloped capital market. As long as bureaupluralism obtained across all sectors and the household (the public) was excluded from the policy making process, "stability" in the financial order was reinforcing, and reinforced by, the "producer economy" that Japan had been in the postwar era.

In the below sections, we will see how these two institutions have evolved since 1995, making use of the above theoretical framework of institutional change.

8.3 Applying Our Theoretical Framework (1): Situating Our Analysis of Financial Politics in the Larger Picture

In this section, we will relate our story of Japanese financial politics to the larger picture, or the development in the technological and institutional environment, mainly relying on our theoretical framework of institutional change developed above. We develop further the theoretical framework of "institutional change" within the context of Japanese financial politics of the 1990s. (In the next section, we will see how the changes within finance are related to one another.)

What drives "institutional change"? Basically, it is the collective perceptions that "things are not going right". In this regard, "failures", or the gap between the pace of environmental changes and the pace of institutional adaptation, are important factors that affect the collective perceptions and give rise to alternative strategies. Let us see how this framework applies to our story of financial politics.

1) Changes in the Environment

We may identify three types of changes in the environment applicable to our story of financial politics in Japan of the 1990s: technological innovation, internationalization, and demographic maturity. Technological innovation has been a significant source of changes in finance worldwide. The development in computer and communication technology has drastically reduced the cost of financial transactions as well as contributed to the developments of new products based on financial technology. Strange (1998) summarizes the technological innovation in finance under three headings: computers (e.g. money settlement), chips (e.g. credit cards), and satellite (e.g. communications through satellite and the Internet[2]). International capital flow, including short-term (e.g. portfolio investment) and long-term (e.g. foreign direct investment) investments, has increased drastically over the past twenty years, especially in the 1990s with the rise of the emerging markets in the developing world. The most important innovative change in the mid-1980s may have been the fast development of derivative markets: their size vastly increased in the 1990s. Derivatives drastically enhanced the financial actors' ability to manage risks and reduce transaction costs, and thus increased the efficiency of the international capital market. They also provided the means of arbitrage over differences in funding costs and returns as well as national regulations, thus increasing pressures for the global integration of capital markets. (Chadha and Folkerts-Landau 1999)

Such developments in finance led to the increased global integration of capital markets. With regard to our story, this means the integration of the Japanese capital market to the overseas market: the Japanese market has increasingly become sensitive to what happens in the overseas market. As we saw in Chapter 4, Japanese stocks are now increasingly traded in London largely due to lower transaction costs (including taxation): trends in London affects Tokyo immediately. Japanese banks now have increased exposure to international markets, after their extended presence of the late 1980s of the bubble economy and the increase in size of the international capital market in general of the 1990s. In this situation, the domestic banking system is more and more influenced by what develops abroad. To see this point, one only needs to recall the Daiwa Bank Scandal in New York and the practice of Japan Premium, in which Japanese banks were forced to pay a premium in the international call market.

Another change in the environment may be the demographic factor. As mentioned in Chapter 4, by 2020, the bulk of the baby-boomers will reach the retirement age, while the birth rate for the younger generation which supports the system has shown a steady decline. Regarding the financial sector, this translates to a need for increased efficiency, as more and more citizens will depend on their past savings to sustain their lives. While the demographics does not produce an imminent "threat" and thus does not determine when and how the financial reforms materialize, it has an effect of delineating the deadline, which makes such financial reforms inevitable, sooner or later. At least, this ticking time-bomb of demographic maturity may be used by "reformers" as a focal point that increases support for their causes.

2) "Failures"

What kind of failures can there be in financial politics? First comes the economic situation. We may think about four types of economic situation along a continuum: economic boom (high growth, close to potential growth rate: e.g. U.S. in the late 1990s), economic stagnation (low growth, discrepancy between potential and actual growth rates: e.g. Japan in the early 1990s), economic slump (negative growth rate: e.g. Japan after 1997), and economic depression (negative growth rate accompanied with social catastrophe: e.g. the Great Depression). In our framework, we are not likely to see "failures" in an economic boom: performance failures and scandals by actors may happen, but are not likely to undermine the collective beliefs regarding "how the world works".

Thus, we focus on the remaining three types of economic situation. While the economic situation may be possibly classified as "environment", we see it as "failure" or the result of the domestic political and economic institutions' response to the changing environment. The economic situation arises from the interaction of the actors within the domestic political economy. If one adopts a position that the economic situation is beyond the control of the actors (including of the government), then, the economic situation may be the "environment".[3] On the other hand, if the government and other economic actors have the tools to impact the economic situation, then it may be seen more as "failure".

The Japanese experience suggests that the actors have the impact on the economic situation: at least, this is what is part of the actors' collective beliefs about "how the world works". For example, take the economic stagnation of the 1990s and the government policy in response. To respond to the collapse of the bubble, the government increased its fiscal spending through various economic packages. In 1995 and 1996, the economy picked up growth. The government's fiscal policy may or may not have been effective in materializing economic growth, objectively speaking. Even if the objective reality should be that the government does not have much impact on economic growth due to such causes as the "rational expectations" of the nation, this "fact" is far from being shared by the actors as part of their beliefs on "how the world works". In short, if the economic stagnation persists, it is perceived as "failure" by the actors: it does not matter whether the government truly has the ability to bring the economy out of the stagnation or not. Thus, below, we adopt the view that the "economic situation" is a function of the response by the domestic political and economic institutions rather than the environment beyond the actors' control.

The economic situation can be expected to influence the actors' views on "how the world works". When the economy is booming, it is unlikely that the actors doubt whether their strategies are the best ones. On the other hand, when the economy is in stagnation, the actors may be led to doubt the worth of the prevailing institution; when the economy is in a slump, a collective awareness that "there is something wrong" in the prevailing institutions is likely to emerge; this would eventually culminate in a perception crisis (Aoki) if the economic situation turns from stagnation to crisis (e.g. depression).

The second possible "failure" in financial politics may be the performance of the financial system. As in economic performance, if the financial system is working as expected, with banks booming with record profits (e.g. Japan in the 1980s), little "failures" that drive institutional change can be expected to be observed: if scandals regarding the financial system occur, they are likely to be dismissed as exceptions. However, as the financial institutions have financial troubles due to mismanagement and/or bad loans, the financial system becomes unstable with the emergence of some troubled financial institutions. As some major financial institutions (e.g. Continental Illinois in the U.S. Savings Loan Crisis; the twenty "money-center" banks which the Minister of Finance professed were "too big to fail") fall, the financial system reaches a crisis, in which a meltdown of the financial system is feared. At its extreme, such meltdown may materialize in the form of a massive bank run and/or a bank moratorium (e.g. the "bank holiday" in the United States in the 1930s; the Japanese financial panic of 1927).[4] As the financial system worsens in terms of performance, we may see a rise in scandals, the other component of "failures": as things break down, more and more scandals are likely to be uncovered in the financial sector. Unlawful conduct such as embezzlement and corruption, unethical conduct such as deals with conflict of interests, and mismanagement due to false diagnosis of the situation (e.g. past optimism) may be some examples of financial scandals that may be revealed in such instances. Combined with "performance failures", "scandals", if recurrent, provide the symbol (or "focal point") for those doubting the worth of the prevailing institution: the notion that "there is something wrong" in the institution rises.

3) Change in Institutional Environment

The change of government in 1993 may be the most important institutional change in the institutional environment of the financial politics of 1990s Japan. Why such a change of government happened at all is beyond the scope of our analysis. However, we may speculate that the above notion of "failures" can be expanded to make sense of this event to a certain extent. The change of government came out of the strategic interaction of lawmakers, who sought to respond to the growing sense among the populace that "there is something wrong in politics" (or "First-rate economics, third-rate politics"), as a result of recurrent political scandals (e.g. Recruit and Tokyo Sagawa Kyubin), political inability to deal with important issues (e.g. how to "contribute" to the Gulf War; electoral reforms), and environmental changes (e.g. the end of the Cold War).[5]

This institutional change of "change of government" is an important causal factor in our story of financial politics. "Change of government" after thirty-eight years of continued rule makes the political actors aware that such change is a possible scenario. Under the stable LDP rule, this was a distant scenario in the actors' mind, as can be seen by such common expressions used by government officials as *tou* (the party), implicitly assuming that there is only one ruling party, the LDP.[6] The actual change of power has had a strong impact on the lawmakers: the lawmakers realized that the threat of electoral replacement at the party level (as opposed to the individual level) was real. One of the most important strengths of the LDP was that it had dominant access to government resources (e.g. public works and regulatory policy). Its power was guaranteed by the decision making process that made sure that any policy proposal or legislation proposed by the government would pass its internal policy making body, the PARC: this was an "equilibrium" in our usage, as the process was sustained based upon a set of common expectations rather than a legal code on policy making process. However, being thrown out of power made this channel ineffective, and the LDP lawmakers suddenly faced the loss of influence over the government agencies, to which the new non-LDP coalition made sure that they sever ties with the LDP. When the LDP came back to power, its top priority was to stay in power at all costs. Thus, the LDP was quick to "incorporate" (or "fully swallow") its rivals' programs through compromise or imitation, earning itself a label as a "mollusk", as we saw in the previous chapters.

The change of government not only made the LDP sensitive to the increased threat of replacement but also changed the actors' collective expectations about "how politics works". If ruling parties are expected to change over time, then, the policy making process cannot be left unaffected. The stable "bureaupluralism" as an institution that arose out of the bargaining involving the LDP, the bureaucracy, and the industries has to change in various ways. First, the policy making process has to involve other parties' policy making bodies. Since 1993, coalition government has been the norm: the decision-making process involves the negotiation of the ruling parties. Second, now the political actors have to take into account the various possibilities that arise from the re-alignment of party coalition. As today's opposition may be tomorrow's ruling party, the opposition's political influence increases: the bureaucracy or the industries now have to pay more attention to the opposition than in the past. Third, as the change of government becomes a possibility, the political parties become more sensitive in gaining the general public support, especially in the case of the LDP. If the change of government is only a distant threat, the LDP may concentrate its efforts in cultivating the support from its constituents (e.g. interest groups and industries). However, if the change of rule becomes a believable possibility, the LDP has to be more sensitive to "public support" than it was in the past, in which the LDP could pursue a wildly unpopular policy (e.g. the Consumption Tax) without much fear of electoral replacement, being the only "alternative", or pro-business catch-all party (in the

Cold War context). This may be even truer under the electoral reforms of 1994, introducing the single-member district and partial proportional representation. It is not that political parties now take their support groups (i.e. interest groups) lightly: especially, under the new electoral rules (with single-member districts), the support from such groups may be even more critical for individual lawmakers to be reelected. However, in the new electoral system, the party label may become all the more important, because of the single-member district (one party, one candidate) and because of the proportional representation in the Lower House (where the public votes for parties).[7] Thus, in cases in which the political parties have to choose between the "constituencies" and the "public", they have increased incentives for choosing the latter.

In this sense, one important effect of this change in the institutional environment, or "change of government", is that it made the actors aware that they are operating under a higher-level institution, "liberal democracy": the public matters. It was not that the public did not matter in the pre-1993 politics; however, actors are increasingly aware that the public is the ultimate decision-maker in a liberal democracy, due to the expanded scope of possible scenarios of politics shared among themselves. Thus, we may characterize this development as a process in which the higher-level institution of "liberal democracy", in which all interactions have been taking place before and after 1993, came to be increasingly incorporated in the actors' calculations over strategic choices as a result of the change of government. (Theoretically speaking, we may refer to this process as the shift of "liberal democracy" from "institutional environment", perceived to be beyond control and outside strategic calculation, to an "institution" for the actors.[8])

4) Public Interest and Public Support

Thus, with the change of government, the public matters more in politics. In the earlier chapters, we saw that the role of the public in financial politics drastically increased through the rise of alternative public policy making channels. The presence of "failures" made the public more aware and focused on the issue of finance and the actors involved (i.e. the LDP, MOF, and the financial industries). The political parties, the bureaucratic agencies, and the regulated industries saw their behavior more heavily constrained by the public acting as a parameter. With the help of our framework of "institutional change" focusing on the feedback mechanism between the objective reality and the subjective perceptions about it, we may be able to understand better how the public operates as a parameter of political behavior of actors.

"Public interest" is the objective criterion regarding the (economic or social) welfare of the general public or the consumers: it is a function of "what objectively increases the welfare of the public". However, because of the imperfect rationality of the actors, including the public, what matters more in politics may be "public support", which is a function of "what the public perceives as good to the public". "Public support" needs the reality check of "public interest" theoretically: thus, for example, populist appeals without material results are bound to fail, in the long run, to maintain the level of support it initially commands. However, whether such a feedback really materializes is questionable: political actors as well as the public may not have a memory long enough to assess a policy decision made, say, five years earlier. (For example, would the public reward or punish the LDP in 2001 for its 1996 decision to initiate administrative reforms?)

Thus, for our purpose, what drives the political calculations of actors is "public support" rather than "public interest". In Chapter 6, how "administrative reforms" work to the benefit of the "public interest" was unclear: however, as long as the policy was likely to generate "public support", the political parties adopted it anyway. In the future, it may be shown that administrative reforms have little effect on the nation's well-being: then, this agenda might lose its appeal to the populace. However, this agenda was at the center of the political debate in 1996, because of "failures" by the bureaucracy: whether it provided the "objective" way to get out of the performance failures (economic stagnation of the early 1990s) of the national economy was beside the point. It may be possible that the reality check of "public interest" prevails some day: however, it is the politics of "public support" that drives the strategic interaction of actors, the focus of our analysis.

5) Causal Mechanism of Change

What do we obtain? We may be able to situate our account of financial politics in the larger picture in the following manner. Changes in the environment take place. Technological innovation in finance, international integration in the capital markets, and demographic maturity make financial reforms for increasing efficiency an inevitability. However, the domestic political and economic institutions are slow to respond: "failures" take place in the economy as well as in the financial world in the form of "economic stagnation" of the early 1990s and "financial instability" since 1995, and the accompanying recurrent scandals in the financial sector.

An important change in the institutional environment occurs: the change of government of 1993, probably a response to "failures" in politics of the late 1980s with similar dynamics: now the public matters more in politics, as the higher-level institution of "liberal democracy" increases its presence in political calculations. This triggers a decay (or, a situation in which actors start to doubt the effectiveness of the institution) in bureaupluralism in public policy making: it now has to incorporate the non-LDP parties in the coalition or in the opposition as well as the "public" (as opposed to "constituencies"). The above "failures" — performance failures and scandals— in economics and finance undermine, in particular, the "institution" of bureaupluralism in finance and economics under the jurisdiction of MOF. Bureaupluralism in finance (which is part of bureaupluralism in public policy making) starts to crumble: MOF starts to lose its standing as the "organizer" of financial policy making. Institutional change in finance thus materializes; bureaupluralism in general is affected by the decay in bureaupluralism in finance, its component.

Recall that we identified "the change of government in 1993" and "performance failures and scandals" as two causal factors that drove the changes observed in financial politics in the previous chapter. We may be able to reinterpret the process of how changes are brought about in financial politics as follows. Environmental changes (technological innovation, internationalization of capital, and demographic maturity) and the slower institutional response give rise to "failures" in finance and economics. The change in institutional environment, or "the change of government", triggers a "decay in bureaupluralism in public policy making". "Decay in bureaupluralism in public policy making" and "failures in finance and economics" translate to "decay in bureaupluralism in financial policy making", an important component of the Convoy, and thus triggers the institutional change in finance and affects bureaupluralism in public policy making in general.

We now have the prototype of causal mechanism of how changes in public policy making and finance materialize. We have yet to specify what can be the institutional changes in public policy making and finance, what components of the system shifted so as to change the collective expectations about "how the world works", and to what extent "institutional change" has materialized in the two fields. We shall turn back to these points after we identify how the Big Bang is related to other changes in finance in the next section.

8.4 Applying Our Theoretical Framework (2): Relating the Big Bang to Changes in Finance

We now turn to the task of situating the Big Bang within the changes in finance. We may break down the changes in finance along four levels, with the various definitions of "institution" in mind.

a) Players (actors involved in financial politics)
b) Formal rules (formal regulatory rules)
c) Interaction patterns (between the government and private sector; private sector practice in finance)
d) Shared expectations (about politics and about finance)

Figure 8.1 summarizes the changes in finance: the Big Bang can be characterized as the changes at level b), as it alters the formal regulatory rules. How each feature of the Convoy relates to each other is shown in Chapter 3.[9] It does not take much to see that the players of financial politics, the formal regulatory rules, and the interaction pattern between the government and the private sector (policy making process, policy tools, and policy substance) were intertwined with one another, reinforcing the stable reproduction of one another. The private sector practice in finance — such as the main bank system and the *keiretsu* system — complemented such arrangements within financial administration.[10] The shared expectations "about how the world of finance works", the core of the Convoy as an institution, both resulted from and reproduced, the stable practice at the levels of players, formal rules, and interaction patterns. Below, we focus on how the changes that materialized in finance can be dissected at each level of the institution. It will be shown that once a change takes place in one component of the institution, it triggers changes in other related components of the institution.

Fig. 8.1
Big Bang as Part of a Larger "Institutional Change":
Breakdown of the Convoy System in Finance

Stability & Cooperation **Convoy System**	*Organizing Principles* →	*Transparency & Competition* **New Institution**
	a) Players	
MOF	1. regulatory agency	FSA/FRC [FA] & MOF
{LDP; MOF; the domestic financial industries}	2. relevant players	addition of {non-LDP; non-MOF; "outsiders"}
	b) Formal Rules	
segmentation entry control product control	3. formal regulatory rules (= The Big Bang)	deregulation/liberalization transparency/fairness
	c) Interaction Patterns	
industrial association of domestic financial actors informal "hearing" wining and dining *amakudari* MOF Councils/LDP PARC	4. between the government and the private sector (policy making process)	addition of "outsiders" formal "hearing" formal conference lawyers/accountants hired rise of alternatives (MOF WT/LDP ARPH...)
preventive/*ex ante* discretionary/*ad hoc* administrative guidance licensing/authorization informal admonition	(policy tools)	*ex post* legalistic/rule-based administrative order legal sanctions early warning
regulated competition without exit or entry *hokacho* (lifeboat) too big to fail implicit state guarantee	(policy substance)	enhanced competition with exit or entry bridge banks/nationalization bank shutdown payoffs starting in 2001 (2002)
rescue by main banks long-term relational financing cross-shareholding financial *keiretsu* bank dominance	5. private sector practice in finance	legal recourse/bankruptcy short-term (profit/capital) alliances (inter-*keiretsu*/international) shift to direct finance
	d) Shared Expectations	
LDP continued rule MOF as "organizer"	6. about politics (institutional environment)	coalition /change of rule MOF breakup
myth of no failure implicit state guarantee symbiosis with no losers no entry/exit: "collusive" consensus making stability/cooperation	7. about finance (institution)	can fail no more (payoffs) survival race with losers entry/exit: "anonymous" public support transparency/competition

1) Change in Each Level of the Institution

Let us recall how changes in finance are understood in our theoretical framework. "The change of government in 1993" affected "bureaupluralism in public policy making"; this and "failures in finance and economics" brought about "change in bureaupluralism in finance", which was an important part of the Convoy in finance. Below, we will see how such changes appeared at each level of "institutions".

a) Players

An increase in players took place in finance (1 and 2[11]). Due to the breakup of MOF in 1998-99 (a direct result of "failures"), the regulatory agency became from {MOF} to {MOF; FSA; FRC}. Starting from January 2001, the Financial Agency (FA) will integrate the FSA and the FRC, completing the separation of financial powers from MOF.[12] Moreover, the relevant players in financial politics under the Convoy were [LDP; MOF; the domestic financial industries}. However, with "the change of government in 1993", the non-LDP parties in the ruling coalition are now part of policy making, as are the opposition parties, attested by the Financial Diet of the fall of 1998 (see Chapter 7). The newly created financial agencies are now the main actors of financial administration, putting MOF on the sidelines. In the private sector, financial politics now also involves the "outsiders" in finance, such as the new entrants (e.g. foreign financial firms and domestic entrants in the market), the corporate users of financial services, and the consumers, as shown by the Big Bang experience.

b) Formal Rules

The Big Bang policy package is essentially the reforms of formal regulatory rules (3). As shown in Chapter 4, the important formal rules that supported the Convoy — segmentation of finance, entry control, and product control — are now abolished by the

Big Bang package, which includes deregulation and liberalization measures as well as addresses transparency and fairness concerns.

c) Interaction Patterns

Regarding the interaction between the government and the private sector, the prevailing practice in financial regulation under the Convoy — the informal interaction in the policy making process, and the financial regulatory policy based on *ex ante* regulation— shifted towards a more formal, rule-based system with emphasis on *ex post* regulation (4). This can be broken down into three parts: policy making process, policy tools, and policy substance.

First, regarding the policy making process, the industrial associations of the domestic financial industries used to be the dominant channel of interaction between the government and the industries, as in other sectors.[13] The means of exchange of information was heavily based on informal "hearing", often through the practice of wining and dining of officials. The relationship between the government and the industries was further secured through *amakudari*, or the practice of the industries hiring retired officials.[14] Now that such "outsiders" as foreign financial firms, new entrants, and corporate users are brought into financial politics, the exclusive position in policy making enjoyed by the industrial associations of domestic financial firms has to decline. With the "failures" — the scandals in particular —, we see a departure from informal means of information exchange: the bureaucrats now engage in formal "hearing" and formal conference, as the wining and dining practice is dying away due to public criticism and the resulting tight restriction. *Amakudari* is also under heavy public criticism with the scandals involving MOF and its retired officials: as of late, MOF has had increasing trouble in placing its retired officials within and outside government. In response to the criticism that financial administration lacked expertise (and thus resulted in such scandals as the Daiwa Bank Scandal of 1995), the FSA has been recruiting lawyers and accountants, notwithstanding the prevailing practice of in-house breeding of experts under the lifetime employment system. Finally, the policy making process under the Convoy was centered around the MOF deliberative councils and the LDP PARC: while no laws forced any proposals to go through this process, almost all legislation regarding finance did. The industries had their guaranteed entry points, as deliberative councils would have heavy representation of their views and the "tribesmen" in the LDP under their influence would intervene on their behalf at the PARC. However, as we saw in the previous chapters, we are seeing a steady rise in alternative policy making mechanisms: MOF's WT, the LDP ARPH, and the ruling coalition's PT may be some examples that make the policy making process more complex and thus open to actors other than the domestic financial industries.

Second, regarding the policy tools utilized by the government, discretionary regulation was what characterized financial administration. MOF regulated the financial industries on an *ad hoc* basis, with the use of administrative discretion over regulatory power (e.g. branch licensing; product authorization): such regulatory power enabled the use of administrative guidance, or informal "guidance" over corporate behavior without specific legal grounds. However, the system has shifted towards a legalistic (rule-based) regulation. In 1993, the Administrative Procedure Law curtailed the procedural discretion commanded by the government concerning regulation: for example, it codified the practice of administrative guidance and increased the transparency of the process in which regulatory power is exercised. In the old days, troubles (e.g. mismanagement and scandals) would often be dealt with in secrecy between the regulators and the regulated: MOF would place informal sanctions (e.g. forced retirement of the management) through administrative guidance. Since the Daiwa Bank Scandal of 1995, MOF and the financial agencies have been issuing administrative orders (e.g. submission of reform plans; temporary shutdown of operations): while the regulatory laws have always contained such measures, that such measures have been activated is a very recent phenomenon. In sum, the old system sought to take a preventive approach, in which troubles were to be prevented *ex ante* by the *ad hoc*, discretionary intervention of the regulator using such informal means as administrative guidance. The new system is, on the whole, a shift towards *ex post* regulation, in which the regulator intervenes after something happens in the financial industries through such rule-based, legalistic means as administrative orders. Even in instances where the new system keeps the preventive approach (e.g. the capital requirements on banks), its form is legalistic: informal admonition gives way to early warning activated automatically according to inspection results and pre-determined objective rules.

Third, regarding the substance of regulatory policy, we see a change in the forms of competition. In the old system, competition among firms were within the segmented sectors (e.g. among city banks, or between city banks and long-term credit banks) without entry or exit: the competitors were essentially the same. In the new system, the competition is enhanced by the Big Bang as well as other developments in finance (e.g. the financial crisis of 1997-98): entry and exit into the financial businesses abound. For example, consolidations among banking, securities, insurance, and trust businesses are taking place *en masse*, following the introduction of the cross-entry schemes by the Big Bang package. The failure of the two large long-term credit banks in 1998-99 (the LTCB and the NCB) led to the entry of foreign nonbank financial firms specializing in restructuring failed financial institutions and a Japanese software giant in the banking business (see Chapter 4).

Regarding troubled financial institutions, the policy was *"hokacho"* (the equivalent to the "lifeboat operation" utilized by the U.K. regulators in the 1970s), in which healthy banks and other financial institutions would be asked to contribute to the preservation of the "stability of the financial system". The "too big to fail" principle, or the proposition that some financial firms are too big to fail without causing a financial meltdown, applied as well.[15] For the operation of *"hokacho"*, the regulatory rent guaranteed to large financial firms under the old system was indispensable. However, with numerous failures during the 1990s, this mechanism eventually collapsed: the healthier firms became burdened by the recurrent requests for contribution, while they themselves were facing a financial slump due to the asset deflation and general economic slump.[16] The NCB's rescue in April 1997 may mark the last case in which the lifeboat operation was carried out. The collapse of Yamaichi Securities and Hokkaido Takushoku Bank in November 1997 as well as the collapse of the LTCB a year later showed that *"hokacho"* as well as "too big to fail" are no more the policies adopted by the financial regulators.[17] As a result, the implicit state guarantee of the past is gone, and the payoffs are to start from 2002.

We may now turn to the interaction among private sector actors in finance (5). First, the main bank system may be collapsing at various fronts. The rescue by main banks may increasingly be a less favored option for large banks which have to be concerned about survival under the increased competition and financial slump; combined with the abandon of informal regulation, exemplary cases of "main bank rescue" such as the rescue of Mazda coordinated by Sumitomo Bank (under the implicit request by MOF) in the 1970s are highly unlikely to be reproduced in the future.[18] Banks would increasingly resort to legal recourse, including bankruptcy proceedings. Second, relational financing, based on a relatively long-term horizon for banks in their reaping benefits for loans, may decrease in importance because of banks' increased short-term concerns for profitability and capital requirements, under the new environment of increased competition and regulation based on capital/asset ratio (as set forth by the Basle accords).

Third, the widespread cross-shareholding among large firms and the financial *keiretsu* system organized around the six major banks have been eroding. Firms are increasingly diminishing their cross-shareholding due to altered accounting standards (market-value-based standards); banks, under pressure for survival under the bad debt problem, have been increasingly forced to relinquish their holdings of shares once the stock price level rises. Likewise, the financial *keiretsu* system is eroding fast, especially now that inter-*keiretsu* alliances are quickly taking place. Sumitomo and Sakura as well as the DKB and Fuji, or four banks among the Big Six have announced their merger plans in 1999: this means that the Sumitomo, Mitsui, DKB, and Fuyo groups will be significantly affected.[19] Moreover, international alliances make the picture even more complex: for example, Nikko Securities chose Travelers Group (the later Citigroup) as its strategic partner, severing its traditional ties with the Bank of Tokyo-Mitsubishi of Mitsubishi Group. Fourth and last, as we saw in Chapter 4, the dominance of banking in finance has been steadily eroding as the shift to direct finance has been a continuing trend in Japanese finance. The Big Bang, by liberalizing and deregulating a variety of new products, is expected to accelerate this trend.

d) Shared Expectations

We now reach the core of the "institution" and "institutional change": the shared expectations among actors as to "how the world works". We see the shared expectations at two levels in finance: in politics (institutional environment) (6), and in finance (institution) (7). All the observable changes at the levels of players, formal rules, and interaction patterns generate, and are reinforced by, corresponding shared expectations. The sets of players increase, the formal regulatory rules are revised, and the patterns of interaction shift: altogether, the shared expectations in finance change.

In the institutional environment, as we saw earlier in this chapter, the LDP's continued rule has ceased to be a "given" due to the "change in government in 1993": this reality, combined with "failures" such as scandals since 1995, made MOF's "taken for granted" standing as the "organizer" of financial policy making questionable. Now, the era of coalition government has arrived, and the change of government is a feasible scenario. As we saw in the previous chapter, MOF has been stripped of its jurisdiction over finance, and the "organizer" of the financial policy making process has shifted away to non-MOF agencies and political parties (1 and 2).

In finance, "the myth of no failure" of financial firms and "the implicit state guarantee" give way to "financial firms can fail" and "no more state guarantee: payoffs"

(4). Such unwritten laws of the postwar era, reinforced by such incidents as Yamaichi Securities' rescue by a lifeboat operation in 1965, collapsed with the failure of such financial giants as Yamaichi Securities or Hokkaido Takushoku Bank and other banks in November 1997. As Aoki (forthcoming) suggests, this may have caused a perception crisis, convincing the actors that the "institution" in place has ceased to be an effective representation of "how the world works". Yet, this transition may not be complete: the payoffs would not start in 2001, as initially planned, but in 2002 due to concerns that the payoffs may result in financial instability: the national government may not have the correct notion on the financial situation of smaller financial institutions, whose inspection would be under the jurisdiction of local governments until 2001.

The "symbiosis with no losers" (*sumiwake*), an expectation *cum* normative value embraced by some leaders of "weak" financial institutions as we saw in Chapter 4, gives way to a "survival race with losers", as regulated competition within segmented sectors now gives way to enhanced competition with entry and exit, with the Big Bang regulatory reforms enhancing competition (3 and 4). This affects the policy making process in financial politics. Finance was once a field in which the same "insiders" interacted with one another: it was a "collusive" system, to refer to the typology of the interaction between the government and the private sector developed by Aoki (forthcoming).[20] However, with the inclusion of new entrants, financial politics becomes closer to "anonymous markets"(Aoki) in which the government deals with private sector actors without distinguishing financial firm A from B.

The increase of players in finance — the new entrants as well as the "public" in financial politics — alters the pattern of interaction between the government and private sector (4). In a collusive system where all the actors are fixed over time, an informal pattern of interaction, based on a set of implicit understandings between actors supported by long-term relationship (or repeated interaction), may reduce transaction costs by allowing flexible adjustment for future contingencies that cannot be explicitly specified beforehand.

However, as the actors in the private sector come and go, the "implicit understanding" inherent in informal transaction face more challenges from the "outsiders". The interaction pattern becomes more formal, codified to provide for the market becoming more "anonymous", which entails increased demands for transparency and public accountability.[21] For example, MOF has been repeatedly stressing its efforts to depart from the "old type of financial administration" since 1995. *Tsutatsu*, once notorious for its *de facto* binding power on the regulated, has been drastically reduced in number and either formalized into administrative legislation for regulation that needs to remain binding, or downgraded into "guidelines" that only affect the regulators.[22]

Thus, the nature of public policy making in finance changes accordingly. The old system used to center around consensus building. In the words of one MOF retired official, financial administration was carried out so that "no one drowns": it was a system of "symbiosis". However, in his view, the new environment that surrounds Japan makes it inevitable to take away the "right to survive" for some firms. Administration and deliberative councils, or "coordination by reason and consensus", may have to give way to "bloodshed and violence", which the market or political decisions will wield to materialize effective reforms. (Nishimura 1999, 170).

Indeed, the new way of public policy making has less emphasis on consensus building. Based on our analysis in the previous chapters, we characterize the emerging public policy making as one in which "public support" determines the outcome. Whoever succeeds in gaining "public support" has the upper hand: whether this means the enhancement of "public interest" is another issue. (See Chapter 9.)

What does all of the above add up to? We observe a shift in the "organizing principles" (or, the fundamental principles recognized by all actors as objective characteristics as well as normative values of the institution) of the institution. Under the Convoy, the organizing principles were "cooperation and stability". This was not peculiar to the financial sector: cooperation between the private sector actors and the government through the mechanism of bureaupluralism was once characterized as one of the strengths of the Japanese state.[23] Financial stability, or the stability of the financial order, was the goal of financial administration as well as of the financial industries, organized into industrial associations along the lines of segmentation.

Now, "competition and transparency" is the organizing principle of the emerging new institution. Enhanced competition jeopardizes the "stability" of the financial industries by the increasing prospect of forced exit. The increased threat to organizational survival as well as the addition of new entrants in the market also lessens the cooperation among financial actors through the industrial associations in preserving the financial "order". The demands for competition and transparency, through the legalistic procedural arrangements, make the relationship between the government and financial actors adversarial rather than cooperative.

2) Big Bang and the Other Changes

Let us sum up below how the Big Bang has triggered other changes in finance, and vice versa. The Big Bang, or the change in formal regulatory rules, brings down the financial segmentation and liberalizes entry and products. As a result, the relevant players in the financial market increase (2). The "failures" in finance since the mid-1990s led the shift within finance towards *ex post*, legalistic regulation from preventive, informal regulation: the increase of players in finance brought about by the Big Bang reinforces this trend, as the policy making process (or the pattern of interaction between the government and the private sector) is expected to shift from "collusive" to "anonymous" accordingly (4). Because the Big Bang increases competition within the financial sector, financial firms face increased pressure for securing profit in order to survive: this makes such policies as *hokacho* as well as such private sector practice as the rescue by the main banks, relational financing, and cross-shareholding increasingly unsustainable (5). The Big Bang thus affects the shared expectations of the actors as they increasingly realize that "survival race with losers" is a more accurate picture of "how the financial world works" and that "transparency and competition" are now the organizing principles rather than "stability and cooperation" (7).

On the other hand, our analysis of the political process of the Big Bang in the earlier chapters suggest that the Big Bang was a product of, and reinforced by, the other related developments in finance. The change of regulatory agency, or the breakup of MOF due to "failures", was shown to have had an important effect on the Big Bang (1). Likewise, the "failures" brought about the rise of alternatives in the policy making process and the shift towards an *ex post* legalistic approach (4), reinforcing the changes brought about by the Big Bang. Similarly, the ongoing decline of the dominance of the banking sector in finance (5) was also an important supporting development in the Big Bang, which diversifies the channels of financing for the users of financial services. The "change of government in 1993" and the breakdown of the shared expectations about the LDP's continued rule as well as the challenge to MOF as the "organizer" of financial politics (6) were also material in leading MOF and the LDP to launch the Big Bang financial reforms. Clearly, the increasing demands for "transparency/ competition" in the face of financial failures and scandals were reinforcing the ongoing process since 1996 in which the Big Bang package has been conceived and carried out (7).

8.5 Institutional Change in Finance: The Breakdown of the Financial Convoy

The shift in the shared expectations as well as the players, the rules, and the interaction patterns, described above, seem to sufficiently support our case: the Financial Convoy has broken down, and a new institution has been on the rise since 1995. In this sense, while the various components of the Financial Convoy were reinforcing one another, once the environment changed, or "failures in finance and economics" and the "change of government in 1993" materialized, many components within finance began to shift, from an institution of "stability and cooperation" into one of "transparency and competition". The Big Bang, being a program launched by a political leader, may have provided a focal point for those "reformers": in any case, it was produced by, and is producing, various related changes in finance.

The fact that institutional change, in terms of "the shift in critical mass of the actors' collective beliefs", in finance has been achieved is further confirmed by an incident in February 2000. The Cabinet Minister for the FRC was forced to resign, because he made comments suggesting to heads of small financial institutions that he might be able to somehow influence the inspection results and the ensuing rule-based decisions on early warning and shutdown of operations. That he was promptly dismissed by Prime Minister Obuchi without much political opposition from within the ruling LDP shows that the collective beliefs of actors in finance have entirely abandoned the Convoy. A consensus seemed to have obtained across the ruling parties and the opposition as well as among the media that the Minister's comments were unacceptable as they were interpreted to suggest a return to the Convoy: this fits the definition of "institutional change" as a shift in collective beliefs about "how the world works".[24]

We may identify some critical moments in the breakdown of the Convoy system. Guided by our theoretical framework that emphasizes the "shared expectations" in the institution, we refer below to some events that may have marked the change in the shared expectations of actors in this process.

As the start of the process of institutional change, we may point to 1991, when the Loss Compensation Scandal took place regarding the regulation of the securities industry (Chapter 6). This may have been the start of the "decay" of the institution, where actors began to doubt the worth of the "institution". One event in the process may be of particular interest: Nomura Securities Chairman testified at a Diet hearing that MOF had given permission for the loss compensation. By revealing the truth, he chose to jeopardize his company's relationship with MOF, the regulator. (Nihon Keizai Shimbun 1992, 29) This may be, according to a retired BOJ official, the first time that financial firms dared to confront the regulator, upsetting the prevailing "order" or the relationship between the government and the regulated.[25] If so, this event may have marked the beginning of the process in which MOF's competence as the "organizer" of financial policy making has become increasingly questioned.

The next juncture may be the end of the LDP's thirty-eight year rule in 1993. As mentioned earlier, this ushered in the era of coalition government as well as the notion that "governments change" among the actors: it was shown that the LDP PARC with its "tribesmen" may not be the only policy making process. Then, in 1995-96, MOF suffered from a series of "failures" (Daiwa Bank, Housing Loan, and Wining and Dining). As a result, the political process eventually led to the discussion of MOF breakup, and MOF lost its standing as the "organizer" of bureaupluralism, as it lost the public trust regarding both its competence and ethics. MOF was no more the legitimate actor in charge of financial policy making in the actors' eyes.

Finally, the financial crisis materializes in fall 1997: some mega banks and securities houses collapse, dealing a final blow to the effectiveness of the "institution" (the Convoy) as a summary representation of the objective reality. Now, the expectations or the "myth of no failure" and the "implicit state guarantee" are irrevocably defied by the events in the real world. As for *hokacho,* its end was clear in the crisis of October 1998, in which the LTCB was nationalized. As in above, the prompt firing of the FRC Minister who suggested a return to the old system in February 2000 confirms that the institutional change has indeed materialized.

8.6 Institutional Change in Public Policy Making: The Decay of Bureaupluralism

We turn to the other institutional change that we can identify from our story of financial politics: the decay of bureaupluralism in public policy making. The policy making process in financial politics is part of bureaupluralism in the political economy in general: obviously, what happens in finance cannot but affect the whole mechanism, but whether finance may be appropriately seen to represent the change taking place in the whole mechanism may be another issue. In this section, we first recall how much change has materialized in bureaupluralism in finance. Then, we turn to a more general argument, offering a prediction.[26]

How much change can we see in the policy making process? It is not that the policy making process of bureaupluralism has been entirely displaced even in the world of finance, as shown earlier. While the Big Bang policy package came out before, rather than, after, the discussion at MOF's deliberative councils, it still had to go through these councils; the policy package was then referred to the LDP PARC before submission to the Diet, as in the past. What changed is the fact that these bodies lost their "monopolies" in the policy making process as actors found ways to "go around" such processes, in which the industries' influence were expected to be dominant. Moreover, although MOF lost its monopoly as the "organizer", it still organizes the deliberative councils such as the Financial System Council until 2001: the measures regarding the follow-up of the Big Bang or the strengthening of the financial system is being produced by this Council as of 2000. The same can be said about the continuing influence of the LDP PARC, as can be seen in the decision to postpone the start of the payoffs from 2001 to 2002.[27]

Thus, bureaupluralism in finance is not dead: it is in decay. Referring to our frameworks of institutional change and organizational survival (Chapter 3), we may interpret the process of "rise of alternative policy making mechanisms" as decentralized experiments in which actors engage when "a split appears" among the "entrenched actors": the "reformers" who were the minority among their organization (the LDP and MOF) have found ways to "go around" the policy making mechanism of bureaupluralism, by making use of the crisis situation in finance since 1995 (i.e. MOF scandals, Housing Loan, MOF breakup, the financial crisis of November 1997, and the financial crisis of October 1998). Such decentralized experiments may have corresponded to the centralized efforts to reform the public policy making system which appeared in the forms of calls for administrative reforms and for political leadership over the bureaucracy. In either case, that "something is not right" about the policy making mechanism of bureaupluralism, which has a distinct feature in aggregating interests, seems to have achieved a near consensus status among the actors: a "decay" has materialized in bureaupluralism. This trend is not limited to finance, and applies across policy areas.

Thus, we may be seeing a start of institutional change, or a "decay", in public policy making. Our theoretical framework suggests that this trend is likely to continue: the shared expectations of "continuity", including "informal interaction", "same actors", "repeated interaction with similar results", that sustained bureaupluralism, cannot be stably reproduced in the post-1995 world, in which the "change of government" as well as deregulation and administrative reforms have been introduced. The "change of government" provides an alternative scenario to "continued LDP rule" to actors, affecting their steady relationship of interdependence (as seen in Chapter 3): obviously, the exchange of votes and money for access to governmental power cannot go on to take place between the LDP and the industries as it once used to, and the policy making through the LDP PARC does not function if the LDP is not in power. With deregulation and administrative reforms, the following changes can be expected to be seen at the levels of "players", "formal rules", and "interaction patterns": the sets of actors have increased by the very practice of "going around" and now are not stable over time through increased entry and exit in the market; the formal rules have changed through deregulation in general and the administrative reforms shaking up the central bureaucracy since 1996; the informal interaction patterns, including such means as "wining and dining" and "administrative guidance", cannot prevail without the existence of the shared expectations of "continuity" (e.g. "same actors", "repeated interaction with similar results"), not to mention the fact that such informal means are now increasingly out of favor because of public criticism, which has gathered steam during the decade.

How much confidence can we have of this theoretical prediction of ours in face of the reality? Whether this trend leads to an entirely new institution, as in finance, is unclear as of writing (May 2000). As our theoretical framework suggests, there is always a possibility at any stage of the process of change that things revert back to normal, confirming the resilience of the institution: it may be that the shared expectations of "continuity" will somehow be re-instated by developments in the objective world. Indeed, bureaupluralism has shown such resilience in the past: such attempts (often frustrated) to reform the public administration as the one under Prime Minister Nakasone of the 1980s attest to this observation.[28]

Nevertheless, we may offer some clues as to which scenario is likely to materialize, based on our theoretical framework. It depends on the following two factors:

1) Whether such experiments of "going around" the established policy making mechanism take roots; and

2) Whether the conditions ("failures"/ "change in institutional environment") that make "public support" an important concern for political parties, bureaucratic agencies, and firms continue to hold.

1) Will Such Experiments ("Going Around") Take Roots?

In our framework of institutional change, actors with alternative strategies increase as such strategies are rewarded by the objective reality. So far, things look at best uncertain for those minority "reformers" who brought about the reforms in the finance: it is unclear whether they have been rewarded for such strategies. The LDP "mavericks" who brought about the MOF reforms and other changes (as in the Financial Diet of fall 1998) are now off the center of the political stage: compared to 1996-98, it is rare as of writing (May 2000), that such names as Shiozaki and Ishihara appear in the newspaper headlines (with the exception of Yanagisawa, who headed the FRC in 1998-99). The LDP mavericks and the Democratic Party failed to take credit for the Financial Diet of the fall of 1998.[29] As for

Prime Minister Hashimoto, he had to resign from office in July 1998 after a humiliating electoral defeat: he can hardly be said to have been rewarded for his reform agenda.[30] Among the MOF "mavericks", some may have obtained credit, while others had to resign due to their involvement in the wining and dining scandals.

However, looking beyond financial politics into other policy areas, there are ongoing decentralized experiments challenging the policy making process of bureaupluralism. Let us note two examples below at the level of local governments influencing the national politics of bureaupluralism.

First, there has been a rise of direct referendum at the local government level on such various issues as nuclear power plant construction, waste disposal facilities construction, and U.S. military bases in Okinawa: this is a new development beginning in 1996.[31] Referendum does not have any basis under the current legal order and thus does not have any legal effect. Nevertheless, it allows the expression of the public's views on an issue, heavily constraining the decisions of political actors, especially the local politicians from the same electorate. In one such instance, there was a referendum in January 2000 against a public works project in the Tokushima prefecture: in the first such attempt, the voters of Tokushima city (the capital and largest city of the prefecture) overwhelmingly cast opposition votes to the project. The Ministry of Construction (MOC), with the request of the heads of thirty-two local governments affected, was planning to move forward with the project: however, now that the voters of Tokushima city have cast a "no", its mayor has switched sides and announced his opposition to the project. This presents a challenge to the way bureaupluralism in public works operates: a project typically originates from the request of the local governments (executives and legislatures), is supported by the construction industries and the LDP, and is processed by the MOC. A project which started with the request by democratically elected local governments is now facing public criticism as its worth came to be questioned. With the success of Tokushima, this kind of effort to "go around" the process of bureaupluralism through referendum may be expected to be emulated elsewhere.[32]

Second, there was a successful attempt (from February 2000 on) to introduce a special tax on banking industries by the local government of Tokyo, which was fiscally impoverished due to the decrease in tax revenue caused by the economic slump. Its governor, Shintaro Ishihara, elected by a landslide victory over candidates from the LDP and the Democratic Party, announced that Tokyo would start taxing large banks which were paying a much smaller amount of local tax than they used to, due to the necessity to spend their pre-tax profits on the write-offs of their bad debts amassed through the bubble years: Tokyo would adopt a new criterion that taxes pre-tax profits. Ishihara's attempt is another effort to "go around" the decision making process of taxation policy in bureaupluralism, that is centered around the Tax Commission (a deliberative council) in the government and the LDP Tax Research Council.

Naturally, the banking industry was vehemently opposed. Although it was technically legal under national law, the national government was opposed, too. This may create an inequality among local governments, according to the Ministry of Home Affairs in charge of local governments; according to MOF and the FRC, it conflicted with the national policy to revitalize the damaged financial system. Lacking compulsory measures to override Ishihara's decisions, the national government expressed "concerns" and unsuccessfully tried to convince him to reconsider his plan. Ishihara's strength lay in his large popularity, as shown in his recent landslide victory. The banking sector has been, as in our analysis, the "public enemy". Thus, the public supported Ishihara's plan: according to an opinion survey by a newspaper, 59% supported the plan as opposed to 15% of those against. The major parties (the LDP, the Democrats, the Komeito, and the Communists) in the Tokyo legislature, no doubt in consideration of the above factors, expressed their support, and thus the plan was adopted by an overwhelming majority.[33]

Some of these experiments "to go around" may succeed and be emulated, and others may fail.[34] The interesting thing about them is that they point to the increased importance of the public as a determinant of political outcomes as suggested in our account of financial politics. Those who seek to materialize policy outcomes that are sure to be opposed by the "constituencies" (e.g. financial industries in the Big Bang; construction industries and local politicians in the Tokushima case; the banks in the Ishihara case), would challenge the policy by "going around" the policy making process of bureaupluralism (e.g. government councils, the LDP PARC, and local governments), dominated by the "constituencies". Again, we see that "public support", not "public interest", is key to political decisions. Whether the construction of a river barrier would be better for the nation is unclear, as it may prevent flood or it may turn out to be a waste of public money. Likewise, whether the special tax on banks increases the public's welfare is far from being clear: even if the calculation of Ishihara is correct that Tokyo would be able to raise a certain amount of revenue, with its impact on other local governments and the financial system, there is no clear answer to this question. In these cases as well as in our account of financial politics, what matters is the fact that the public supports the outcome (e.g. no construction; tax on banks; reform agenda). Whether the reality check applies after a while is questionable: will the public check, some day, whether the interruption of the construction plan was truly wise, whether the taxation on banks was truly effective, or whether the reforms under Hashimoto government were truly enhancing the public interest? If not, then, we have to rely on "public support" as a determinant of political outcomes: not what is objectively in the interest of public, but what the public think it is, determine the political behavior of actors.

2) Will the Conditions for the Importance of the Public in Politics Continue to Hold?

This discussion of the role of the public leads us to our next criterion in predicting the fate of bureaupluralism. We saw that "failures" are important sources of institutional changes, as they lead the actors to question the worth of the prevailing institution that tells them which strategies to choose by showing "how the world works". We also saw in our account of financial politics that "failures" inflicted the loss of public support upon such actors as MOF and the LDP, driving them to lead the reforms. We also showed that such changes in institutional environment as the "change of government in 1993" were important in increasing the public's worth in politics.

In this regard, then, we may project that the public's new importance in determining political outcomes will continue to hold, if such conditions as "failures" or "change of government" will hold. As for the latter, we are quite confident that "change of government" will continue to be the shared expectations, especially after the electoral reforms of 1994 introducing the single-member district. As for the former, Japan is in the midst of plenty of "failures", and faces many potential "failures" in the future. For example, the fiscal crisis at both national and local governments is imminent as of writing (2000): this cannot leave issue-areas that are apparently insulated from institutional change such as public works, agriculture, and construction intact for ever. The retirement pension and the medical insurance systems are also in danger of collapse. The unemployment benefit system is also under pressure with the sharp rise in unemployment. The postal savings system seems intact: however, little is known about its objective fiscal health or whether it truly has a future as it is. Shifting our emphasis to long-term problems, demographic maturity leads to fiscal crisis at both national and local levels: by the year 2020, an entire overhaul of the systems of taxation and social security would be needed, probably entailing a drastic increase in the national tax burden, which remains low compared to international standards as of today. Thus, we know that all areas of public policy will face "judgment day" one way or another in twenty years' time.

Given the increasing pace of immutable environmental changes applying to all sectors (such as technological innovation, globalization, and demographic maturity as identified earlier), we cannot but expect a shift to a more "anonymous" system of public policy making in general, built upon the assumption that "actors change over time" (instead of the old institution which assumed the opposite, "actors remain the same ones"). In such a system, as in financial politics, "transparency and competition" will be expected to be more prized over "stability and cooperation". As one institution (such as finance) shifts, the other institutions are expected to be pressured towards a similar shift, as the demand of "transparency" is hardly resistible under the higher institution of "liberal democracy", whose stability seems beyond doubt for some time. Then, "transparency" will be key to institutional change in many sectors. We have yet to know how and where institutional change materializes in each sector and in the political economy in general: it may take "failures" such as "performance failures" and "scandals". However, with the ever-increasing demand for "transparency", it is not hard to imagine, in any given sector, for such "failures" to become apparent and provide the grounds for institutional change.

Thus, on both counts, we see evidence that shows the deepening of this trend: we are seeing the emergence of similar experiments as the ones we saw in financial politics, and the conditions that make "the public" important in politics seem to hold over time across issue-areas in the political economy. Thus, we may be confident in offering our prediction that the decay of bureaupluralism is an initial stage of institutional change toward an alternative policy making process: as the shared expectations of "continuity" collapse, bureaupluralism will increasingly erode over time.

8.7 Conclusion

In this chapter, we posed two sets of questions:

1) How can we situate the Big Bang within finance and the political economy in general? How can we link our story on domestic political economy with environmental changes (e.g. technological innovation and globalization)?

2) What causes changes in our story, and how do they happen?

In response, we applied our theoretical framework of institutional change, developed in Chapter 3, to the account of financial politics we offered in Part II. First, we located our analysis of financial politics in the larger picture. The gap between the faster environmental changes (technological innovation, internationalization of capital, and demographic maturity) and the slower institutional response give rise to "failures" in finance and economics. The change in institutional environment, or "the change of government", triggers a "decay in bureaupluralism in public policy making". "Decay in bureaupluralism in public policy making" and "failures in finance and economics" translate into "decay in bureaupluralism in financial policy making", an important component of the Convoy, and thus triggers the institutional change in finance and affects bureaupluralism in public policy making in general.

Second, we related the Big Bang to other changes in finance. We broke down the changes in finance along four levels with the possible ways of defining institutions in mind: players, formal rules, interaction patterns, and shared expectations. As all levels have shifted, including the Big Bang, or the changes in formal regulatory rules, we observe a shift in the organizing principles, the fundamental principles recognized by all actors as objective characteristics as well as normative values of the institution: from "cooperation and stability" to "competition and transparency". The Big Bang was triggering and triggered by, reinforcing and reinforced by, other shifts in the same direction, towards the breakdown of the Convoy System in finance.

As a result, we observe institutional change in finance and public policy making. First, in finance, the Convoy System, based on "cooperation and stability", has broken down, and a new institution, based on "competition and transparency", has been on the rise. This process may have started in 1991, when MOF's status as "organizer" first came under doubt, with such critical moments as the change of government in 1993 and the loss of MOF's standing in 1995-96, culminating in the financial crisis of 1997-98, where the critical mass of actors have changed the shared expectations about "how the world works".

That the institutional change was completed was confirmed by an incident in February 2000, in which the head of the FRC was promptly dismissed, amidst public criticism, for a casual comment suggesting a return to the old institution.

Second, in public policy making, bureaupluralism has been decaying. Reflecting the fact that the shared expectations of "continuity", alongside "players", "formal rules", and "interaction patterns", have undergone a significant change, actors have started to question the worth of the institution. As what supported the "continuity" in this institution cannot be stably reproduced in the future, an institutional change is likely to occur. However, as our framework of institutional change suggests, it remains to be seen whether this will lead to full-scale institutional change or another instance of institutional resilience.

Based on our causal framework, we predict that it is likely that this decay eventually lead to an institutional change on two counts: such experiments as "going around" of the policy making process of bureaupluralism, as observed in financial politics since 1995, have been emerging; the conditions that make the public important in politics, such as "failures" and "change of government", are likely to continuously hold in the foreseeable future in Japanese politics. Thus, bureaupluralism will erode over time, as the shared expectations of "continuity" collapse.

How can we summarize the role of the Big Bang in the larger picture? The Big Bang was part (i.e. the reform of the formal rules) of the institutional change in finance, the breakdown of the Convoy, which culminated in the financial crisis of 1997 where it was shown that "banks can fail", leading the critical mass to shift the shared expectations about "how finance works". The Big Bang was also part of the ongoing institutional change in public policy making, the decay of bureaupluralism, by giving rise to the practices of "going around" bureaupluralism, which has come to be, and will surely be, increasingly observed, given the continued existence of the possibility for "change of government" and the numerous "failures" looming over Japanese political economy of today and the future.

Chapter 9 Conclusions

9.1 Summary of the Findings

This chapter, as a whole, provides our conclusions. In this section, we summarize our findings in response to our problematique. Next, we explore how our findings relate to other policy areas, in an effort to expand the scope of the analysis. We provide a discussion of policy implications of our analysis, closing with an identification of issues that need to be pursued further.

In Chapter 1, we embarked on our inquiry with the following sets of questions in mind, the first being the main concern:

1) *Has Japanese politics changed over the 1990s? Which aspect is more important, "continuity" or "change"? How can we explain Japanese politics of the 1990s?*

2) *What caused the Big Bang? What determined its timing, scope, and pace? Who gains and loses from it? Who brought it about? First of all, what is so significant about the Big Bang?*

3) *How can we situate the Big Bang in finance and the Japanese political economy of the 1990s? Any causal framework?*

4) *Can we draw any theoretical insights that are applicable to regulatory reforms in general, in Japan as well as in other countries?*

Below, we offer our response, summarized in four points.

1) Main Contention: Japanese Politics Has Changed Since 1995

Japanese politics has changed since 1995. The evidence is that there has been institutional change, or a shift in the shared expectations about "how the world works", in two pivotal institutions in financial politics developed over the postwar era: "stability and cooperation" and "continuity" have ceased to prevail in the post-1995 world. The Convoy

System in finance has broken down, and the public policy making mechanism of bureaupluralism is in decay. Our prediction for the latter, which is an ongoing process, is the following: this decay is likely to deepen in the whole political economy, as the causal factors of changes in financial politics, "performance failures and scandals" and "possibility of change of government", will probably affect other policy areas as well.

2) A Realistic Image of the Big Bang and Financial Politics since 1995: the Outcome of the Strategic Interaction of the LDP and MOF and an Increased Role for the Public

As shown in Chapter 5, the Big Bang initiative cannot be explained by the alternative frameworks that were identified in Chapter 2. The Big Bang was not:

a) A pre-designed and coordinated initiative by a single bureaucratic agency;
b) The result of financial institutions' domination of financial politics;
c) The result of the politicians overcoming or subduing the bureaucrats;
d) The result of the non-financial firms (and MITI) gaining the upper hand of MOF and financial industries; or
e) An achievement by the LDP backbenchers promoting consumerism as a result of the electoral reform of 1994, introducing the single-member district.

Rather, the Big Bang was brought about by political winners, the LDP and MOF, which saw political gains in obtaining public support independently from the exchange of goods and services with their constituents. Their strategic interaction through the logic of organizational survival explains the process of financial politics in 1995-96. As the loss of public trust in the scandals and performance failures (e.g. the Housing Loan Affairs) was what brought the threat to their survival, the LDP and MOF sought to re-coup public trust by enhancing public interest over constituents' interest. The views held by the sub-organizational groups that won in the policy contest within the LDP and MOF were those rewarded by the environment (continued public criticism due to recurrent failures; and increased probability of change of government): as long as "survival" was the ultimate goal for all members, what appeared to increase the prospect of survival eventually controlled the organizational policy. Our framework stressing the strategic interaction of actors enables us to understand the complexity of the relationship between the LDP and MOF in

1995-96: cooperation (the Housing Loan Affairs), competition (the Big Bang), and conflict (the MOF reforms). The timing of the Big Bang reflected Hashimoto's reform agenda at the beginning of his second Cabinet, the pace and the scope reflected the fact that MOF planned the content, and the sequence reflected which field in financial policy making the "reformers" within MOF and the "mavericks" within the LDP controlled.

As shown in Chapters 4 and 5, it is unlikely that economic "winners" such as large city banks, the corporate sector, the newcomers to finance, and the consumers were influential in bringing about the Big Bang. The large city banks were unsure of the benefits of the Big Bang, facing competition with the more efficient, foreign rivals; the efforts by the corporate sector (through MITI and/or the LDP) for financial deregulation did not materialize into a large scale financial reform package; the newcomers to finance lacked the entry points to the political process; and the consumers were largely unaware of the Big Bang at the time.

We demonstrated in Chapter 6 that the domestic financial institutions were, on the whole, unable to effectively oppose the reforms, which threatened their survival through increased competition. This became clear from the comparison with the financial reforms of the past. While the financial industries affected the "pace" of the reforms, the "timing" (i.e. immediately, and until 2001) and the "scope" (e.g. with or without insurance) were largely unaffected. Because the regulated industries were by-passed by those who conceived the Big Bang in the planning phase, they were forced to face the already public Initiative; political leadership by Hashimoto made it hard for the industries to campaign through the LDP; public support of reforms markedly raised the cost for assembling a counter-coalition. The financial scandals drastically hurt the political influence of the financial industries to forestall the reforms; the subsequent scandals propelled the Big Bang further, as the initiative became part of the process of the departure from the Convoy System, vilified by the scandals and discredited by the financial crisis.

Our empirical analysis in Part II, based on the analysis of various financial reforms in the 1980s and 1990s, found that the essence of the new developments in financial politics since 1995 (including the Big Bang) was that "the public now matters" as a determinant of financial politics in a world in financial crisis where changes of government can occur. The most significant change in financial politics since 1995 was not so much the altered financial landscape itself (which may have happened in various occasions in the past) as the change in the public policy making process towards larger inclusiveness. The public policy making mechanism of the "insiders" has been increasingly allowing the "outsiders" to wield a significant influence through the practice of "going around" the mechanism of bureaupluralism by relying on public support.

3) The Mechanism of How the Big Bang and Other Changes in Finance Proceed: "Institutional Change" in Finance and Public Policy Making, and Patterns of Financial Reforms

As shown in Chapter 8, our framework of institutional change, developed in Chapter 3, enables us to make sense of the new trend in financial politics that "the public matters". In financial politics, there were two institutions in place before 1995: the Convoy System in finance (the Convoy) and bureaupluralism in public policy making. The Convoy was a financial system in which all financial institutions would proceed at the same speed as the "slowest" institution as in a naval convoy: this was secured by regulatory rules setting up segmentation walls between financial businesses as well as restricting entry and exit, a reliance on informal policy tools for governmental regulation, and essentially, the shared expectations of "stability" (i.e., continuity of the current arrangement) and "cooperation" (i.e. cooperation among such insiders as MOF, the LDP, and the domestic financial industries). Bureaupluralism was a steady bargaining process involving the bureaucracy, the industries, and the LDP: it was a stable interaction pattern of these three sets of actors, based on the informal interaction of the same actors over time, guaranteed and reinforced by formal rules, sustained by the shared expectations of "continuity" (e.g. "the policy making process will always be the same").

There has been institutional change in financial politics since 1995: the breakdown of the Convoy and the decay of bureaupluralism. Our inquiry into the collapse of the Convoy was two-fold. First, we showed how exogenous developments (technological innovation and globalization of finance) and change in institutional environment led to institutional change. Our causal mechanism of institutional change was as follows: *"performance failures and scandals" in finance, caused by the gap between the faster exogenous developments and the slower institutional response, as well as the "change of government" of 1993 in politics, have brought about a new development in financial politics (as observed in Part II), or "the increased importance of the public in politics", triggering institutional change in finance and public policy making.* Second, through an analysis of the evolution of the Convoy at the levels of players, formal rules, informal interaction patterns, and shared expectations, we identified a shift in the organizing principles, the fundamental principles recognized by all actors as objective characteristics as well as normative values of the institution: from "cooperation and stability" to "competition and transparency". The Big Bang was triggering and triggered by, reinforcing and reinforced by, other shifts in the same direction, towards the breakdown of the Convoy System in finance.

As for public policy making, bureaupluralism has been decaying. Reflecting the collapse of the shared expectations of "continuity" that sustained bureaupluralism, actors have started to question the worth of the institution; nevertheless, it remains to be seen whether this will lead to a full-scale institutional change or not. Our causal framework enabled us to offer a prediction: institutional change is likely to happen on two grounds. The experiment of "going around" in the policy making process has been on the rise; the conditions that make the public important in politics, such as "failures" and "change of government", are likely to continuously remain salient in the political economy in general. Thus, as the shared expectations of "continuity" collapse, bureaupluralism will erode over time.

In Chapter 3, we also developed a four-by-two typology of financial reforms, focusing on the evolution of coalitions and the way state actors interact with societal actors. The evolution of coalitions yields four categories (status quo, inclusion, defection, and replacement) along a continuum, regarding who can participate in public policy making. In "status quo", "insiders" remain in charge; in "inclusion", some "outsiders" see their interests incorporated while the policy making process itself remains intact; in "defection", some "insiders" switch strategies and "go around" the established policy making process; and in "replacement", "outsiders" take over, eliminating the status quo policy making mechanism. How state actors interact with societal actors has two patterns: "interest group politics", in which state actors act based on the exchange of goods and services with interest groups, and "public interest politics", in which state actors act independently of interest group pressure.

4) Insights into Regulatory Reforms in Other Contexts: Entrenched Actors and the Role of the Public in Politics

With our empirical analysis in Part II, we can now establish that within our four-by-two typology of financial reforms, the Big Bang fits the one that combines "defection" and "public interest politics" (as opposed to "interest group politics"). Chapter 5 has shown that the Big Bang was a "defection", organized by MOF and the LDP. Chapter 6 demonstrated that the process of the Big Bang was "public interest politics" rather than "interest group politics". Chapters 7 and 8 have given us reasons to think that the Big Bang had an important part in the institutional changes in finance and public policy making taking place in the political economy. Figure 9.1 shows that the Big Bang fits (D,P) and is part of an institutional change in public policy making.

Fig. 9.1 Scenarios of Financial Reforms: Big Bang as (D,P)

Interaction Patterns of State and Societal Actors?

Coalition pattern?	Interest group politics (I)	Public interest politics (P)
Status Quo (S)	**Past Financial Reforms** *(Domestic Financial Firms)*	
Inclusion (C)	**Gradual, More than in the Past** *(Non-banks and Foreign Firms)*	
Defection (D)	**Drastic, Benefiting the Powerful** *(Some Large Banks)*	
Replacement (R)	**Drastic, Overall Reforms** *(Corporate Sector)*	**Drastic, Overall Reforms** *(Non-LDP Parties, MITI)*

In Parentheses: Actors Who Could Bring About the Financial Reforms
Shaded: Institutional Change
(Departure from Bureaupluralism: Alternatives to Deliberative Councils and LDP PARC)

Gradual / Drastic: concepts regarding scope, depth; timing and pace
More than in the Past: measures benefiting the "outsiders" with compensation to some "insiders"
Benefiting the Powerful: e.g. liberalization of entry into other areas of finance
The Big Bang: private finance (banking, securities, insurance, and foreign exchange) under MOF's aegis
Overall Reforms: scope including areas outside MOF jurisdiction (e.g. postal savings, pension funds)

The above enables us to offer insights with relevance to other cases of regulatory reforms. *First, entrenched actors may not be as entrenched as they may seem.* Our analysis showed that such seemingly "entrenched actors" as the LDP and MOF would willingly engage in efforts of deregulation if given a set of incentive structures (loss of public support and threat to organizational survival). The image of the past may be misleading: the past does not necessarily prohibit future shifts in strategy.

We contend that our theoretical devices have been useful in establishing the above. The introduction of the hierarchy of goals (survival on top of the others) led to a more realistic behavioral assumption for the bureaucracy. The "logic of organizational survival" shed light on the mechanism of the formation of a single organizational policy, enabling us to account for the seemingly puzzling behavior by MOF, which planned the give-away of its regulatory power, or by the LDP, which engaged in a complex relationship with MOF in the financial politics of 1995-96.

Second, the public's control over the politicians through elections may not be the only way the public influences politics. Elections certainly matter to political parties: the Big Bang experience confirms this generally accepted view, as can be seen in the LDP's strategy facing tough competition from its rivals in the 1996 elections. However, not only the politicians, but also the bureaucrats and the regulated industries have the incentives to cater to the general public's interest to boost public support, besides taking care of their own immediate concerns. "Failures" lessen public support for the organization at the level of competence ("performance failures") and ethics ("scandals"). It is when "failures" occur and organizations become "public enemies" (e.g. polluting firms; corrupt bureaucrats and politicians) that such incentives to promote the public interest become salient. When organizational survival is in danger, actors would seek to pursue this ultimate goal. The public does not need to engage in direct action (e.g. boycott, mass protest) to wield political influence, as politicians, bureaucrats, and industries would risk losing political influence regarding matters of their interest by becoming "public enemies".

We claim that our model of strategic interaction among actors gave us an improved characterization for the role of the public in politics. It enabled us to question the conventional assumption that societal interests can only have significant political influence through organized groups; it shed light on the public's influence other than through the principal-agent relationship between the voters and the legislators.

9.2 Implications to Economic Reforms in Other Policy Areas: Generation of Hypotheses

Our research is largely based on the study of a single sector of the economy, and it may be mistaken to conclude that the Japanese political economy as a whole is undergoing a significant change by naively generalizing the findings. While we contend that the trend in bureaupluralism — the rise of alternative public policy making with more inclusion of the public — is likely to continue in public policy making in general, we need to further ascertain the extent to which our assertion holds vis-à-vis other issue-areas in the political economy. As one critic suggested, there are many areas of non-change in the political economy, such as agriculture and construction; developments in finance, a special sector, may not be appropriate for generalization.[1] Yet, it is hard to believe that the changes in bureaupluralism will not spill over to politics in general to a certain extent. For example, in budget politics, an LDP staff member describes the changes as follows: the key persons— leaders of factions for policy areas such as bullet train construction or taxation — used to be clear in the past, and things went well by dealing with them, but the "manual" of the old days is not working any more. The LDP's influential Koichi Kato (see Chapter 5) has been stressing the need to keep a distance between politicians and bureaucrats, or "weaning" (*chichibanare*). According to Kato, a new way of politics has been on the rise in Japan where "politicians are increasingly forced to grapple with public policy issues rather than simply rely on the bureaucracy to solve most of the problems."[2] There is hardly any reason to believe that his words are meant to apply only to finance.[3] Besides, the loss of public support for the bureaucracy and scandals have not been limited to the fields of finance. Thus, if our contention is right, we may see changes in the other fields.

If changes in bureaupluralism are likely to spill over to some extent, then, we need to ponder how finance differs from other areas in the political economy, precisely because the above criticism has merits. Thus, in this section, we proceed to pursue the implications of our findings about financial politics to other areas (e.g. agriculture, construction, telecommunications, transportation, and postal savings) where the politics of bureaupluralism, and its entailing heavy protection over the constituencies, had been the norm in the past. We will start from the issue of comparability, and then turn to a discussion of causal factors. In the end, we will construct a rudimentary two-level model of economic reforms of domestic politics and economic environment, which offers some possible determinants of economic reforms in general.

1) Comparability: What Would the Big Bang Be in Other Fields?

First of all, there is the issue of comparability: in expanding our analytical scope to include other areas, we run the risk of "conceptual stretching" (Sartori 1970). Our analysis concerns the politics of "economic reforms", including the "economic regulatory reforms", or the reforms of economic regulations over private actors, and the reforms of the economic regulators themselves. "Economic regulatory reforms" can be distinguished from "budgetary politics", where public spending is the main issue, or "social regulatory reforms", where the reforms of social regulations (e.g. food, drugs, environment) are concerned. (Our main interest in the political economy and economic reforms leads us to exclude social regulatory reforms from our analysis below.)

"Economic regulatory reforms" include such areas as finance, telecommunications, transportation (e.g. passenger and freight transportation), and energy (e.g. oil and electricity). In these areas, the grounds for regulation were mostly from economic perspectives, including "natural monopoly" (e.g. electricity), "scarcity of resources" (e.g. telephone), "excessive competition" (e.g. taxi), and "information asymmetry" (e.g. bank deposit).[4] Thus, the reforms would mostly center around those of governmental control over price, entry, and business range of the industries. The rationale for economic regulatory reforms would be that the public (the users of the services or the consumers) would be able to pay less and enjoy more choices regarding the provided services they use in their daily lives.

Budget expenditures naturally affect all areas of the economy, reflecting the encompassing range and size of the national budget of an industrialized nation. However, by "budget politics", we mean the areas of political economy whose stake in budget politics for their businesses is high. Industries with heavy dependence on public works come under this category: for example, agriculture and construction[5]. The rationale for reforms in budget politics, comparable to that for "economic regulatory reforms", would be that the reforms would bring down the price level for the services, reduce the public expenditures, and thus result in lower taxes for the general public.

However, reforms involve many different perspectives for these areas of construction and agriculture as well. The construction industries on the whole do not face economic regulations (entry control or price control) from the government. What is perceived to be the pivotal hindrance in construction, the bid-rigging system, is nothing but an illegal, *de facto* system of survival that construction firms derived. It is a private sector practice; if any meaningful reforms are to be done, they would rely much on the stricter enforcement of anti-monopoly laws (while changes in government bidding practices may be helpful).

As for agriculture, the reforms of the laws governing agriculture as well as the introduction of foreign products may bring down the price level of food, benefiting the consumer public (though, accompanied with the demise of the agricultural sector). However, not all the agricultural regulations are economic regulations with economic purposes, such as guaranteeing adequate supply or protection of the users. The laws governing agriculture are hostile to the commercialization of agriculture (e.g. land use, corporate ownership, and entry control) largely due to historical and political reasons, to prevent the land ownership pattern to revert to that which existed before the post-WWII land reforms, where landlords dominated sharecroppers. Because these reforms were part of the initiative to "democratize" the economy, the issue still has a social dimension, powerfully hindering reforms from economic perspectives.[6] Moreover, agriculture is an area where such economic reforms as the introduction of international competition face strong opposition from non-economic perspectives, such as national food security and environmental protection.

Thus, one may ask what the Big Bang would be in other areas than finance. Is it the removal of governmental regulatory control over price, entry, and business ranges as in "economic regulatory reforms"? Or, is it the much stricter enforcement of anti-monopoly laws and change in government practices (e.g. procurement, bidding, execution of budget expenditures), as in construction? Or is it the change in agricultural laws, many of which are non-economic regulations?

In "economic regulatory reforms", the benefits for the public are easier to grasp: the users of the services pay lower prices and enjoy more choices (e.g. lower utility bills, more phone companies). In construction, the price level may come down: however, the public cannot be said to benefit as frequently from its services (e.g. lower construction costs?). Reforms are not so much about lifting governmental regulations than changing the behavior in the private sector through strengthening the regulations. The other causal link, of efficient public works leading to fewer public expenditures and lower taxes, is very opaque and thus much less tangible than the benefits of economic regulatory reforms. As for agriculture, the economic concerns for reforms (e.g. lower prices) may encounter a powerful opposition from non-economic perspectives not without support from historical reasons: protection of the small farmers, food security, and environmental protection may powerfully counter reforms with economic goals.

In light of these large differences between economic regulatory reforms and such areas as construction and agriculture, our findings are more likely to be relevant to the former areas, such as telecommunications, part of transportation (provision of transportation services), and energy, where reforms with similar aims have been carried out since the Hashimoto administration's efforts of deregulation.[7]

We acknowledge this limitation. Nevertheless, some reforms in such fields as construction and agriculture are proposed from economic perspectives, and to a certain degree they bear similarities with economic regulatory reforms (e.g. "reform of government bidding practices" in construction or the "introduction of price mechanism" in agriculture). Thus, we proceed to identify some possible determinants of economic reforms from a comparison of finance with other fields.

2) Political Cover: Indicator of Politicians' Behavior

In finance, we saw how public support for MOF and the financial industries was lost, rendering the LDP unwilling to provide political cover to either one of them: under threat of replacement, the LDP chose "public interest" over "constituencies interest". Thus, focusing on the politicians, we obtain "political cover" as a possible indicator of how politicians balance the two sets of interests when they collide with each other in economic reforms. How is "political cover" over an industry or bureaucracy determined? Again, in line with our two sets of interests, politicians' behavior is determined by their constituencies and the general public, who provide the support for their elections: "electoral vitality" of a constituency and "public support" appear as variables.

a) Constituencies' Support: Electoral Vitality

We seek to differentiate among constituencies regarding how they appear to the politicians. This question leads us to ask how vital (or expendable) the support of a particular group is to the political parties. In this aspect, the characteristics of the ties between the LDP and the industry may be important in determining the amount of political cover provided to the industry. Finance can be distinguished from sectors upon which the LDP relies heavily in its electoral efforts (e.g. agriculture, construction). Financial industries supported the LDP mostly at the party level by supplying electoral funds without many specific policy demands, or "untied financial support" according to Okimoto's characterization .[8] (Okimoto 1989) The degree of influence the industries were able to obtain through this contribution was significantly lessened in the post-1993 world for the following three reasons. First, the LDP lost the monopoly over this type of contribution — of maintaining the pro-business political regime of liberal democracy — as some of the non-LDP conservative parties were also given contribution from the industries fearing their reprisal once they came to power. Second, the financial industries, especially banking, had to curtail contributions made when their businesses were suffering in face of mounting public criticism. Third, one certain result of the 1994 electoral reforms was to reduce the amount of money involved in campaigning.[9] According to a retired LDP lawmaker, "the financial industries do contribute money [to the LDP], but it does not matter much to the elections."[10]

On the other hand, concerning construction and agriculture, the electoral support is at the level of individual politicians, not only supplying funds but also blocs of votes. This may have a large effect on the LDP's willingness to take steps that might drastically curtail the vested interests in these areas. Politicians who only receive funds through the party and those who receive funds and votes at the individual level face different incentives when facing the call for structural reforms aimed to benefit the consumer public: the latter is much more likely to be constrained by their constituencies than the former.

Electoral vitality may be merely a reflection of the over-representation of the rural population because of the electoral system. In the rural areas, the local economies heavily depend on agriculture and construction, supported by public works. The sheer number of those directly and indirectly involved in these industries, magnified by the electoral system over-representing the rural areas' political influence, may be another constraint on the changes.[11]

b) Public Support : Public Attitude and Volume of Attention

Another variable that determines the political cover over a constituency may be the public support for the industry: how would the politicians appear to the public if they speak in favor of or against an industry? What can we derive from our analysis of the financial reforms, and how do other fields differ from finance?

Failures, or performance failures and scandals, turn the public against the affected actors. As we discussed in Chapter 3, without performance failures, scandals are unlikely to take roots, being dismissed as exceptions; however, scandals provide the "symbols" (or "focal points") for public criticism against one set of actors. Altogether, they undermine the prevailing institution's effectiveness as a representation of "how the world works": these two factors lead the actors to think that "something is not right".

However, given the public's nature — short span and limited range of attention — such failures have to be recurrent and long-lasting to have effects. This may be part of what determines public support regarding a certain industry. We should also expect the "volume" of the attention (i.e. how much the public cares) to be diverse across fields: people may decrease their support of an industry, yet may not care enough to allow tangible results to materialize. Below, we delve into these two issues of "public support" and "volume of attention": we define "public support" to be a function of "public attitude" and "volume of attention".

α) Public Attitude: Performance Failures and Scandals

Our story about the Big Bang tells us how significant performance failures and scandals may be in influencing the public attitude toward the industries or bureaucratic agencies. Policy failures and scandals hurt public trust in MOF in two dimensions: the policy failures (e.g. financial crisis) undermined public trust in its competence, and the scandals (e.g. Wining and Dining) hurt public trust in the bureaucrats' ethics (integrity). As a result, MOF faced a believable threat of breakup, as protecting MOF became a very unattractive choice for the politicians under increased threat of replacement.

How MOF's political influence was hurt after 1995 can be illustrated by invoking two past incidents. First, in the late 1980s, MOF was wildly unpopular throughout the attempt to introduce the consumption tax; however, the LDP's leadership was there to cover MOF despite its notoriety.[12] The Recruit Scandals questioned the politicians' ethics, but the bureaucrats' ethics were not much in doubt, despite the arrests of two top officials of two other ministries. For example, an Asahi Shimbun editorial in 1988 was worried about the morale (not morals) of the bureaucracy, stating that despite some defects "the enthusiasm for their jobs and the high morale ought to be credited." (8 November 1988) Second, in the 1991-93 financial reforms, while questions regarding the bureaucrats' competence were raised, not much doubt regarding its ethics existed. Two collections of newspaper articles by Nihon Keizai Shimbun (a leading economic newspaper) published in 1992 and 1998 show the difference of before and after 1995. Nihon Keizai Shimbun (1992) suggests MOF's prospect of incompetence in financial administration; however, its tone is much more subdued compared to Nihon Keizai Shimbun (1998), which deals with the financial crisis of 1997-98, raising severe criticism against MOF regarding both its competence and its ethics.

The financial industries suffered from the scandals as well as bad performance. The banks were vilified in their involvement in the scandals; their performance was hurt by the bad debt problem; their restructuring efforts were slower than the rest of the economy; and they had to rely on public funds for recovery: these were enough to turn the public against the banks. The securities industry fared no better: the scandals hurt them, while the stock market's slump severely constrained their businesses. The insurance industry was the least affected by the scandals, yet they suffered from damaged balance sheets due to the excess of the Bubble years and the interest rate gap.[13] The financial industries in general were shaken up further by the financial crisis of 1997-98, where major banks and securities firms went under.

In this environment, there were instances where public repugnance against the financial industries erupted. Recall the uproar against the Housing Loan Package and the Racketeering Scandals, resulting in a boycott in some cases with serious effects on the profits of the firms involved, undermining their prospects for survival.

Thus, we posit that performance failures and scandals matter in determining the public's attitude towards these actors. In this regard, agriculture, telecommunications, or transportation — which some described in the past as "pockets of inefficiencies" (Okimoto 1989) — did not suffer from any scandals of similar intensity.[14]

However, there is an interesting case in which a wave of scandals with a similar magnitude to that of finance took place: construction.[15] The construction scandals bore many similarities with the Big Bang. With the waves of scandals, resulting in the arrests of numerous politicians (one influential LDP politician and many heads of local governments, including governors), which revealed the systematic involvement of the construction industries, the scandals certainly turned the public against the construction sector. As for performance, the construction industry has been badly hit by the slump in the real estate market: this industry is one of the major borrowers involved in the bad debt problem plaguing the banking industry.

Yet, few would see a development similar to the Big Bang in finance. Performance failures and scandals may not be sufficient for the public to act as a determinant of economic reforms.

β) Volume of Attention: Public Visibility

We now turn to the second determinant of "public support". As we saw from the comparison of finance and construction, the change in attitude towards one constituency may not necessarily lead the political actors to take actions that might hurt the other sets of interests they have to consider, the "constituencies interest". What more then is needed?

We submit that the volume of public attention matters: even if one forms a negative opinion about certain actors, whether this leads to material results may depend on how visible and influential this discontent becomes. How is the volume of public attention determined? The degree of visibility and tangibility to the public of a field, "public visibility", may be key here. How does the field affect the public's life? What is its position in the economy?

Finance distinguishes itself from construction in this aspect. The financial crisis, in which large banks and other financial institutions were going down, was highly visible and directly affecting everybody's life, giving the public many reasons to worry. Bank deposits and loans, securities investment, and insurance products are much closer to the public's life than the products offered by the construction industries (e.g. houses, condominiums). Besides, the fact that billions and trillions of public funds was injected in the financial system made the public more concerned. During the Housing Loan Diet, the public was strongly opposed to the idea of injecting 685 billion yen (a minor sum compared to the later, 30 to 60 trillion yen ceiling set three years later) of taxpayers' money: political rhetoric such as "blood tax" (ketsuzei) was often invoked to turn the public against the banking industry, MOF, and the LDP. As for MOF, that the economic slump since mid-1997 was affecting the public seriously may have also counted, as MOF was often charged as largely responsible for the economic slump due to the fiscal contraction and tax increase it introduced in April 1997. In this regard, the Ministry of Construction [MOC] is hardly visible to the public.

As we saw earlier, construction as "budget politics" largely differs from finance in terms of "visibility". While inefficient public works projects may amount to a waste of public money and thus higher taxes eventually, this concern is much less tangible to the Japanese public: the causal connection is opaque and the result (e.g. how much more it costs the taxpayers) is far from being clear. It is not that concerns regarding construction do not exist: some of the top firms have had financial difficulties, with numerous small firms going under. However, compare the above with the imminent financial crisis, in which the danger arises to one's deposits or credit line, both vital lifelines for the public, or with the injection of taxpayers' money of a certain amount (e.g. 685 billion yen), not necessarily large compared to the sheer size of the problem or in international comparison, yet much larger than the amount most people deal with in their lives! Clearly the problems in finance were much more visible to the public, keeping the volume of the public's attention toward finance consistently high amidst the financial crisis compared to its attention to construction.

"Public visibility" may possibly differentiate the behavior of the construction industry and bureaucracy from that of the financial industries and bureaucracy. The financial industries face a more direct threat of sanction from the public ("boycott") than the construction industries: this is a function of exposure to the public. The bureaucratic agencies face a different set of incentives as well: if the MOC does not see a threat to its survival, it may have fewer reasons to jeopardize its relations with the industries by introducing reforms in the "public interest" at the industries' expense.

So far, we saw that "public support" is a function of "public attitude" towards the industry or bureaucracy (affected by "performance failures and scandals") and "volume of attention" (affected by "public visibility") of the issue. An interesting case in comparison may be the postal savings system which may have been a beneficiary of the plight of the financial industries, its rivals for individual savings. That the banks had seen their public support drastically undermined seems to have increased public support of the postal savings system. The individual depositors are flocking into postal savings, with its government guarantee and higher rates than the banks in the era of low interest rates. The post offices, located in almost all municipalities, seem to have increased public support as the "small depositors' ally". (In addition, the local postmasters provide bloc votes (and thus "vital" electoral support) to the LDP, giving the latter reasons to provide strong political cover.)

<u>3) Survival of the Bureaucracy</u>

Turning our attention to the bureaucracy, we may posit from our findings that the concern for organizational survival gives a strong impetus for the bureaucracy to re-coup the loss of public trust even at the expense of the industries' interests. Naturally, "political cover" over the bureaucracy directly affects the bureaucracy's prospect for survival. However, this is affected by the "electoral vitality" of the sector and the "public attitude" towards the actors in the sector. Moreover, the "public attitude" may directly affect the bureaucracy's behavior, as the bureaucracy needs the acceptance and cooperation of the public for the policy measures it devises and enforces. While the ties with the industries under its jurisdiction are important concerns for the bureaucracy as well, the public attitude towards these ties also determines the relative importance of the industries' concerns for the bureaucrats.

In this regard, the public attitude towards the bureaucracy in general has systematically turned negative, both at the levels of competence and ethics: the above discussion does not only apply to MOF. We cited above the Asahi Shimbun editorial in 1988, in the wake of the Recruit Scandals, that assumed the integrity of the bureaucracy. In 1993, an influential economist, Yukio Noguchi, described the bureaucracy as "ethically clean and relatively competent" while arguing against bureaucratic rule. (Noguchi 1993) Such a characterization did not sound preposterous then; however, this type of positive characterization is difficult to find in the media or among opinion leaders after 1995.

Public opinion polls show this declining trend of public support towards the bureaucracy in general. Asahi Shimbun polls show that people responding to "do not trust the bureaucrats" have shifted from 51% in 1994 (before the scandals), to 65% in 1996 following the Ministry of Health and Welfare (MHW) scandals (concerning HIV-contaminated blood products), finally to 71% in 1998 after the MOF Wining and Dining Scandals.[16] (Asahi Shimbun 4 March 1998)

4) The Industries: Addition of the Economic Dimension

Finally, we maintain our claim that "public support" matters in determining the industry's behavior, indirectly — through determining the political cover and the bureaucratic behavior — as well as directly — through its threat of sanctions (e.g. boycott). Such factors as "electoral vitality", "public attitude", and "public visibility" all affect how the industries' concerns are translated into economic reforms.

We may add another important dimension that has been missing in our discussion of domestic politics: the economic environment. "Performance failures and scandals", a determinant of public attitude, reflect a bad performance by an industry: if all is well, it would be much less likely to see such problems erupt in the first place. How, then, is the performance of an industry determined? We need to turn our attention to the economic environment, in which regulatory reforms take place, in order to fully capture the dynamics within the domestic political economy. The economic environment, beyond the reach of the actors, may drastically change and render the existing regulations meaningless, or may reduce the benefit of the regulation (or the "rent" to be distributed among the regulated industries).[17]

Thus, we add the dimension of "developments in the environment" outside the political interplay of actors in financial politics, involving such factors as "technological innovation", "international competition", and "institutional environment". This dimension affects not only the industries (though its effect is most direct on them through its performance) but also the other actors (politicians, bureaucrats, and public) alike.

In finance, technological innovation is rapid (in comparison to other fields such as construction). Under such conditions, even if the regulated industries succeed in keeping the regulations that guarantee the continuation of the status quo, its effectiveness is undermined by rapid innovation, taking place outside of the interaction of actors within the domestic political system.

Exposure to international competition may be another factor that may accelerate or hinder regulatory reforms. For example, if the global integration of national markets is proceeding to a large degree (as in finance), "failures", or a gap between what should be achieved and the reality, are more likely to be perceived by the actors, increasing the chance for regulatory reforms to materialize. On the other hand, if an industry is insulated from the international market (e.g. construction at the local level), regulatory reforms may not be implemented soon, as "failures" are unlikely to be perceived in the absence of alternatives to what is currently available.

"Institutional environment" may be another factor: what is happening in other industries may be relevant to one industry, reflecting the existing relationship among industries. In this regard, the spillover from finance may be significant, given the pivotal position of the financial sector in the political economy. Suppose that regulatory reforms take place in finance (increased competition; increased presence of foreign capital), drastically altering the behavior of financial firms, in that they become more survival-conscious and more interested in pursuing short-term profits than relational financing, which, given the increased future uncertainty, may not turn out to be worth the effort. Then, some industries with a heavy dependence on financial firms (e.g. construction on banking) may be forced to alter their strategies, increasing the chance of regulatory reforms, while other industries with less dependence on private financial firms (e.g. agriculture) may not face this issue.

5) Two-Level Model of Economic Reforms: Domestic Politics and Economic Environment

In this section, we have identified some causal factors from our analysis of financial politics, and explored the implications to other areas of the political economy. We proceed to build a two-level model of economic reforms, using our case for "theory-building". We posit two levels of economic reforms: a) domestic politics and b) economic environment.

In "domestic politics"(D) , "public support" (PS) can be characterized as an increasing function of "public attitude" (PA) (an increasing function of the performance of the actors, e.g. scandals and performance failures [SF}) and "volume of attention" (VA) (an increasing function of "public visibility" [PV] of a sector). Political actors' behavior, "political cover" (PC) over an industry or bureaucracy, will be an increasing function of "public support" and "electoral vitality" (EV), or how crucial the support from a sector is to the election efforts. The bureaucratic behavior, driven by "bureaucratic survival" (BS), is an increasing function of "political cover" and "public support", the latter in fact determining the former to a large extent. The industry's survival (IS) will be affected by "public support" and "political cover".[18]

In addition to the factors mentioned above, mostly affecting the industries by determining their performance, comes the level of "economic environment" (E), which can be conceptualized as an increasing function of such factors as "technological innovation" (TI), "global integration" (GI), and "institutional environment" (IE).

Figure 9.2 shows the above. We saw from the Big Bang that "public support", "political cover", "bureaucratic survival", and "industry survival" are the central causal factors. By transforming the causal factors, we may posit that "scandals and performance failures", "public visibility", and "electoral vitality" within the domestic political system as well as the economic environmental factors give us clues to understand and compare the economic reforms across sectors. We propose this rudimentary model in the hopes of providing a building block towards a better understanding of regulatory reforms in general. By gathering data across sectors and specifying the interaction and the relationship between each factor, we may be able to see which factors in our model contribute mostly to advancing or hindering economic reforms.

Fig. 9.2 Two-Level Model of Economic Reforms: Domestic Politics and Economic Environment

1. Domestic Politics (D):

PS = (PA, VA); PA = (FS); VA = (PV)

PC = (PS, EV) = (PA, VA, EV)

BS = (PS, PC)

IS = (PS, PC)

Economic Reforms = (PS, PC, BS, IS) = (PS, PC) = (PA, VA, EV) = (FS, PV, EV)

2. Economic Environment (E)

E = (TI, GI, IE)

→ ***Economic Reforms = {D (FS, PV, EV); E(TI, GI, IE)}***

Notes:

X = (Y, Z): X is an increasing function of Y and Z

D: Domestic politics
- BS: Bureaucratic Survival
- EV: Electoral Vitality
- FS: performance Failures and Scandals
- IS: Industry's Survival
- PA: Public Attitude
- PC: Political Cover
- PS: Public Support
- PV: Public Visibility
- VA: Volume of public Attention

E: Economic environment
- GI: Global Integration
- IE: Institutional Environment
- TI: Technological Innovation

9.3 Policy Implications and Suggestions

Our analysis enables us to offer the following suggestions for improving public policy making in Japan. (The reader is strongly reminded that these views should not be attributed to any organization with which the author has been affiliated.)

1) On Public Policy Making

a) From Stability to Change in Practice: Decreased Role for Precedents

As our study shows, we now need to shift our emphasis from "stability" to "change" in dealing with today's Japanese politics. This shift in emphasis ought to take place not only at the level of theory but also at the level of practice, given the fast pace of technological innovation, the deepening global integration, and the change in the institutional environment (e.g. change of government; flexible labor market). Public administration needs to be carried out with the assumption of "change" rather than "continuity": the current emphasis on precedents in policy making has to be significantly altered in this regard.

b) Public Support of the Bureaucracy

Our study has also shown the importance of public support for the bureaucracy. That MOF came to be dismantled may be said to be a result of the lack of recognition on the part of its officials that public support is not always guaranteed, but has to be won over. It is true that the "political stock" (Aoki 1988) of the bureaucrats has been high as a result of the accumulated credit during postwar economic development. However, such past savings have been depleted during the 1990s with "performance failures and scandals". Some MOF officials liken themselves to *kobushi* (old *samurai*), who try to contribute to the nation while not getting much credit: what motivates them, despite this lack of recognition, is that the nation will understand them in the long run. Nevertheless, in a world in which public support determines political outcomes, a more active attitude, reaching out to the public, to cultivate public support is necessary, as the (assumed) implicit bonding of trust between the bureaucrats and the public has markedly weakened during the 1990s.

The realization that public support is not automatically guaranteed and that "performance failures and scandals" are key variables that affect public support will certainly improve the bureaucracy in many ways, by forcing it to continuously prove its worth to the public as well as avoiding such imprudent conduct (e.g. shady, yet not unlawful conduct) that was often observed during the excess of the bubble years.

c) Social Science in Policy Making

Looking back on what occurred in financial politics in the 1990s, one notes how those "insiders" at MOF and the financial industries have been slow to grasp what was happening in finance. True, today's world is complex and prediction of the future is almost impossible; yet, an attempt to formulate strategies with an anticipation of what is to come in five to ten years is necessary if public policy making is to benefit the nation.

In this regard, we may point to the possible benefit of social science, which is under-represented in the public policy making process of the Japanese government. To have a better grasp of today's world is the first step towards better policy making. If accompanied by efforts on the part of social science to address questions with relevance to today's issues rather than theoretical debates that are distant from the concerns of the "real" world, social science can contribute to public policy making by showing "policy makers" "how the world works", enabling them to interpret and influence the complex world in a better way.

d) Alternatives to Bureaupluralism?

This study itself is meant to provide a focal point for institutional change by demonstrating "how politics is changing" and making actors aware that an institutional change is taking place in public policy making. Hopefully, this study will accelerate the search for a new system of public policy making: the breakdown of the institution has been observed and analyzed so far, while a search for a new system has not been advanced much. We ought to seriously consider the alternatives to the deliberative councils and the LDP PARC, by asking the following: what kind of arrangement would better reflect the public interest, in a world in which "stability and cooperation" and "continuity" have ceased to prevail?

e) Policy Suggestions

The above four points suggest some measures for improving public policy making:

- Efforts to systematically reflect new technological innovation in policy formation;
- Efforts to reach out to "outsiders" (including foreign actors, public); and
- Questioning the "given" in the bureaucracy such as permanent employment and the current division of labor between politics and administration.

Better use of the Internet may have the potential to materialize some of these concerns. The recently introduced "public comment" system through the Internet, or the practice of soliciting comments for a planned measure (in the mold of the U.S. "public comment "system) has already resulted in an inclusion of "outsider" views (ranging from the public, foreign financial firms, and even the U.S. government) to bureaupluralism, while how to make use of such outsiders' feedbacks to improve public administration is unclear as of writing (May 2000).

That politics is driven by public support leads to the recommendation to introduce the use of public opinion surveys and strategies that are akin to "marketing" in the private sector. The experience since the Housing Loan onwards suggests that MOF's understaffed public relations department is grossly inadequate in this regard.

In-house breeding of experts who can cope with new developments can always be useful; however, in the years to come, depending on how "flexible" the labor market becomes in the private sector (or the institutional environment), the government will have to procure talents from other channels than the usual recruiting process. This trend is slowly evolving for financial inspectors (former banking employees), lawyers, and accountants.

Given the increase of the importance of social science in public policy making, the same should happen for social scientists in research divisions, which cannot be characterized as adequate (as of 2000).

2) On Politicians- Bureaucrats Relationship: "Fusion" of Power Needed

Our analysis shows that public interest cannot be objectively determined and that public support determines politics. This fact has implications for the relationship between politicians and bureaucrats, one of the hotly contested issues in the political debate of the 1990s. As often observed, when a consensus exists on goals (e.g. economic catch-up), the bureaucrats may have greater roles as in the postwar experience. Yet, when goals conflict with one another, in a liberal democracy, politicians are the ones to present their views and bear responsibility through the elections. If our analysis is correct in that public interest, which cannot be objectively determined, has to be substituted by public support, then, politicians, who reflect the amount of public support, ought to be the ones to determine what the public interest is.

Given the above, with "changes of government" and "failures" in the future, what needs to be done? We need a re-formulation of central bureaucracies far beyond what was done in the 1996 administrative reforms, in order to strengthen the "fusion" of the legislative and executive powers, the basic principle of a well-functioning parliamentary government according to the English political thinker, Walter Bagehot. (Bagehot 1928 [1867]). As "failures" are bound to be plentiful in the future, and tough choices (such as increased burdens for the nation or extinction of a particular sector) cannot be avoided, it is essential that public administration increases its unity with the political leadership. Given "changes of government", it is clear that the old-style alliance between the LDP (assumed to be always in power) and the permanent bureaucracy (always there, under lifetime employment) cannot be sustained over time. As Nishimura (1999) suggests, bureaucratic initiative works best to forge a consensus among all; when the "death" of a certain party (e.g. an industry) is involved, decisions made by the political leadership become necessary.

The above suggests a need for increased political presence in the bureaucracy, given the decline in the political influence of the latter in the 1990s. Traditionally, the bureaucracy has prided itself in its independence from the legislative branch. However, as Bagehot speaks of parliamentary government, parliamentary ministers are the best defenders of the bureaucracy against the parliament: "the appointment of a parliamentary head, connected by close ties with the present ministry and the ruling party in Parliament" is as necessary in today's Japan as in Victorian Britain.[19] Of course, Japan already has a Cabinet with Ministers heading each ministry: however, given the increase of the task for the government, the current system of two or three politicians overseeing each ministry is not adequate. No doubt in recognition of this concern, the recent reforms, effective from 2001, will increase the number of politicians in public administration following the practice in the United Kingdom. This is one important step, but we need to remind ourselves that this is not the only way to increase political presence: the increased difficulty for newcomers to politics to run for the Diet (especially salient with the introduction of single-member districts) may limit the resources available for a well-functioning of public administration. Provided that the labor market in the private sector regarding managerial resources becomes flexible (i.e., a shift in the institutional environment), a U.S.-style appointment system that recruits experts (e.g. lawyers, business executives) in the government with political mandates may be an interesting alternative.

3) On Institutional Change: Good or Bad for the Japanese Nation?

Our framework of institutional change suggests that while the "old" institution is discredited by "failures", nothing guarantees whether the "new" institution is any better. In the process of institutional change, such focal points as foreign practice, history, and leadership provide competing symbolic systems (Aoki): the introduction of a new system does not require an objective proof that it will provide a better result even if introduced in a different "context" (or, "institutional environment") from the original one (e.g. foreign country; distant historical past). More often than not, what appears to be successful in other countries (e.g. the U.S. financial system in the late 1990s; the German "Universal Bank" system in the late 1980s) are pursued by the proponents of "change", without much examination about impacts resulting from institutional complementarity (e.g. the impact on the institutional environment, such as the labor market and income distribution).

This suggests the following: while institutional change is taking place as analyzed in our study, whether this turns out to be beneficial to the Japanese nation is another matter. While the cost of the old institution has become apparent, whether what lies ahead benefits the public is unclear. While the shift from "stability and cooperation" towards "competition and transparency" may be unavoidable in the "globalization" trend which forces national systems that protect domestic industries to undergo a significant shift, the extent to which such shifts ought to take place needs to be decided upon a cost-and-benefit consideration with institutional complementarity in mind. In this regard, those who advocate the need for "institutional change" tend to emphasize the benefit of the institutional change, without adequately addressing the cost that such institutional changes entail.[20] Instead, a balance sheet that honestly identifies the problems the changes entail ought to be provided so that solutions can be developed.

4) Politics of Reforms in General: Better International Economic Policy Through A Multi-Disciplinary Approach

Our analysis suggests that entrenched interests may not be as entrenched as they may seem. The key is to see whether actors have different incentive structures, produced by the environmental changes. This may suggest an alternative approach to encouraging reforms in developing nations or newly democratizing nations. On one hand, the former "insiders" may turn out to be the ones to be better equipped to carry out economic reforms:

all that matters is the incentive structures. On the other hand, the introduction of some formal institutions developed in market economy and liberal democracy may only bring about a nepotism of the former "insiders" taking advantage of the discrepancy between such formal institutions and the social reality. (Aoki forthcoming)

Thus, careful attention to institutions, extending beyond the conventional attention on formal rules and organizations are necessary if one wishes to establish the "right" set of incentives. As our study suggests, one needs to identify the informal interaction patterns as well as the shared expectations of the actors to grasp the true functioning of institutions.

This need to understand better the institutions, including its shared expectations, points to the need for an inter-disciplinary approach in public policy making, reaching beyond the boundaries of neoclassical economics. Such an approach may help ameliorate international economic policy making in such international organizations as the International Monetary Fund (IMF), in which, due to an over-emphasis of macroeconomics under the dictates of the principles of market economy (or "market fundamentalism" [Sakakibara 2000] according to some critics), numerous policy failures appear to have been committed during the 1990s (e.g. Russia; Indonesia).

9.4 Further Issues

We close this dissertation by identifying issues that need to be pursued further, if we are to improve our research and connect it to other studies.

The first way to expand the scope of the research is to apply the above framework to other areas in the political economy , as suggested in Section 9.2. Among the sectors where "change" appears to be distant, the area of public finance (e.g. postal savings, the Fiscal Investment and Loan Program, and the pension fund system) appears to be promising in particular, given its strong relationship with private finance: a comparison of the two fields demonstrating how changes occurred or did not occur, as well as the evaluation of the impact of changes in private finance on public finance may be interesting areas to pursue.

The study of bureaupluralism may be improved by introducing a longitudinal comparison akin to the one we produced regarding financial reforms. In this regard, an inquiry into past attempts to "go around" bureaupluralism, especially the Nakasone administrative reforms of the 1980s, may tell us what changed and what did not in the public policy mechanism of bureaupluralism. Moreover, our research did not delve into the impact of the change of government of 1993 on the evolution of public policy making mechanism of bureaupluralism in detail: how the LDP PARC withstood its loss of influence and how the alternative mechanisms that sprung up fared over the 1990s may need greater attention, if we are to offer a better prediction on the fate of bureaupluralism.

The role of the media in politics may also contribute to a better picture of how the public influences politics. The experience of financial politics (e.g. the Housing Loan Affairs, the MOF Reforms, and the Big Bang) suggests that the media has played a significant role in setting the public's attitude in many issues. How the influence of the media, as studied under the stable LDP rule (e.g. Kabashima [1986]), evolved after the change of government in 1993 may complement our argument that sees an increased role for the public in politics.

Finally, international comparison is another promising field: the institutional change in the Financial Convoy and bureaupluralism is highly likely to have its counterparts in other countries, which have also been facing technological innovation, globalization, and other "economic propellants" as well as similar "political impediments" to Japanese financial reforms.[21] According to the U.S. Federal Board of Reserves Chairman Alan Greenspan, the shift from "stability" to "competition" is a global trend under fast technological innovation:

"We are seeing the gradual breaking down of competition-inhibiting institutions from the keiretsu and chaebol of East Asia, to the *dirigisme* of some of continental Europe. The increasingly evident advantages of applying the newer technologies is undermining much of the old political wisdom of protected stability. The clash between unfettered competitive technological advance and protectionism, both domestic and international, will doubtless engage our attention for many years into this new century."[22]

In the United States, the Glass-Steagall Act of 1933, after which the financial segmentation in Japan was partially modeled, was finally reformed in a significant manner in 1999, after a long process of reforms that involved a struggle of lobbying interests (e.g. securities and insurance industries) opposing financial reforms as well as developments in finance since the mid-1980s to make such regulations largely obsolete.[23] As Greenspan's comment suggests, France and the European Union, as well as South Korea and other Asian nations, may provide interesting comparative grounds to assess how different countries have coped with similar international developments. Studying the timing, pace, and scope of the shift in the basic institutions in the political economy comparable to *keiretsu*, the main bank system, and bureaupluralism may give us a better understanding of the effect of such potential causal factors as globalization, regional integration (for European states), or financial crisis (for Asian nations).

Notes

Chapter 1

1 See for example, Zysman (1983) and Aoki and Patrick (1994).

2 For example, asset management accounts have been introduced, and banks are now selling investment trusts, a market traditionally dominated by the securities industry.

3 See Suzuki (1997), Nishimura (1999), Saito (1997), and Horiuchi (1998) on these points.

4 See economist Yukio Noguchi's view in Chapter 8.

5 Housing loan companies are non-bank financial firms that originally specialized in housing loans to individuals, but had been heavily involved in real estate development loans during the bubble years of the 1980s. See Chapter 5.

6 Similar views can also be widely found in the journalistic (non-academic) literature. For example, see Hartcher (1998) and Katz (1998).

7 Examples include the liberalization of brokerage fees and the abolition of legal quasi-cartel in casualty insurance.

8 We mean the economic theories of regulation such as Peltzman (1998). See Chapter 2 for detail.

9 The deregulation of foreign exchange control will be also discussed, although it receives less attention. This is because the regulatory rent from the foreign exchange business is trivial, compared to that accrued from the core business (i.e. banking, securities, and insurance) of the three industries, from the financial industries' standpoint . However, changes in domestic finance may come from abroad: the implication of foreign exchange deregulation on domestic finance will be a key factor in the emergence of the Big Bang. See Chapter 5.

10 The demarcation between public and private finance has also been a very interesting political process, involving the powerful Postal Savings lobby, the LDP tribesmen, and the Ministry of Post and Telecommunications. However, we choose to put this issue aside, as these actors (and the issue itself) were largely outside of the political process of the Big Bang.

Chapter 2

1 For the distinction between the two approaches, see Steinmo, Thelen, and Longstreth (1992), W. Scott (1995), Bates et al. (1998), and Krasner (1999).

2 For rational choice analysis, see for example, the essays in Alt and Shepsle (1990). Levi (1997) provides a summary of this methodology's strengths and weaknesses. In economics, the actor-oriented neoclassical approach has dominated the field for a long time. See W. Scott (1995, chapter 1).

3 For historical institutionalism in general, see for example, Steinmo, Thelen, and Longstreth (1992), Katzenstein (1978), Skocpol (1985), and Karl (1997). The new institutionalism in sociology shares this institution-oriented approach: see, for example, the essays by Meyer and Rowan, and DiMaggio and Powell collected in Powell and DiMaggio (1991).

4 See Calder (1993), Woodall (1994), Vogel (1996), and Pempel (1998). Also see Katzenstein (1978) and Zysman (1983). For an example of the application of the "garbage can" model (March and Olsen 1989) to Japanese politics, see Mabuchi (1994).

5 For example, see Samuels (1987, 285), where the rejection of mono-causal explanations is defended as follows: such explanations focusing on interaction of causal factors (as his) "predict little but explain much".

6 In the economic studies of the Japanese political economy, the actor-oriented approach was, of course, the norm. There have been numerous economic studies on Japanese finance: see, for example, Hamada and Horiuchi (1987), Aoki (1988), Aoki and Patrick (1994), Aoki, Kim, and Okuno-Fujiwara (1997), and Hoshi and Kashyap (1999) in English; Ikeo (1995), Ueda and Fukao (1996), and Horiuchi (1999) in Japanese. However , relatively little attention has been placed on the political struggle between the actors: the politics of distributional conflict is largely absent from all but a few exceptions (e.g. Aoki, Kim, and Okuno-Fujiwara above).

7 Needless to say, this view of institutions is under the strong influence of the new institutionalism in economics such as North (1990, 1), which defines institutions as "the rules of the game in a society", or "the humanly devised constraints that shape human interaction."

8 Of course, it is up to what the theorist seeks to explain: career advancement (Tullock 1965), budget maximization (Niskanen 1971), and discretionary power (Kato 1994) may provide some examples of plausible assumptions. However, these examples fall short of explaining the principal case of our interest, the Big Bang financial reforms, where MOF willingly shed its regulatory power (see Chapter 5). Isn't there a possible way of integrating the confusing state surrounding these assumptions? We will come back to this point in Chapter 3.

9 Levi (1997, 21) states that "rationalists are almost always willing to sacrifice nuance for generalizability, detail for logic, a forfeiture most other comparativists would decline." This point seems to be central to criticisms from the non-rational choice view point in the context of Japanese politics: see Johnson and Keehn (1994) and Curtis (1999).

10 The examples originate from McCubbins and Noble (1995, 70) and Ramseyer and Rosenbluth (1993, Chapter 8). Those who know better about Japanese politics would ask the following questions. Is there any evidence that the LDP obtains information from the deliberative councils? (Interviews with the LDP or bureaucratic officials would easily disconfirm this assertion). Here, the theorists seem to be too easily enchanted by the theory of "fire alarm" developed in the United States. As for the assertion that "the LDP appoints the Supreme Court justices", one should note that the justices selected from the bar are typically those who have managed the highly independent Japanese Bar Association, whose progressive policy is far apart from the conservatism of the LDP. Why isn't this fact mentioned? It seems that the theorists are projecting the partisan practice of judiciary appointment in the United States onto the Japanese process too heavily. The LDP may control the cabinet, which appoints the justices; however, whether the LDP really has a say in the appointment process is what needs to be

uncovered through deeper empirical research, and merely asserting the existence of a control mechanism based on deductive logic is clearly insufficient to make the case.

11 See Steinmo, Thelen, and Longstreth (1992) and Thelen (1999) for the historical institutionalist view on this point, and Levi (1997) and Bates et al. (1998) for the rational choice view.

12 This, we believe, contributes to the advance of social science, as more resources are likely to be invested in efforts that have greater relevance to what is happening in the "real world".

13 This may be also true in international organizations dealing with issues of political economy: how many political scientists are there in the International Monetary Fund (IMF)?

14 See Curtis (1999, 234-42).

15 A "regime shift", according to Pempel (1998), occurs when socioeconomic coalitions, political institutions, and public policy profile (which compose a "regime") all shift: this is his "third-order regime shift". Japan of the 1990s is said to have experienced a "second-order regime shift".

16 Note that the abovementioned division between actor-oriented and institution-oriented approaches do not necessarily coincide with this division: both can generate theories of "stability" and "change". For example, rational choice approaches have centered around equilibrium analysis. (See Levi [1997] or Green and Shapiro [1994].) Thus, theorists have mainly dealt with cases of stability, while some have shown that this approach can apply to the question of institutional change. (For the latter, see, for example, North [1990]. As we will see later, Aoki [forthcoming] extensively takes on this question of institutional change.) Some works of historical institutionalism have sought to deal with changes, such as social revolutions or democratic transition. (For example, see Skocpol [1979] and O'Donnell and Schmitter [1986]).

17 I am deliberately not addressing the triumvirate view (the so-called Japan Inc. view) or the Marxist approach, as they seem to be of little salience in today's debate in the field. It is clear that these views do not appropriately address the numerous conflicts among elite actors, which is the reality of Japanese politics.

18 Also see Zysman (1983) and Vogel (1996).

19 I am referring to the concept of pluralism as developed by Dahl (1971). Note that this concept of "pluralism" can also be used to refer to stress the dominance of the bureaucracy, as in Inoguchi (1983).

20 He calls it "refractive state". He includes "patterned pluralism" among one of the theories that form this consensus (see below).

21 Thus, we do not find faults with some theories of pluralism (Muramatsu and Krauss 1987; Inoguchi and Iwai 1987) that asserted dominance as a result of empirical analysis, although our actor-oriented approach diverges from these institution-oriented approaches, as discussed above.

22 See Noble and McCubbins (1995, 70), where this assertion is made without much empirical evidence.

23 For example, Masaharu Gotoda, in Otake (1997a), recalls his hardship in the administrative reforms, serving as Chief Cabinet Secretary under the Nakasone government in the 1980s.

24 The "rules of the game" certainly matter: bureaucratic initiatives have to be in the "win-set" of the legislators to become laws. But what if, as is the case in many non-politicized issues, the bureaucratic agent negotiates with the interest groups, drafts the bills, informs the legislators as to its broadest outline, and in this way enjoys a large discretion over the choice of multiple outcomes as well as setting the timing, scope, and schedule of the initiatives, which may all fit the principal's interests?

25 Needless to say, this view is held by those who embrace the "revisionist" view of the Japanese state, such as van Wolferen (1990), Johnson and Keehn (1994), and Hartcher (1998).

26 For economic analysis, see for example, Dekle (1997), IMF (1997) and OECD (1997). For journalistic accounts, see for example, Asahi Shimbun (1997), Nihon Keizai Shimbun (1997), and Mainichi Shimbun (1997).

27 For example, see such representative works on financial politics of the 1980s and 1990s as Rosenbluth (1989), Vogel (1996), Mabuchi (1997), and Amyx (1998), and also such representative works as Johnson (1982), Okimoto (1989), Samuels (1989), and Calder (1988; 1993). What is the role for the public? As for works of rational choice, see Ramseyer and Rosenbluth (1993), Cowhey and McCubbins (1995); for financial politics, see Rosenbluth and Thies (1999).

28 See Muramatsu, Ito, and Tsujinaka (1992) on this point.

29 For example, a firm can demote (or fire) individuals who do not comply with its organizational policy decided by the steering board. Or, its President may utilize the threat of demotion or the promise of promotion to ensure compliance to his views. Political parties can expel or place other sanctions to members who do not comply with its policy, decided by such bodies as the LDP's Executive Council. The LDP's political leaders can utilize a threat of demotion (or withholding of funding) or the promise of positions within the party or the government to ensure compliance. The same holds for the bureaucracy, although the bureaucrats are by law protected from being fired at will.

30 Because our behavioral assumptions on the bureaucrats depart from conventional ones, we do delve into the individual incentive structures for this set of actors.

31 See Simon (1979) on bounded rationality. In the study of Japanese politics, our definition of rationality is similar to that of Kato (1994).

32 See Aoki (forthcoming). Also Fujimoto (1997), where the pattern of "emergence" of a new system is analyzed in a study of the Toyota production system.

33 This is not to deny the likelihood that such factors are subject to the law of diminishing returns and other laws. The point here is to distinguish the "ultimate" from the "ceteris paribus".

34 Needless to say, I am referring to the so-called neo-realist literature that followed Waltz (1979) as well as such neoliberal perspectives as introduced by Keohane (1984) that share this "survival" assumption.

35 In this way, we extend the framework of "bureaupluralism" provided by Aoki (1988), which holds that the bureaucrats seek to cater to both "jurisdictional constituents" and public interest, to state actors in general, as politicians do pursue these two sets of interests as well. See Chapters 5 and 6.

36 See Peltzman (1998) and Noll (1989) for this approach. Rosenbluth (1989) and Noll and Rosenbluth (1995) provide some examples of the application of this approach to Japanese politics.

37 See Aoki (forthcoming), which delineates this approach.

38 Even if there are formal rules or the accumulation of informal interaction patterns, if the actors collectively believe that they are irrelevant, they cannot be "institutions" that shape and constrain human behavior. Imagine that there is a widely accepted practice by all actors (e.g. wining and dining of officials), while it was known that the laws and past court decisions treated them as bribery. However, once the collective beliefs shift from "acceptable" to "not", such practice starts to be punished as stated by the laws. What is the fundamental causal factor? Should we focus on the laws prohibiting bribery? Or, the informal practice of wining and dining? Or, the collective beliefs concerning the acceptability of wining and dining?

39 See Ragin (1987) for a discussion of comparative methods, including longitudinal comparison. This method is similar to one adopted by Skocpol (1979) in her contrast of the Russian revolution of 1917 (success) to that of 1905 (failure): similar settings, different results.

40 See Bates et al. (1997, 13-18).

41 See Bates et al. (1997). Note that this strategy is hardly limited to analytic narrative perspectives. For example, see Kohno (1997) for an example of such a methodology in Japanese politics.

42 It is not that others analyze the Big Bang using the same theoretical tools as the ones they used for different cases: thus, we may not be doing total justice to the alternatives. However, given the general tendency for theorists to advocate one theoretical position consistently from case to case, we will construct the alternative explanations, which should be understood more as a counterfactual (i.e. asking "How would this theory explain this?") than a criticism against existing theories.

43 There may be many other variations, but we limit the alternatives to five to keep the analysis under control: the admittedly arbitrary criteria for the selection is the plausibility against the known reality of Japanese politics and the influence within the academic discourse on Japanese politics today.

44 Also see Cowhey and McCubbins (1995).

Chapter 3

1 See Chapter 2 for a discussion of two different approaches to "institutions" in political science (actor-oriented and institution-oriented).

2 Following the examples of many in the field of actor-oriented approaches to institutions, we sometimes refer to the terminology of "game" as used in game theory to facilitate conceptual understanding.

3 For example, see North (1990, 110).

4 See Morrow (1994) for an overview of applications of game theory, especially sub-game perfect, to political science. See Young (1998) for an overview of how evolutionary game theory relaxes the assumptions of classical game theory.

5 This framework was developed from evolutionary game theory and dynamic adaptive learning models of large populations composed of subjectively rational actors. See Young (1998) for a methodological discussion of this approach.

6 In Aoki's terms, institutions are "collectively shared, self-sustaining system of beliefs regarding a salient way in which the game is repeatedly played". What follows in this section is an effort to represent the conceptual thinking developed by Aoki in a summarized, somewhat cursory, manner without using the language of game theory, while adding some interpretation and examples of my own. See Aoki (forthcoming), especially Chapter 1.

7 In this sense, institutions reduce transaction cost, as in the transaction-cost perspectives (North 1990).

8 That is, all actors are better off in institution a than b; or actor A may be better off than actor B in a, and vice versa for b. Note that institutions a and b are still Nash equilibria. The definition of a Nash equilibrium is that no single actor has the incentives to alter his own strategy, given the other actors' strategies.

9 The "main bank system" in Japan, an accumulation of practices in banking and industrial sectors and the government, is given by Aoki as an example of such institutions. See Aoki (forthcoming). For the Japanese "main bank system", see Aoki and Patrick (1994).

10 For lifetime employment in Japan, see Aoki (forthcoming) and Noguchi (1995). According to Sakakibara (1993), "anthropocentrism" such as employee sovereignty in firms assumed a normative character over time.

11 See Aoki (forthcoming) where the synchronic linkage of institutions is discussed. The "institutional fields" correspond to what he calls the "domains" in which the games take place. Aoki's "domains" are classified into four categories along the characteristics of the strategic interaction (the availability of "exit" and the symmetry of actors); however, in our framework, we call the domain in which strategic interaction takes place as "institutional field", without making such a distinction among fields.

12 Aoki (forthcoming) develops this concept in a thorough and formalized manner.

13 Suppose that there are two institutional fields (A and B); actors have two options in each field (a1, a2; b1, b2); actors have identical payoff functions regarding their choices in each field. If all actors choose a1 in A, institution A1 arises in A (likewise, a2 gives rise to A2). Similarly, b1 (b2) in B gives rise to institution B1 (B2). The actors in one field may have differing preferences over the institution in the other field: for example, some actors in A1 may prefer B1 in B, others B2 in B. In each field, strategic complementarity obtains: when an institution (= equilibrium) has not arisen and actors

are making their choices, each actor always sees his/her own marginal gains of switching choices increase, when any other actors make the same shift. When the following two conditions hold ("super-modularity"), multiple equilibria arise. First, all the actors in A see that the marginal benefit derived from choosing A1 over A2 increases, if the institutional environment is B1 rather than B2. Second, all the actors in B see that the marginal benefit derived from choosing B2 rather than B1 increases, if the institutional environment is A2 rather than A1. Under this condition, two Nash equilibria in terms of institutional arrangements arise: (A1, B1) and (A2, B2). When such multiple equilibria arise, fields A and B are said to be institutionally complementary, and institutions A1 and B1 (A2 and B2) are complementary institutions.

14 For "institutional change", see the chapter on diachronic linkages of institutions in Aoki (forthcoming).

15 The following examples may be thought of: areas other than finance in Japan; financial and other areas in other countries; the drastic changes of the political system and/or the economic system that occur in such situations as "democratization" or "revolution".

16 This was a common characterization of Japanese political economy in the 1980s: in the 1990s, not many would characterize the economy as "first-rate".

17 The process may possibly be compressed into one short event that unfolds very fast.

18 See, for example, Kohno (1997) and Pempel (1998) for the political process of before and after 1993. Also see Reed and Thies (1999) for the electoral reforms since 1955 including the origin of the one in 1994.

19 See Chapter 6 for the later political process, in which Hashimoto resigns in 1998, succeeded by Keizo Obuchi.

20 As noted above, this is in line with the Downsian tradition that assumes that "every government seeks to maximize political support", that "the government exists in a democratic society where periodic elections are held, and that the government's goal is "reelection". (Downs 1957, 11)

21 Japan has a bicameral system: the Lower House (*Shugiin*), with priority over the election of the Prime Minister as well as votes on budget and treaties, and the Upper House (*Sangiin*).

22 See Kohno (1997, 12-13) on this issue. We agree with him that the outcome (the LDP one-party rule) does not necessarily mean the lack of competition among political parties for the postwar era.

23 Note that "winning" does not necessarily involve gains in electoral seats. For example, in the 1993 elections, the Komeito seems to have adopted a strategy to keep as many seats as possible, by limiting the number of their candidates: victory may also be "having most of its candidates elected".

24 See the fate of the Sakigake Party: once a prominent coalition member for the 1993 non-LDP government and the 1994-1998 three party LDP-coalition, it was disbanded in 1999 with only a few Diet members left.

25 This led to a bargaining behind closed doors between the LDP and non-LDP party officials in charge of Diet affairs, which gave a certain bargaining power for the non-

LDP parties. However, under both houses under the LDP control, the opposition party does not seem to have wielded considerable power. See Sato and Matsuzaki (1986, Chapter 7).

26 The Japanese Constitution guarantees the primacy of the Lower House for proposals over budget and treaties: however, for the passage of a proposed legislation, the approval of both Houses is required.

27 This term comes from Okimoto (1989), which offers a discussion of the types of exchange of goods and services between the LDP and the members of its support coalition. Note that the power to grant particularistic policy favors has been almost monopolized by the LDP since 1955 (with its structured process of distributing such favors developed over the years).

28 See Kim et al. (1995), including such articles as Pempel and Muramatsu (1995) and Inoki (1995). Also see Johnson (1982), Samuels (1987), Okimoto (1989), Vogel (1996); and Ramseyer and Rosenbluth (1993) and Calder (1993). See Chapter 2.

29 Although how Kato defines discretionary power is unclear, according to Amyx (1998, Chapter 1), which uses a similar behavioral assumption, discretionary power is the power to decide when or when not to enforce rules.

30 Although, whether this is the starting assumption, or the conclusion, or both is somewhat unclear.

31 For instance, take the case of administrative reforms of the 1980s and see the interviews of politicians collected in Otake (1997a). Does the interview of Masaharu Gotoda (Cabinet Chief Secretary) who recalls the hardship to overcome the bureaucracy's resistance, support such an empirical assumption?

32 For example, Muramatsu (1994, 206-7) argues that the bureaucratic officials' maximization of volume of activity of their organization, their maximization of the resources and values under one's control, and the maintenance and enlargement of the organization are their behavioral regularities.

33 The highest rank that a career official can reach is the Administrative Vice-Minister. Politicians in the Ministry consist of one Cabinet Minister, and one or two Parliamentary Vice-Ministers.

34 For *amakudari*, see Inoki (1995). Also see Amyx (1998, Chapter 3); Okimoto (1989, 161-65), Aoki (1988, Chapter 7), and Ramseyer and Rosenbluth (1993, 115-22).

35 Besides, the ties between the retired officials and the bureaucracy do not end when they leave the bureaucracy: most bureaucrats would move over to other similar positions, very often under the recommendation of their old ministry.

36 Our discussion on "power" parallels the contrast often drawn in international relations literature between material resources that actors command and intangible influences over other actors. See Gilpin (1981, 31), which distinguishes power (material capabilities) from prestige, or the reputation of power, which is the "everyday currency of international relations". Also see Keohane (1984, Chapter 2) for a review of the concepts of power.

37 See Eda (1999) for a proposal by Prime Minister Hashimoto's private secretary (from MITI), towards MITI assuming a role over macro-economic policy by merging into the Economic Planning Agency (EPA). Given the relative power relationship between MITI over EPA (e.g. in personnel practice), it may not be surprising if MITI's strategy towards administrative reforms under the Hashimoto government included the concern mentioned here.

38 In Aoki's language, these two factors determine the political stock that the bureaus command. While we assume, as Downs (1957, 11-2) does, that "every government seeks to maximize political support", we define "government" not as "governing party" but rather as "state actors", or "politicians and bureaucrats with direct access to governmental power".

39 Note that this distinction may be the result of how one defines corporate governance: "the control of suppliers of finance over corporation" or "the design of institutions that induce or force management to internalize the welfare of stakeholders." (Tirole) For example, contrast Shleifer and Vishny (1997) from the former approach, against the "stakeholder" approach in Tirole (1998). As we are interested in the Japanese political economy, we adopt the latter view.

40 See Aoki (1988; forthcoming), Sakakibara (1993), and Aoki and Patrick (1994).

41 See Yoshida (1993, 63-65). Also see Yoshitomi (1998, Chapter 6), which shows how the "purpose" of the Japanese firms are markedly different from that of the U.S. firms. However, this trend is also undergoing a change, as some "mavericks" (e.g. Yoshihiko Miyauchi of Orix Corporation) who openly adhere to the dictates of "shareholder capitalism" have been on the rise. See Nikkei Bijinesu (18 October 1999, 148-151), where he debates against Toyota Motors Chairman, Hiroshi Okuda, who professes that his company sees priority in pursuing "the balance among such stakeholders as shareholders, employees, and customers" and that "there is a responsibility for firms to provide for continued employment, given the inflexible labor market."

42 The reasons (e.g. to increase bargaining power vis-à-vis the less organized actors, such as the public) why firms organize themselves into interest groups needs not concern us much here. See Noll (1989) for a survey of the interest-group theory of regulation in economics.

43 See Okimoto (1989, 165-71), Aoki (forthcoming), and Vogel (1999).

44 See Downs (1957), Olson (1965), and Peltzman (1998).

45 For example, see Grossman and Helpman (1994), Noll (1989; 1999), and Peltzman (1998) for interest group theory of regulation; see Laffont and Tirole (1991) and Dixit (1996) for transaction-cost perspectives.

46 According to Aoki (forthcoming), the development of bureaupluralism in the postwar era can be characterized as the Japanese state has moved from a collusive system ("developmental state") to a more inclusive arrangement, incorporating more and more societal interests (e.g. environment, retired citizens) in the process. See Okimoto (1989) and Calder (1988) for the way the Japanese state evolved where the LDP constantly enlarged its supporting coalition. As for the continuity of the Convoy system in finance, in the postwar era, see Noguchi (1995).

47 Aoki's concept focuses on the interplay of bureaucratic agencies regarding budgetary politics: bureaucrats maximize two sets of interests, that of "public" and "jurisdictional constituents". In our view, this holds true not only for bureaucratic agencies but also for political parties in the pursuit of their organizational survival. Also, the competition among "bureaus" that Aoki (1988) describes is focusing on budgetary politics, but a similar mechanism is at work in public policy making in general, including regulatory policy making. Thus, we expand the concept to refer to an "institution" in public policy making in general, in which bureaucratic agencies as well as political parties interact with interest groups and the public.

48 This framework laid down under the basic law on administrative set-up, the National Administration Organization Act (*kokka gyosei soshiki ho*), did not go through a major revision until 1996. The Cabinet Minister and the Parliamentary Vice-Minister [later called Parliamentary Secretary] (two in some ministries), were the only politicians in a bureaucratic agency; however, the resulting reforms would, starting from 2001, upgrade the Parliamentary Secretary (*seimujikan*) to Deputy Minister (*fukudaijin*) and would introduce a junior rank political position (*seimukan*), increasing the total numbers of politicians in the government.

49 See Haley (1995). Also see Sakakibara (1993, 57) for a table showing the high ratio of cabinet-proposed legislation to all legislation between 1975 and 1987. This trend has been steadily observed since: for example, as of 1995, 90% of the bills submitted were government-proposed.

50 For the policy making process concerning legislative bills, see Haley (1995, 90-91) and Muramatsu, Ito, and Tsujinaka (1992).

51 See the survey by Muramatsu (1981) of bureaucrats and politicians' views of deliberative councils.

52 We may add another policy making body operating within the bureaucracy: the Cabinet Legislation Bureau (CLB). In the third stage, the CLB, headed by a bureaucrat with a rank of just below a Cabinet Minister and staffed by bureaucrats from various ministries, operates to ensure that legal technicality accompanies policy proposals. This organization commands high prestige over the interpretation of statutes concerning public administration, including the Constitution: the interpretation by the CLB is usually considered to be authoritative (unless cases go to courts), as can be seen in the fact that the government interpretation by the CLB over the controversial Article 9 of the Constitution (ban on the armed forces) is highly influential in the political process. See Haley (1995) for the role of the CLB. From the critics' viewpoint, the CLB operates so as to maintain an entry point for the bureaucrats into the policy process: see Mabuchi (1997), where the CLB, heavily penetrated by MOF officials, raised a constitutional argument against the proposed independence of the BOJ from MOF. See also Amyx (1998) for the relationship between MOF and the CLB.

53 See Inoguchi and Iwai (1987) for the LDP tribesmen.

54 See Muramatsu, Ito, and Tsujinaka (1992, Chapter 8).

55 For nemawashi and the deliberative councils, see for example, Kumon (1992).

56 One such example may be the environmental issues before the creation of the Environment Protection Agency in the late 1960s to early 1970s.

57 Independent administrative legislation is considered unconstitutional. See Shiono (1991).

58 See the above note on the CLB.

59 See Muramatsu and Pempel (1995, 69-70). On administrative guidance, also see Johnson (1982) and Okimoto (1989). See Mabuchi (1995) for administrative guidance in finance.

60 Tsutatsu do not bind court decisions, however. See Shiono (1991, 78-9).

61 Recognizing the prevalence of this administrative practice off the legal statutes, "administrative guidance" was incorporated in the Administrative Procedure Act of 1993, allowing the private parties to ask for the documentation of administrative guidance. Also, MOF, in response to criticism against the "opaque" nature of tsutatsu, has been drastically reducing their number from 1997.

62 Administrative discretion has been an established long tradition in the Japanese public administration since the pre-WWII days: although such administrative discretion can be challenged in court, the court precedents adopt a standard that requires an existence of "overstepping / misuse" (*itsudatsu ran'yo*) of the discretionary power on the part of the public administration, which makes such challenges quite hard in practice. (Shiono 1991) In the Japanese context, that the public administration is given considerable discretionary power was rather a given, and how to curb administrative discretion has rather been at the center of policy debates concerning public administration. This trend has been reinforced by recent arguments that administrative discretion leads to inefficiency and that a shift towards a rule-based system with greater involvement of the judiciary is necessary. See Okuno-Fujiwara (1997) and Muramatsu (1994).

63 See Noble and McCubbins (1995).

64 Public works such as agriculture, transportation, and construction, in budget politics are also good examples of the importance of tribesmen in bureaucratic competition.

65 To see this point, we may observe how the business and political influence of polluting companies (e.g. Chisso in Minamata Scandal) or pharmaceutical companies with contaminated products (e.g. Midori Juji in the HIV Scandal) deteriorated, following their becoming "public enemies", attracting widespread public criticism.

66 This is what Okuno-Fujiwara [1997] calls relation-based, as opposed to rule-based government. This also corresponds to what many works on Japanese politics have described with such concepts as "network state" (Okimoto 1989) and "reciprocal consent" (Samuels 1987). See the summary by Curtis (1999, 59-60) on this point.

67 On the Financial Convoy, see Pempel and Muramatsu (1995), Aoki and Patrick (1994), Rosenbluth (1989), and Vogel (1996); see also Ikeo (1995) and Horiuchi (1998; 1999). Also, Nishimura (1999) gives an insiders' account of the Convoy, analyzing why "financial administration lost" from MOF's standpoint.

68 Two-year maturity bonds were also introduced in 1991.

69 See Packer (1994) for the long-term credit banks.

70 See Aoki and Patrick (1994) and Amyx (1998) on the state of the segmentation within banking.

71 As the Convoy is also part of bureaupluralism in public policy making, we may add the legal statutes guaranteeing MOF the exclusive jurisdiction over financial regulation to our list of formal rules.

72 See Okimoto (1989), Samuels (1987), and Pempel and Muramatsu (1995).

73 For example, see Fuchita (1997) for how the formal rules and the administrative practice would hinder new entry into securities.

74 For the main bank system, see Aoki and Patrick (1994). For financial keiretsu, see Okimoto (1989).

75 See Rosenbluth (1989) for the 1979-82 banking reforms, and Vogel (1996) for the 1991-93 financial reforms. The former argues that the industries dominated the process, while the latter sees more bureaucratic initiative in the reforms.

76 This book, recollecting revised newspaper articles, pursues "the precursors of the collapse of the myth of no bank failures" while observing that, "Of course, the failure of banks have not surfaced as of now." (Nihon Keizai Shimbun 1993, 1-2)

77 See Chapter 4, where the reaction to the Big Bang by the "weak" will be cited. Also see Nishimura (1999), which delves into this concern for the weak from the regulators' viewpoint. See Chapter 8.

78 See his discussion of the "state" domain in Aoki (forthcoming).

79 See Kumon (1992) and Okimoto (1989) for the role of consensus in government policy.

80 See Okimoto (1989) for example.

81 Even the Big Bang plan of June 1997 includes a section on "financial stability", which may not be necessarily compatible with the measures enhancing competition. See Chapter 4.

82 This assumption applies to domestic firms only: foreign (especially American) financial firms are known to have higher priority placed on profit than continued employment, reflecting the difference in corporate governance. See above note on different views on corporate governance.

Chapter 4

1 However, Komine (1997) points out that there is nothing unusual for the Japanese household to have this amount of financial assets, however large the figure seems to be. Indeed, the comparative figure for the United States, presented below, is roughly twice as much, proportionate to the relative size of the GDP.

2 Source: MOF.

3 "Do efficient financial markets mitigate financial crises?" Remarks made before the 1999 Financial Markets Conference of the Federal Reserve Bank of Atlanta, Sea Island, Georgia in 19 October, 1999. Accessed on 8 March, 2000 at http://www.federalreserve.gov/boarddocs/speeches/1999/19991019.htm

4 A financial center is a city or a market exchange where there is an accumulation of financial institutions trading many financial products in the money market, the capital market, and the foreign exchange market. An international financial center is a financial center that deals in international products and have many foreign participants. (Ito 1996, 187)

5 However, it must be noted that, at that time, the 1991-93 reforms were perceived as a great leap forward, at least by MOF and the financial industries. See Nishimura (1999).

6 The discussion below largely draws on Hoshi and Kashyap (1999, 10), where they divide their discussion into "the responses of the borrowers, savers, and lenders" to the deregulation.

7 Based on Table 6 of Hoshi and Kashyap (1999), which shows the ratio of bank debt to assets for publicly traded Japanese Firms over 120 billion yen at 1990 prices.

8 Samurai bonds are Euro-yen bonds; Shogun bonds are yen bonds issued by non-residents in the Japanese market.

9 This required the matching of trade flows for foreign exchange transactions .

10 See Osugi (1990). Other measures include: purchase of foreign bonds by Japanese residents and widening of foreign financial institutions' access.

11 See Chapter 3.

12 See Noguchi (1993) and Yoshitomi (1998) for a discussion of the economics of the bubble, and the mechanism by which the bubble bursts.

13 Fiscal year for the Japanese government: April-March.

14 The two other reforms were education reforms and economic structural reforms.

15 Japanese banks have traditionally held a large portfolio of stocks, which they were allowed to hold up to 5% ownership under the Anti-Monopoly Law. Banks' stockholdings represented more than 25% of market capitalization by 1988 (IMF 1998, 101), reflecting the practice of cross-shareholding among financial and non-financial firms.

16 As the capital requirements under the Basle accords allowed Japanese banks to include 45% of these hidden assets as Tier II capital, the hidden losses caused by asset deflation later resulted in a credit crunch later on.

17 As for the current situation, at new, more stringent standards "intended to be broadly in line with the U.S.", 35 trillion yen (approximately 7% of GDP) of non-performing loans exist for all-deposit taking institutions as of end-March 1998. Based on the self-assessment of asset quality of all deposit institutions, which resulted in the 88 trillion yen of "problem loans" (grouping loans of categories II, III, and IV) at the same

period, IMF estimates that the uncovered losses may amount to 19 trillion yen, or around 4% of GDP. (IMF 1999, 111)

18 See for example, Yutani and Tsujihiro (1996).

19 See Horiuchi (1998, 169-79).

20 Later on, in 1997, Hokkaido Takushoku Bank, one of the twenty largest banks, or "money-center banks" which the government earlier committed not to let them down, failed. In 1998, the Long-Term Credit Bank of Japan (LTCB), and in 1999, the Nippon Credit Bank (NCB) failed, bringing the long-term credit banks' number down to one, the Industrial Bank of Japan (IBJ). See Chapter 7.

21 See Yutani and Tsujihiro (1996), Mabuchi (1997), and Nishimura (1999) on the Housing Loan Problem. Also see Chapters 5 and 6.

22 These measures would enable the regulator to take necessary measures, including bank shutdown, based on capital/asset ratio required by the Basle Accord. As earlier noted, this measure preceding the Big Bang initiative was included in the MOF announcement of June 1997 as part of the Big Bang.

23 This would enable the Deposit Insurance Corporation to represent the depositors in a "Chapter 11" situation.

24 A new quasi-public bank owned by the Deposit Insurance Corporation, the Resolution and Trust Bank (*Seiri kaishu ginko*), was set up to purchase the businesses of the failed credit cooperatives. A special account was temporarily created in the Deposit Insurance Corporation as well to deal with the credit cooperatives' failure. In accordance with the legislation, the deposit insurance corporation decided to raise the deposit insurance rate fourfold from 0.012% to 0.048%, while charging an extra 0.036% for five years for funding.

25 It must be noted that Ryutaro Hashimoto, the Prime Minister in 1996, had to resign from his post of Minister of Finance, taking responsibility about this scandal.

26 Later on, several MOF officials were arrested on bribery charges, mostly based on wining and dining. MOF sanctioned 112 officials in 1998, forcing to retire two of its top officials. See Chapter 7.

27 Stability and stabilization (*antei, anteika*) are terms frequently used by MOF in the context of the bad debt problem, distinct from such reforms that are forward-looking and have vitalization (*kasseika*) as a goal.

28 I owe this point to Steven Vogel.

29 We classify liberalization and deregulation in the same category for the following reason. Most measures bear both characteristics of competition promotion and reduction of government control, making it useless to distinguish between the two criteria. For example, the de-segmentation of finance is a measure seeking to increase competition, but it also reduces governmental control on business restrictions on financial firms. In another example which appears to be "deregulation" at first, the reduction of entry control on security businesses is actually introduced in part to encourage competition. Thus, we chose to group such cases and differentiate them from cases where the

development of market infrastructure (mostly through tighter regulations regarding transparency and solvency) is in question.

30 See Dekle (1997), IMF (1997), and OECD (1997) for a summary of the Big Bang package. What the Big Bang plan precisely includes is equivocate for two reasons. First, some observers include measures clearly outside the package announced by the government. For example, Dekle (1997) includes the creation of Financial Supervisory Agency (FSA) in the initiative. Second, the government's announced plan includes past developments, such as the prompt correction measures already legislated by June 1996, in the initiative, blurring the content of the Big Bang plan proper. Reflecting the problematique of the analysis, this table and the analysis below exclude such measures as international economic sanctions, which, despite their importance in themselves, do not have a major relevance to the political conflicts regarding financial reforms.

31 There were two important exceptions for banks taking over failing institutions, such as Daiwa Bank taking over Cosmo Securities in 1993 and Mitsubishi Bank (the later Bank of Tokyo-Mitsubishi) taking over Nippon Trust Bank. In these cases, the need for rescue of failing "ships" was given priority over the maintenance of segmentation in finance under the Convoy System. (Mitsubishi Soken 1997, 86)

32 Ordinary banks include city banks, regional banks, second regional banks, and trust banks.

33 That is, long-term debentures (bonds with two or five years maturity) sold over-the-counter.

34 A commercial paper is a short-term promissory note issued by a large corporation for financing purposes.

35 From authorization (which takes time until approval, which will be granted after an examination of the applicant's qualifications) to registration (automatic, if meeting certain formal requirements).

36 In reality, taking effect in October 1999.

37 See Sanwa Soken (1999) and Nihon Keizai Shimbun (1997). We will see later the comment of Kimihiro Higuchi of Tokio Marine and Fire Insurance.

38 Carried out in 1998. Note that the consolidation of the eight securities exchanges into the ones in Tokyo and Osaka is taking place, as more and more firms are becoming increasingly reluctant to list themselves in the smaller, regional stock exchanges other than Tokyo and Osaka.

39 For the changes in accounting, see for example, Tanaka (1999).

40 Established in December 1998. However, because some of the small domestic securities firms were not separately managing the clients' assets and their own accounts, the foreign securities firms decided to set up a different client protection fund from the domestic fund, resulting in two separate client protection funds.

41 The fund provided only up to 200 billion yen, which can be exhausted by a single failure of a mid-sized insurance company. The inadequacy of this system was demonstrated in the failure of Nissan Life Insurance in April 1997.

42 Established in December 1998.

43 For example, see Igarashi (1995) and Mabuchi (1997).

44 The FSA came into existence in June 1998. Then, an overarching authority with a Cabinet Minister, the Financial Revitalization Committee (FRC), was created in the aftermath of the Financial Diet of the fall of 1998 (see Chapter 7). The administrative reforms, scheduled to take effects in 2001 for MOF, will divest all financial powers but those regarding the co-planning of crisis management to the Financial Agency, which will be given priority even in the remaining financial co-jurisdiction of MOF.

45 For examples of such a criticism, see Mabuchi (1997) and Shiozaki (1996). Shusei Tanaka of the Sakigake Party also expresses this view in an interview with Asahi Shimbun. (26 November 1996)

46 The FSA and the FRC (see above note) have rigorously been promoting this change to date: this is an important part of the "institutional change" in finance. See Chapter 8.

47 As a result of the increased competition, the Wimbledon effect, as it was called in the United Kingdom, may take place, at least to a certain extent. Just as the Wimbledon tennis tournament in the United Kingdom seldom features British players, the British Big Bang drove most of the major local brokerage houses out of the market, while the City (the Wimbledon tournament itself) thrives as the main financial center in Europe. Likewise, the Big Bang may bring about a situation in which Tokyo prospers as a financial center while a large number of Japanese financial firms suffer a fate similar to their counterpart in the U.K. However, the extent of this effect is far from being clear.

48 For *keiretsu*, or the six large financial groups in Japan, see, for example, Okimoto (1989).

49 An IMF report observes that "foreign financial institutions have already won a substantial share in securities trading and asset management business." (IMF 1998, 129, fn.4)

50 See Nihon Keizai Shimbun (19 August 1999), Asahi Shimbun (31 May and 1 June 1998; 21 October 1999; 28 March, 19 April, and 30 April 2000), and Yomiuri Shimbun (20 April 2000). Note that the table reflects the information available as of writing, May 2000.

51 The most conservative scenario is one in which only the large manufacturing firms (the ones that are most likely to shift towards capital markets) are assumed to converge into U.S. bank dependence level (asset/debt ratio) , while all remaining firms are assumed to move halfway towards the U.S. level.

52 A cautionary note must be added in that this estimate simply calculates the share of loans for each bank and estimates how many banks must exit so that the cumulative shrinkage in loans will be accommodated.(Hoshi and Kashyap 1999, 41-42) As there is no way to know how each bank, from top to bottom of the list, cuts down the loans, it must be said that this estimates allows for a large margin of error.

53 Whether this is enough is another issue, reflecting the asymmetry of expertise between service providers and consumers. As of 1999, this point is being supplemented by a legislation on financial services which is specifically designed to protect consumers.

54 It was a survey of 6,000 households (71.4% response). The survey data is available from the web site of this non-profit organization, the Central Council for Savings Information as of April 2000. (http://www.saveinfo.or.jp)

55 It was a survey of 854 people over the age 18 (580 answers obtained). Among those who responded, 28% said that they did not know the Big Bang, 48% replied that they had heard about the terms, "the Big Bang"; 21% answered that they had a fair idea of what that was, and only 3% said that they knew the content quite well. The survey results are available from Dentsu's web site at http://www.dentsu.co.jp (accessed on 24 April 2000).The headline of Yomiuri Shimbun ([Osaka], 23 November 1997) that reports this survey said, "80% do not know the content of the Big Bang."

56 For a comprehensive account of the main bank system, see Aoki and Patrick (1994).

57 Table 5 of Hoshi and Kashyap (1999). This is based on *hojin kigyo tokei*(statistics of incorporated firms) released by MOF. Large firms are defined to have book value of equity greater than 1 billion yen.

58 This is a common saying describing the response to deregulation: everybody is for deregulation in principle, as long as it does not affect oneself.

59 Miyauchi's drive for deregulation led him to be involved in governmental advisory panels on deregulation: he had been heading a subcommittee on deregulation of the advisory panel on administrative reforms since April 1996.

60 These banks are starting to curtail their overseas businesses; some of them (e.g. Tokai and Daiwa) have started to aim for "super-regional banks", meaning that they would concentrate in the retail market.

61 There were only four of them, Tokai, Asahi, Daiwa, and Hokkaido Takushoku. Hokkaido Takushoku went under in 1997. In 1999, Tokai and Asahi announced a plan for merger under a financial shareholding company.

62 For example, the securities subsidiary of IBJ was at the top among the banks' securities subsidiaries in underwriting corporate bonds as of FY1995 (until end of February 1996). The banks' securities subsidiaries occupied one-half of the total amount, although this area was only liberalized in 1993. (Mainichi Shimbun 1997, 21)

63 Both of them went down later: the Long-Term Credit Bank of Japan (LTCB) in 1998 and the Nippon Credit Bank (NCB) in 1999.

64 Personal interviews with a MITI official who was in charge of industrial finance in the past, and Eisuke Sakakibara, a retired MOF official who had a large role in the Big Bang (Chapter 5) on 27 January 2000. According to the MITI official, this was often expressed in an angry phone call from its top management.

65 For the period ending in September 1996, the seven Trust Banks (all trust banks except Daiwa) had averaged 9.5% as the ratio of non-performing loans to outstanding loans; the figure was 4.8% for the ten city banks. (Mitsubishi Soken 1997, 75-6)

66 This is one of the core businesses for trust banking that was prohibited to city banks' trust banking subsidiaries under the reforms of 1991-93.

67 He means the Postal Savings System.

68 Not only measures contained in the Big Bang (e.g. liberalization of foreign exchange business hurting the regional banks), but also paralleling liberalization measures regarding the interest control and branch control would increase the opportunities for large city banks and securities to encroach their customer base.

69 Only Yokohama Bank, the largest regional bank, set up a securities subsidiary, which requires 10 billion yen capitalization. As trust banking was allowed for regional banks proper under the 1991-93 reforms, many regional banks were starting this business; however, it must be also noted that such growing areas of trust banking as pension fund trust would necessitate a large investment. (Mitsubishi Soken 1997, 98-100)

70 The Second Regional Banks' Association.

71 See above note on the remarkable achievement of securities subsidiaries of banks since 1993.

72 Despite the existence of a few mavericks among the securities business, such as Matsui Securities (a small-size firm), whose President looks forward to the liberalized securities market, evidence overwhelmingly suggests that most firms in the business are worried about their survival.

73 Reflecting the attitude of the insurance industry, which did not aggressively endorse the liberalization measures in the Big Bang, as can be seen by the interviews of the presidents of two top firms, we are grouping the powerful insurance firms which might have the potential from the Big Bang in the "losers" group.

Chapter 5

1 See Chapter 3 for our discussion of "bureaupluralism" in public policy making.

2 In the language of Aoki (1988), these two factors determine the political stock that the bureaus command. While Aoki's discussion centers on the "bureaus", or bureaucratic agencies, we expand the scope of discussion to address the political parties, as these two factors also seem to determine the "political stock" of political parties as well.

3 It became law in May 1997 and effective on 1 April 1998.

4 Personal Interview with Kiyoshi Mizuno, 19 July 1999.

5 Within MOF, there are those "career" officials with potential for promotion up to the Administrative Vice-Minister, and there are those "veteran" officials with lesser potential for promotion. See Amyx (1998) for a detailed discussion of these two sets of bureaucrats.

6 Personal Interview with Kiyoshi Mizuno, 19 July 1999.

7 Tahara (1998) confirms this point: he records that Kiichi Miyazawa, the former Prime Minister with expertise on finance (and serving as finance minister under the Obuchi and Mori Cabinets), told him in the beginning of July 1997 that what Sakakibara did (i.e. the foreign exchange reforms) would have a large impact, while most lawmakers passed the law without realizing it.

8 For the Housing Loan Affairs, see Yutani and Tsujihiro (1996), Amyx (1998), and Nishimura (1999).

9 Notice the wording of the question: "The government has put 685 billion yen in the budget proposal to fill in the bad debt of housing loan companies. Do you support or oppose using the taxpayers' money to deal with the bad debt?" It is rather surprising that as many as 7% answered "agree" to this question.

10 Called the "mother banks" *(botai ko).*

11 The last poll with the same methods was in January 1996.

12 Note that this poll was carried out by telephone interview (2,000 questioned, 1,143 responses). It is still puzzling why the newspaper alternated between two polling methods. It acknowledged that because of the difference in methods, telephone interviews tend to have a lower support rate than face-to-face interviews. Thus, one may raise the possibility that the newspaper sought to consciously interpret public opinion in one way over another to support its cause: it repeatedly published editorials in strong opposition to the package. (Asahi Shimbun, 28 February 1996 and 4 March 1996)

13 This strategy backfired on the party, as it was largely disapproved by the public. As a result of the diplomatic success such as the agreement with the U.S. to have a base in Okinawa returned, in May 1996, the public support for the LDP was up to 47%, while Shinshinto was down to 14%.

14 For the political process of the breakup of MOF, see Mabuchi (1997). The account provided below owe much to Mabuchi's detailed research on this process.

15 Yanagisawa was also an influential member of the LDP's ARPH; he headed the section working on the reforms of the public corporations.

16 Personal interview with a MOF official.

17 Personal Interview with Kiyoshi Mizuno, 19 July 1999.

18 How much independence the BOJ would get was debated next. The debate about central bank independence would continue at this study group until November 1996, and later at the Financial System Research Council (the MOF advisory panel on banking) from November 1996 to February 1997. See Mabuchi (1997) for an extensive discussion of the political struggle involving MOF, LDP lawmakers, members of these panels, and the media during this process of determining how much independence the BOJ would gain.

19 See Inoguchi and Iwai (1987). Tribesmen are the LDP lawmakers who are highly specialized in one policy area (e.g. construction, agriculture, transportation), grouping around the sub-divisions of the Policy Affairs Research Council (PARC), Their groups, highly influential in the policymaking of bureaupluralism, came to be called "tribes" and its members "tribesmen".

20 Under the National Administrative Organization Law (*kokka gyosei soshiki ho*), three broad categories of administrative organizations were available for such a new organization: a) "Article 3 organizations", such as Ministries, Agencies, and Independent Commissions, which can engage in independent administrative activities; b) "Article 8 organizations", such as Deliberative Councils and Commissions, which are

organizations which report to the Ministries and other Article 3 organizations; c) "Article 8-3 organizations", which were special agencies with semi-independent functions.

21 The list slightly modifies Mabuchi's chart 4.1, by distinguishing between Article 8 and Article 8-3 organizations. (Mabuchi 1997, 195)

22 To insulate public prosecution from political influence, the National Prosecution Agency has a special legal status: it is under the Minister of Justice's direction, yet the Prime Minister appoints its chief and the Justice Minister does not intervene in specific cases. (Mabuchi 1997)

23 This agency is headed by a career bureaucrat, and is under the Defense Agency, which is, like the Economic Planning Agency, an agency under the Prime Minister's Office with a Cabinet Minister.

24 MOF issued a document that outlined what it saw as the problem in financial administration in December 1995. In response to the discussion on the reforms, MOF set up an in-house project team to ensure that the organizational reforms were discussed and decided out of concern for the improvement of the financial administration (and not just out of punishment of the past failures). On 18 September 1996, MOF issued a document, the result of this project team's work, which discussed the need of in-house reorganization but not of the organizational breakup.

25 It had the participation of Secretary-General Kato, Policy Affairs Research Council Chairman Taku Yamazaki, and Executive Council Chairman Shojuro Shiozaki (the so-called Three Top Party Officials), as well as Party Organization and Public Relations Headquarters Chief Shizuka Kamei, Diet Affairs Committee Chairman Kanezo Muraoka, ARPH Chief Mizuno, and three top officers from the Upper House, Shigenobu Sakai, Masakuni Murakami, and Mitsuhiro Uesugi. (Mabuchi 1997)

26 This section owes much to Mabuchi (1997)

27 See Table 5.1.

28 This was basically MITI's program to promote corporate-friendly reforms such as deregulation, taxation reforms, and labor market reforms.

29 Such examples were given: public administration, regulation on private activities, social security and welfare, educational administration, and relations between national and local governments.

30 This section, unless otherwise noted, is based on a personal interview with Kazuhito Ikeo (9 July 1999).

31 The other two members included a journalist and another economist.

32 This WG would act as part of the Action Program Committee of the Economic Council, an advisory panel to the Prime Minister.

33 *Nemawashi* is a practice to seek prior informal approval from all those concerned before proposing a plan, a widely observed practice in Japanese organizations in general.

34 According to the proposal, all the deregulation measures ought to be completed within three years, that is, by March 2000, and each measure in the proposal was divided into

three periods, FY1997, FY1998, FY1999, according to the fiscal year it should be implemented.

35 According to Ikeo, this may have been the first time the expression "Japanese Big Bang" came to public notice.

36 The parentheses are added by Tahara, whereas the brackets are added by the author.

37 Personal interview with Eisuke Sakakibara, 27 January 2000.

38 According to Sakakibara, at the senior level of the decision-making process within MOF, the Banking Bureau was not keen on pressing the reforms, while the Securities Bureau led by Nagano and the International Finance Bureau under him were advocating the reforms.

39 This was confirmed in personal interviews with MOF and MITI officials.

40 Anticipating the opposition from the financial industries, he tried to enlist the support of the mass media, the trading companies, and the manufacturing firms. (Sakakibara 2000,148-51)

41 This appears to have been the Banking Bureau's view, as is shown in the later discussion of the LDP ARPH's role. A retired Banking Bureau official stressed this view in a personal interview with the author in July 1999.

42 Unless otherwise noted, this section relies on personal interviews with Kiyoshi Mizuno (19 July 1999) and Yasuhisa Shiozaki (6 July 1999).

43 In June 1996, the ARPH drafted what was made public as "Hashimoto Vision" on administrative reforms, which set the basic framework for the later policy discussion.

44 The "Free, Fair, Global" principles of the Big Bang Initiative do not appear in Shiozaki's plan, either.

45 Shiozaki claims to be the first to come up with the label "Big Bang", as the draft plan presented in September was titled, "Aiming for the Big Bang Japanese Version".

46 In this sense, Shiozaki may be credited for being the first to publicly use the label "Big Bang", although it apparently did not attract much public notice at that time. For example, the term "Big Bang" did not appear in Asahi Shimbun, a major newspaper, until the day Hashimoto announced the Initiative. (based on the author's search through Asahi Shimbun's database)

47 This paragraph is largely based on Otake (1999).

48 He successfully uncovered the hidden documents in his Ministry that showed the involvement of Health and Welfare officials in the scandal concerning the HIV-contaminated blood products.

49 That is, to challenge the bureaucracy-led politics of Japan.

50 Personal interviews with MOF and MITI officials.

51 He also forged strong ties with MITI officials, too. Personal interview with a former MITI official.

52 There are also four officials from MOF, MITI, the Ministry of Foreign Affairs, and the National Police Agency, who serve as secretary in charge of administrative affairs. The new political secretary, Kenji Eda, was junior in seniority to MITI's administrative secretary, which added a sense of novelty to his appointment.

53 Personal interviews with MITI officials.

54 This was also supported by personal interviews with officials from MOF and MITI.

55 MITI's Industrial Structure Council's subdivision on industrial finance was working since 1992. (Interview with a MITI official)

56 Personal interview.

57 Personal interview with Eisuke Sakakibara, 27 January 2000.

58 This may have been the Banking Bureau's stance, judging from the process in which the re-examination of the 1993 financial reforms was postponed for one year in the spring of 1996 as mentioned earlier. Also see Nishimura (1999) on this point.

59 Personal interview with Kiyoshi Mizuno, 19 July 1999.

60 One must also note that its importance has been relatively reduced by the introduction of the public financing of electoral campaigns in 1994. Public money was given to political parties which met certain criteria. Also note the empirical observation by Otake (1997b) that the electoral reforms of 1994 reduced the campaign funds involved.

61 Shiozaki emphasizes that his plan was drawn independently from MOF and the LDP financial "tribesmen". (Personal interview, 6 July 1999) On MOF's side, Sakakibara confirms that there was no pre-consultation with the LDP ARPH on the Big Bang Initiative. (Personal interview, 27 January 2000)

62 Mabuchi (1997) characterizes the post-1993 MOF-LDP relationship as "neighbors", in contrast to "rivals" of the 1950s and 1960s, and "partners" of the 1970s and 1980s.

63 The headlines are from the titles of the editorials of 6 June 1996 and 23 November 1996 of Asahi Shimbun. The nine editorials appeared in addition to the other more numerous editorials which mentioned in passing the need of MOF breakup. They appeared on 8 February, 6 June, 17 June, 8 August, 25 September, 5 October, 20 November, 23 November, and 4 December of 1996. See Otake (1999) for the role of Asahi Shimbun in the breakup of MOF.

64 We may hypothesize that the difference may reflect the degree to which the bureaucrats are tied to the financial industries and financial administration. See Amyx (1998) for the notion of relational networks that paralyze the state actors. We may think of two inter-related concerns: "past ties with the financial sector and financial administration" (in terms of length of assignment) and "future prospect of relationship with the financial sector" (in terms of likelihood to be associated with the sector, through assignment or retirement positions). While there is insufficient evidence, it may well be that "financial insiders" included those with deeper ties with the financial industries, and those who have been largely involved in financial administration of the past, making it hard to

depart from the past gradualism in approach. On the other hand, it may be that the "reformers" included those "newcomers" to financial administration (and thus less ties with the financial industries or past financial administration) or those who did not expect much future prospect with the financial sector (e.g. the independent-minded Sakakibara).

65 Personal interviews with MITI officials.

66 Personal interview with a MOF official.

67 Personal interviews with MITI officials.

68 Eisuke Sakakibara confirms that there was no coordination or cooperation between the two ministries prior to the announcement of the Big Bang Initiative. Personal Interview, 27 January 2000.

69 This view is corroborated by MITI officials as well. As mentioned earlier, one former senior official exclaimed that MOF, which was forestalling the financial reforms against MITI for the past few years, had come in to take charge at the last minute. This view was confirmed by another official, who claimed that MITI's role was rather to prepare the ground for financial reforms.(Personal Interviews with MITI officials)

70 Personal Interview.

71 Personal Interview with Kiyoshi Mizuno, 19 July 1999.

72 We leave aside possible objections from our first point, that empirical data that shows that the actual elections were not issue-oriented but candidate-oriented: as mentioned earlier, the LDP's pre-election behavior may have rendered the SMD's impact unobservable. We also leave aside whether the attack of consumer groups will materialize as Rosenbluth and Thies (1999) would presume. We are skeptical whether such a thing would happen soon, given the current state of consumer groups . According to Vogel (1999), they hardly represent the consumers' interests.

73 According to Otake, this anti-professionalism, claimed independently from particular issues, corresponds to the anti-Washington, anti-Establishment attitude widely observed in American politics.

74 We rejected the possibility that consumers were influential through consumer groups. We distinguish between "consumers" and "public": the former directly influence the political actors through exchange of votes and favors, and the latter is unorganized. It acts rather as a parameter that influences the other actors' behavior.

Chapter 6

1 As for the first sequence of the Big Bang, the foreign exchange reforms, the legislation was submitted to the Diet in March 1997, becoming law in May 1997. For the second sequence of the Big Bang, or the bulk of the measures: in June 1997, MOF announced the detailed plan that came out through its three deliberative councils; in March 1998 the legislation was submitted to the Diet, and passed in June 1998.

2 Admittedly, these two overlap in certain occasions. See Chapter 9.

3 The ideal-types become more complex if we are to consider the special case of consumers, which can be jurisdictional organized interests and the voting public at the same time. An important distinction needs to be made between organized consumers (consumer groups) and unorganized households. If the consumers are organized and exercise influence on politics through the provision of goods and services, the case fits a), as they must be identified as the main actors who drove the reforms. On the other hand, if the households are unorganized and hence passive, the political actors ought to be perceived as the primary actors of reforms. The consumers are also the voting public: to cater to the consumers' needs through consumer groups may have the effect of boosting public support for a); the promotion of consumers' interests may also increase public support for political actors as in the case for the promotion of "public interest".

4 Note that interest group politics may be compatible with the enhancement of public interest. It may occur that the political actors promote measures that benefit both the general public and a particular sector of the economy. However, whether an exchange of goods and services from the sector exists distinguishes a) from b). If there is none, then, such measures would fall under category b).

5 In the case of administrative reforms, the constituency includes MOF itself or its workers, who face the prospect of the alteration of their status or working environment, and possibly the industries which are under MOF jurisdiction who might see an altered style of regulation because of such reforms.

6 It contained nine, very broadly defined agenda provided as "example", including cross-entry, product liberalization, price liberalization, foreign exchange deregulation, improved disclosure, harmonization of accounting standards. For details about particular issues, see Chapter 4.

7 We exclude the Justice Ministry's Judiciary Council from our scope . While Hashimoto initially asked the Minister of Justice along with the Minister of Finance to carry out the Big Bang, and the Judicial Council was in charge of the clarification of the penal code prohibiting gambling, in the context of promoting derivative products, its role was largely secondary to the MOF councils.

8 Note that the Council on Foreign Exchange and Other Transactions, carrying out the "forerunner" reforms, already issued a report towards drastic deregulation in June 1996. Chapter 5 discusses the process in which the possible objection by the banking industry was successfully pre-empted by MOF and the LDP. The Business Accounting Council, whose discussion included important matters for the corporate sector (most notably the reform towards consolidated accounting standards) only issued an interim report by June 1998. Despite its importance, we leave it aside as the process was largely devoid of the distributional conflict of economic actors. (There was also a panel reporting to the head of the Banking Bureau on nonbank financial institutions, where the issuance of corporate bonds and CP by such firms was discussed as well.)

9 Including the issues of 16 November, 4 December, and 27 December 1996 as well as 31 January, 14 February, 4 March, 21 March, 12 April, 15 April, 22 April, 17 May, 23 May, 31 May, 7 June, 14 June, and 15 June 1997.

10 Including the issues of 24 March, 7 April, 26 May, 23 June, 7 July, 14 July, 21 July, 28 July, and 24 November 1997 as well as 19 January and 9 March 1998.

11 As a matter of fact, the deliberation mainly took place at the Financial Function Vitalization Sub-Committee of the FSRC, and the same kind of delegation took place in the SEC and the IC. Below, however, we will simplify our narrative by referring to the main body, because the reports issued by the sub-divisions of the three councils were adopted by their respective main bodies as official reports.

12 The banking industry was also united in its denouncement of the public finance system, notably the national postal saving system, a behemoth enjoying an unfair competitive advantage, according to the industry.

13 Investment trust products could be sold by their branches by way of space rental in FY 1997; they could be sold directly by the banks by 1999. The business restrictions on banks' subsidiaries in securities and in trust would be lifted in the second half of FY1999. See below for banks' entry into insurance.

14 However, this measure encountered a strong opposition from the LDP at the later stage: the housing loan companies, the principal actors in the Housing Loan Affairs, were also non-bank financial institutions.

15 The following, interrelated grounds were cited to defend this position:
a. Skepticism on the consumers' benefit of increasing consumers' choice of products;
b. Concern for survival of insurance firms and the possible negative impact on the industry's employment;
c. Concern against banks' domination over the corporate sector reflecting the main bank system of the past;
d. Need for "alleviation of drastic change";
e. Need to distinguish insurance from the rest of finance, as insurance products not only function as investment but also provide security of life; and
f. Conclusion obtained through the process of past reforms (i.e. the reports issued by the Council in 1994 and 1996) that the cross-entry from other financial businesses ought to be carried out only after the cross-entry between life and casualty insurance becomes solid.

16 The U.S.-Japan insurance talks had been going on since 1993: the U.S. government sought to thwart the entry of Japanese life and casualty firms into the "third field" (including such niche products as cancer insurance), where its firms had been dominant: this arrangement had been prevalent as a trade-off to the entry control in the "first" and "second" fields, or life and casualty insurance markets. In 1994, the two countries reached an agreement in which the Japanese insurance firms would be allowed to enter into the third field, after deregulating the life and casualty insurance markets. However, afterwards, a difference in the interpretation of the agreement emerged: the Japanese firms sought to enter into the third field through their new subsidiaries, and the U.S. industry cried foul play. The dispute between the two countries went on as the Big Bang was being announced. Finally, in December 1996, an agreement was reached: the Japanese would liberalize the casualty insurance price control by July 1998 (the issue was included in the Big Bang Initiative), while the Japanese firms' subsidiaries would be allowed into the third field from 1997 with restrictions attached. (Asahi Shimbun 1997, 65-72; Nihon Keizai Shimbun 1997, 64-71)

17 In the earlier debates in the Council, some members sought to keep banking out, stating that insurance and finance are different and that liberalization of insurance need not be carried out by 2001 or that the process of past reforms dictates that the entry of banking into insurance be well after the cross-entry of casualty and life insurance, effective in 1996, became solid.

18 As most Japanese corporate workers receive a "bonus" payment in this month, the amount of individual deposits usually increases.

19 Note, however, that this trend of individual depositors punishing the DKB stopped in the fall of 1997, as the financial crisis (see below) triggered a flow of deposits back to the larger banks, deemed to be safer than troubled banks.

20 Financed by government bonds.

21 They would also delay the implementation of the capital requirements for up to one year before its scheduled introduction in April 1998 for banks that only engage in domestic businesses (and to which BIS standards do not apply).

22 Ten trillion yen of government bonds and twenty trillion yen of government-guaranteed loans.

23 It took the forms of preferred stocks and subordinate debts and loans so that the government would not actively take over the management rights of the firms. In contrast, in the later Financial Diet of the fall of 1998, it was decided that the newly created FRC would also purchase common stocks, possibly intervening in the management of the financial institutions. See Chapter 7.

24 This issue will eventually be the center of the political debate in the Financial Diet of the fall of 1998. See Chapter 7.

25 Despite the fact that the Lower House, where the LDP could get hold of the majority, decides who becomes the prime minister and thus Hashimoto's status could be defended, the prevailing norm in the LDP and the political world dictated that he take responsibility for the electoral defeat, considered to be the public's demonstration of non-confidence.

26 One of the two forced to resign was the Securities Bureau Chief Nagano, the leader of the securities reforms in the Big Bang. The public prosecutors also uncovered a similar wining and dining scandal involving the Bank of Japan. A BOJ official was arrested, and numerous BOJ officials were sanctioned in a similar manner.

27 Note that the 1998 and 1994 surveys were carried out by personal interviews, while the 1996 interview was by telephone. The observation that this question concerning public trust in the bureaucracy first appeared in 1994 is based on the author's research, using Asahi Shimbun's web-based database that contains data from 1984 onwards.

28 While the provision of financial benefits to the government officials with specific regulatory power had been repeatedly prosecuted, it was the first time that the mere wining and dining was prosecuted in a corruption case. This reflects a change in prosecutorial standards as well as a possible change in social norms that determine what is acceptable. Contrast the wide criticism in 1998 against the *MOF-tan* system (i.e. financial industry's representatives who build close relationships with MOF officials to get information on MOF policy) and the way the system was treated five years ago in Nihon Keizai Shimbun(1992). Also, Tahara (1998) recalls how the standards about wining and dining were different in the 1980s.

29 Summaries of the proceedings of the Insurance Council General Meeting and its Basic Issues Research Division between December 1996 and June 1997 are available through MOF's web page as of May 2000. (http://www.mof.go.jp)

30 This observation again endorses our view that stresses the role of MOF over that of MITI in the Big Bang political process, presented in Chapter 5. Indeed, the deliberative council under MITI presented a report which was supposed to reflect the "true image" of the Big Bang in May 1997. (Tsusansho 1997) While this report did not have much to do with the enacted policy, it had a more encompassing scope in that it included matters outside MOF's jurisdiction such as the postal savings system or the pension fund system.

31 The life insurance industry pressured the process by making use of the massive number of its sales personnel (400,000) as well: some tens of thousands of letters opposing banks' sales of insurance products were sent to MOF's Banking Bureau, according to a leader of the life insurance labor union. (Kin'yu Zaisei Jijo 23 June 1997)

32 As for the conflict among banking, securities, and insurance industries, the Banking Bureau, the Securities Bureau, and the Insurance Division of the Banking Bureau were the three "organizers" of bargains at the inter- and intra- industries levels.

33 Measures related to accounting followed a different schedule, though this is not a result of the conflicts of the industries.

34 In labeling these cases, the years are assigned as follows: the beginning (1991, 1992, and 1979) refer to the years the deliberative councils issued the final report on the reforms, and the end (1993, 1994, 1982) signify the years the reform laws took effect.

35 See Ragin (1987) for a discussion of comparative methods. Our method falls under what he calls "case-oriented strategy". (p.31)

36 Skocpol (1979) provides an example of works employing longitudinal comparisons: we are referring to her comparison between the revolutions of 1905 and 1917 in Russia.

37 The narrative below is merely a sketch of the complex process of the reforms, and its sole purpose is to provide a sense of how the reforms were produced under bureaupluralism.

38 In the case of the IBJ, that its concerns were reflected in the policy debate stemmed from the fact that the IBJ had been very much involved in the past decision making in financial administration. (Nihon Keizai Shimbun 1992; Mainichi Shimbun 1997)

39 It was illegal for securities firms to guarantee the possible loss before engaging in securities transactions. However, unless such promises were in written forms, it was hard to prove that such engagements were in place. When the losses materialized, the securities firms would often engage in loss compensation for their best customers fearing loss of business. (Asahi Shimbun 28 July 1991) This practice, called loss compensation, was made illegal in the aftermath of the scandals.

40 Critics called for the creation of a new organization in the mold of the U.S. Securities Exchange Commission. Regarding the types of administrative organizations, this would take the form of an "Article 3 independent commission" within or outside MOF; however, what emerged (the Securities Exchange Surveillance Commission) was an "Article 8 organization" within MOF. See Chapter 5.

41 Further, the ensuing years of low interest rate created a difficulty for life insurance: while their assets yielded low returns, they had to face earlier promises of high returns to the insured, made during the high interest period of the bubble economy of the 1980s. See Chapter 4.

42 See Sanwa Soken (1999, 252) for the list of the measures included in the 1992-94 insurance reforms.

43 This section largely draws on Rosenbluth (1989, Chapter 4). Also see Chapter 4.

44 The central bank would absorb about 90% of the government bonds held by the banks after one year from the issuance.

45 Other measures include the following: banks were given choice over their accounting methods to cope with the book losses; the Fiscal Investment and Loan Program would increase the absorption of government bonds. (Rosenbluth 1989, 104-05)

46 Basically, the banks would be allowed to enter into the retailing and dealing of government bonds, although this would not lead to the abolition of the regulatory wall between securities and banking. Securities firms would be given, on the other hand, permission to trade short-term securities issued in the Euromarket, including certificates of deposits and commercial paper. See Rosenbluth (1989, 108-11).

47 For the banking reforms of 1979-82, the FSRC spent four years (1975-1979) before issuing a final report on the wholesale revision of the Banking Law. (Rosenbluth 1989)

48 This may be important as well in understanding why the deliberative councils were able to come up with the reform plan in less than a year in the Big Bang. It is not hard to see that the Prime Minister needed considerable results within a tangible amount of time.

49 Evidence suggests that MOF was aware of this benefit of having the Prime Minister as the leader of the reforms. Tahara (1998) notes how Nagano emphasized Hashimoto's involvement in his interview, being reluctant to become too conspicuous as the initiator of the Big Bang.

50 For the planning of the Big Bang in Phase I, however, the Banking Bureau appears to have been less enthusiastic than Securities and International Finance Bureaus, headed by Nagano and Sakakibara. See Chapter 5. Nevertheless, once it was decided that the Big Bang would be launched, the Bureau was much more willing to advance the deregulation, compared to the Insurance Division. Interview with Eisuke Sakakibara, 27 January 2000.

51 This episode confirms the internal division within MOF, mentioned in Chapter 5, between those who advocated drastic reforms and those who sought to proceed in close cooperation with the industries as in the past.

52 Several representatives of the insurance industry made arguments to postpone banks' entry until after 2001 and to drop insurance from the Big Bang reforms from the discussion topic of the Insurance Council. Asahi Shimbun (1997) reports that Sakakibara pressured the Insurance Division into accepting a full-scale liberalization, emphasizing at times that the Big Bang, including insurance, was the Prime Minister's directive.

53 See the editorials in Asahi Shimbun (13 November 1996, 19 February 1997, and 15 June 1997). Also see Yomiuri Shimbun (14 June 1997).

54 The intensity of public criticism is shown in such editorials as the ones in Asahi Shimbun. See the issues of 21 May 1997 for the DKB, and 8 March 1997 and 31 May 1997 for Nomura Securities.

55 The Big Bang was expected to be supported by its electoral rivals such as the Liberals and the Democrats, as these parties were strongly pushing for administrative reforms and deregulation.

56 As mentioned earlier, the DKB was the only large city bank which lost its household deposits in June 1997, when all the other large city banks saw theirs increase by a large number; the top three securities suffered from loss of business from national and local governments as well as individual clients.

Chapter 7

1 In this chapter, we use "regulated industries" interchangeably with "firms and interest groups" (as introduced in Chapter 3).

2 See Kato (1994).

3 Personal Interview.

4 See the Nagano interview in Tahara (1998) mentioned in Chapter 5.

5 One caveat: this being a very recent event, evidence cannot be said to be profuse. The narrative below is merely a sketch of the complex developments, and its purpose is limited to provide a plausible ground against which the new developments in bureaupluralism can be contrasted. Also see Amyx (2000) for a discussion of the Financial Diet.

6 That is, 13 trillion yen for strengthening the capital base of operating banks, and 17 trillion yen for resolving the failed banks' bad debts. These were "ceilings" for government guarantee on loans: the actual expenditure was initially 1.8 trillion yen, as it appears below. See Chapter 6.

7 For the content of the Total Plan, see Kin'yu Zaisei Jijo, 13 July 1998.

8 A bridge bank is a quasi-public bank which would take up the performing loans of a failed banking institution. Bridge banks are set up so as to prevent massive bankruptcies of borrowing firms who relied on loans of failed banks.

9 The Regular Sessions are from January to June with possible extensions. Other sessions are called Temporary Sessions, except for the Special Sessions, which are convoked immediately following the elections ensuing the dissolution of the Lower House.

10 This was the Upper House arm of the Komeito party, traditionally a powerful opposition party since the 1960s: Komeito itself was merged into the Shinshinto party between 1994 and 1997.

11 For details, see Kin'yu Zaisei Jijo, 14 September 1998. Also see Sakakibara (2000, Chapter 4).

12 This would be an "Article 3 organization with Cabinet Minister". See Chapter 5.

13 That is, until the administrative reforms of Hashimoto will take place, creating the Financial Agency, concentrating the financial powers (which used to be with MOF).

14 As mentioned earlier, this plan in which the government sets a ceiling of loan guarantees of 13 trillion yen to inject capital into operating banks to strengthen their capital base.

15 The establishment is done through the merger of two organizations, the Resolution and Collection Bank and the Housing Loan Administration Corporation, which were set up in 1995-96 for the bad debt resolution for the smaller financial institutions and the housing loan companies.

16 One reason of the intensity of the speculative attack was that Japan lacked an effective regulatory framework against speculative attacks coupled with the diffusion of rumors. See Takeuchi (1999) and Sakakibara (2000).

17 This does not signify that MOF abandoned its efforts to influence the outcomes: it did not. However, it lost control over the course of the events. Personal interview with Yasuhisa Shiozaki, 6 July 1999.

18 This is the lawmaker heavily involved in the planning of the Big Bang. See Chapter 5.

19 This lawmaker headed the PARC's sub-division in finance during the Housing Loan Affairs. It appears that he has since become critical of MOF. (Personal interview with MOF officials)

20 This paragraph largely draws on a personal interview with Yasuhisa Shiozaki (6 July 1999).

21 In his speech at Stanford University, 3 May 1999.

22 However, later in October 1998, the balance sheet of LTCB turned out to be in excess of debt, and thus the LTCB was nationalized under the newly introduced plan after all.

23 With the exclusion of the Liberals.

24 This paragraph largely draws on Sakakibara (2000, Chapter 4) and the personal interview with him on 27 January 2000.

25 Sakakibara described the new approach as "whisper" (Personal interview on 27 January, 2000). Shiozaki did not deny that numerous approaches have been made from MOF officials throughout the process, while he emphasized the independence of the policy making process. (Personal interview on 6 July 2000)

26 For example, while the opposition sought to integrate all financial powers into the FRC, including supervisory powers residing in Agriculture and other ministries, the compromise that emerged limited to what used to be under MOF's jurisdiction. (Kin'yu Zaisei Jijo 5 October 1998)

27 Including other means such as purchasing subordinated bonds and making subordinated loans. Note that in February 1998, the acquisition of common stocks was avoided for the very reason that the government's intervention into banks' management ought to be avoided. This time, public involvement into bank management was introduced.

28 We may add the great involvement of MITI in the planning of "total plans" as another evidence in which the jurisdiction of bureaucratic agencies under bureaupluralism has become increasingly blurred.

29 Indeed, the conclusion, regarding the nationalization of the banks, seems to have been well received by the market: the stock prices went up, following the nationalization of the Long-Term Credit Bank of Japan in October 1998.

30 This person, Yukihiko Ikeda, happened to be an ex-MOF official.

31 See Amyx (2000).

32 In this section, the letters in parentheses correspond to the observations provided in Table 7.1.

33 See Chapter 5.

34 That is, if we are to perceive MOF as "constituents" (and thus similar to "regulated industries") in their being in conflict with "public interest" in MOF reforms.

35 The FSRC, SEC, and IC were integrated into one Financial System Council in line with the creation of the Financial Supervisory Agency and the integration of the Banking and Securities Bureaus into one Financial Planning Bureau within MOF in 1998. This council has been deliberating on the legislation regulating the financial services across fields, including banking, securities, and insurance, as of 1999. PARC has also been instrumental in the decision in 1999 to delay the pay-off for one year, to 2002. See for example, Asahi Shimbun (21 and 29 December 1999).

36 For example, in his classical study of public opinion, Lippmann (1997 [1922]) identifies the brevity of attention and the narrowness of range as the characteristics of "the will of the public" that democratic theories have difficulties dealing with ("Public Opinion", Chapter 21).

37 We will turn back to this issue in Chapter 9.

38 As mentioned earlier, this effort raised a dilemma for the bureaucracy— if the unpopular MOF claimed credit for the proposal, it would jeopardize it —, and thus the Big Bang did not prevent the organizational break-up. Nevertheless, this miscalculation about the result should not concern us, as their rational calculations themselves are what brought about the Big Bang.

39 For example, the Housing Loan, the Racketeering, and the Wining and Dining Scandals.

40 For example, despite the massive loss due to the non-performing loans, the large banks did not opt to write out the losses from the balance sheets at a massive scale until 1996, when Sumitomo Bank became the first bank to do so, suffering losses in the fiscal

year. (Yutani and Tsujihiro 1996) Also see Nihon Keizai Shimbun (1998) for the banking sector's slowness in restructuring. See Mainichi Shimbun (1997) for an example of criticism of high salaries in banking.

41 Their alternatives were severely limited: legal recourse was virtually impossible under MOF pressure and also with the lack of legal infrastructure for addressing the major failure of financial institutions until April 1996, with the passage of the "three laws". See Chapter 4. Somehow, the institutional context of Japan, where the cost of legal recourse is much higher than in the United States, seems to be left out.

42 Wouldn't the reason for the LDP's restraint have something to do with the fact that banks were being heavily criticized, and accepting contributions would not appear good in the public's eyes? If so, we do not have trouble understanding why the request for contributions reappears once the criticism against banking has subsided, with the financial crisis becoming distant in 1999.

Chapter 8

1 I thank Yukio Noguchi on this point, made during a personal interview in July 1999.

2 Whether the Internet ought to come under "satellite" is not our concern here.

3 For an example of this view, we may think of the rational expectations school in economics.

4 See Teranishi (2000) for the Japanese financial panic of 1927.

5 Kohno (1997), Pempel (1998), and Curtis (1999) provide some examples of the explanations as to why the change of government took place in 1993. See Woodall (1994) for these political scandals.

6 The arrival of coalition politics by the electoral loss of 1989 in the Upper House may have made the politicians more aware of such a possibility, although to a lesser extent than the actual change of government. I owe this point to Michael Thies.

7 I owe this point to Michael Thies.

8 Objectively speaking, actors are interacting in a multi-layered set of institutions. However, some institutions are recognized by actors as exogenous to their interaction, due to their limited reasoning ability: such institutions compose the "institutional environment", which rather acts as a parameter to actors' strategy. Once part of the institutional environment shifts to an institution, actors start incorporating the institution into their strategy-formation process. See the sections on the synchronic linkage of institutions in Aoki (forthcoming).

9 For the Financial Convoy, see Aoki and Patrick (1994) and Pempel and Muramatsu (1995) as well as Rosenbluth (1989) and Vogel (1996). See also Ikeo (1995) and Horiuchi (1998; 1999). Nishimura (1999), from the point of view of MOF, gives an account of why "financial administration lost".

10 See Aoki and Patrick (1994) for how the main bank system and the financial administration system (the Convoy) complemented one another.

11 The numbers in parentheses refer to those in Fig. 8.1.

12 After the Financial Agency will be set up in January 2001, it will integrate the FRC in July 2001.

13 See, for example, Okimoto (1989) for the role of industrial associations in Japanese politics in general. See Rosenbluth (1989) for the role of the industrial associations in finance in Japan before the "institutional change".

14 See Amyx (1998) for a discussion of informal networks that tie MOF officials and the financial industries.

15 For the "lifeboat operation" in the United Kingdom, see, for example, Hosoda (1998, 239-43). For the "too big to fail" approach in the United States, see the section on financial regulation in Feldstein (1994).

16 It must be added that the reforms of the corporate law in 1993 facilitating the procedure in which the shareholders could bring lawsuits to hold the management accountable for mismanagement made the financial firms increasingly unwilling to contribute to rescue troubled firms, as the management would face an increased risk of facing such lawsuits in cases of failure of such rescue efforts.

17 This creates an interesting contrast to what is going on abroad, as the recent experience with the rescue of a hedge fund in near collapse in fall 1998 coordinated by the New York Federal Reserve Bank in the United States suggests that "too big to fail' and "lifeboat operation" are not defunct as policy tools in the international context.

18 See Pascale and Rohlen (1988) for the rescue of Mazda by Sumitomo Bank.

19 For *keiretsu*, see for example, Okimoto (1989).

20 I am referring to what he calls the "state" domain. See Aoki (forthcoming).

21 Also see Nakatani (1996) for a discussion of the shift from "insider / developing nation " (insiders being the administration and the domestic financial industries) style of decision making to "outsider / democratic" (outsiders being market players such as consumers, investors, and depositors) system of decision making in financial administration. (187-95) He attributes the need to bring about this shift to the end of the "catch-up" stage for Japanese economic development and the international integration of its national economy. While Nakatani's argument has much in common with the argument presented here in that such a shift is taking place not only in finance but also in other policy areas, his argument puts more emphasis on the "need" for the Japanese economy to accelerate this shift, using the U.S. system as a "focal point" to be emulated. As can be seen below, in contrast, our argument does not take a policy stance regarding institutional change, which is seen to be largely an autonomous process where actors are driven by their realization that "something is not right" in the prevailing institution. While Nakatani (1996, Final Chapter) seems to be aware of "institutional complementarity" as a reason that slows down the kind of reforms he advocate, our discussion presented here shows that once things start to change, they tend to change in a "chain reaction process". More fundamentally, as discussed in the next chapter, we do not share his assumption that institutional change is an inherently positive development for the Japanese nation by questioning whether the calculation of

cost and benefit remains the same even after incorporating the accompanying development in the institutional environment.

22 See Kin'yu Zaisei Jijo (25 May 1998, 7). Also see Chapter 3 for *tsutatsu.*

23 See Okimoto (1989) for example.

24 See Asahi Shimbun and Yomiuri Shimbun, for example, issues of 25 and 26 February 2000.

25 Personal interview with Shijuro Ogata, 5 July 1999.

26 A cross-sectoral comparison of finance and other policy areas will follow in the next chapter.

27 See Chapter 7.

28 Otake (1997a) provides an interesting reevaluation of the administrative reforms in the 1980s under the political leadership of Prime Minister Nakasone.

29 See Amyx (2000).

30 See Chapter 6.

31 The first referendum to take place ever was in Niigata in 1996, regarding a nuclear power plant construction.

32 For the Tokushima case and the issue of local referendum in general, see Asahi Shimbun and Yomiuri Shimbun, issues of 24 and 25 January 2000.

33 For the Ishihara case, see Asahi Shimbun and Yomiuri Shimbun, issues of 15, 16, 17, 21, and 22 February 2000. In a TV news show, Ishihara revealed the planning process, very similar to the Big Bang case: expecting strong opposition, the proposal was planned in great secrecy until its announcement. The idea originated from a senior level bureaucrat of the Tokyo government, but because a premature leak would result in the plan being crushed, the preparation was done in secrecy with the involvement of only a few of his staff. (http://www.zakzak.co.jp accessed on 14 February 2000 10:15 PST)

34 Apparently, Ishihara's policy innovation has already found an imitator: the legislature of Osaka Prefecture introduced a similar taxation scheme in May 2000, notwithstanding a vehement opposition from the banking sector. (Asahi Shimbun 31 May 2000)

Chapter 9

1 I thank Steven Vogel, who suggested these points at the Stanford Asian Pacific Research Center research project meeting, held at Stanford University on 29 October 1999.

2 See Asahi Shimbun (1997) and Kato's speech at the Center for Strategic and International Studies (Washington D.C.) given on 18 May 1998. (Available, as of April 2000, through Kato's web site: http://www.katokoichi.org)

3 See, however, Curtis (1999) for a view that discounts politicians' talks of reforms.

4 See Okimoto and Rohlen (1988) for "excessive competition".

5 Including port construction, which comes under the jurisdiction of the Ministry of Transport.

6 See for example, the difficulty incurred in the reforms of the laws governing the lease of land and housing, which also involve a similar, social dimension: the protection of the weak.

7 In transportation, a "Big Bang Transportation Version" is taking place, virtually doing away with the regulatory control over the demand and supply of transportation services. In telecommunications, the rapid diffusion of cellular phones can be partly attributed to the deregulation over the transaction rules of the cellular phones, which used to be considered a small radio broadcasting station. In energy, the deregulation of electricity as well as oil has been steadily going on.

8 This is part of Okimoto's four-way characterization of political exchange between the LDP and its support groups. Other types include "Clientelistic Votes" (the LDP receives votes from clientelistic support groups for favorable policies; "Reciprocal (Pork-Barrel) Patronage" (the LDP receives financial contributions in exchange for pork-barrel public expenditures or favorable regulatory policies), and "Generalized Voter Support" (the LDP receives votes from the unorganized voters (mostly from the urban areas) for public policy aimed to increase the overall quality of life.) See Okimoto (1989, 193-202).

9 As earlier mentioned, see Otake (1997b) for the third point.

10 Personal Interview in July 1999.

11 Many works have noted this overrepresentation of the rural areas. See for example, Okimoto (1989).

12 See Kato (1994) for example, on how the LDP leaders closely cooperated with MOF for the introduction of indirect taxation.

13 That is, low asset returns and high guaranteed rates to the insured.

14 However, there has been a corruption scandal involving the public works section of the Ministry of Agriculture, Forestry, and Fisheries (MAFF) in 2000: this has the potential to bring agriculture closer to finance in terms of economic reforms.

15 We exclude the scandals concerning the Ministry of Health and Welfare, as the areas are under "social regulatory reforms" (see above): however, it may be helpful to ponder the significance of the scandals in this case as well. The Ministry of Health and Welfare (MHW) was ridden with scandals, one involving the arrest of its top administrative official for bribery regarding the construction of retirement homes, another involving HIV-contaminated blood products. (See Curtis [1999]) The MHW suffered from a similar loss of public trust (as MOF suffered) in both ethics and competence in the two

scandals involving its officials. However, while the particular individual who bribed the officials for retirement homes and the particular pharmaceutical firm responsible for the HIV contamination naturally attracted wild public criticism, this did not materialize in the condemnation of the industries (i.e. retirement home; pharmaceutical) themselves, even less in the condemnation of health-related industries as a whole.

16 Note however, that the 1996 research had different methodologies (telephone) from the ones in 1994 and 1998 (interviews).

17 See Peltzman (1998).

18 We do not delve into the relationship between BS and IS, as PS determines the bureaucratic strategy towards a particular industry. In the Big Bang, given the low public support of the financial industries and MOF, bureaucratic survival for MOF meant to sever ties with the financial industries: IS may seem to be a negative function of BS. Yet, if PS is high for a particular industry, the bureaucracy may be expected to be providing a cover in its pursuit of survival. Thus, in its pursuit of survival, the bureaucracy is expected to support an industry with high public support, while it would not do so for an industry with low public support: as long as bureaucratic survival is linked to public support, this causal factor (BS) seems to be redundant.

19 See Bagehot (1928 [1867] 156-93, especially 165).

20 See Nakatani (1996) for an example of such works that casually dismiss the trade-offs of institutional changes.

21 These expressions originate from Scott and Weingast (1992) which studied the stagnant reform process of the U.S. Glass-Steagall Act that separated banking from securities.

22 "Technology and the Economy", remarks made before the Economic Club of New York, New York, New York on 13 January 2000. Obtained at the FRB web site accessed on 7 March 2000 at the below address. http://www.federalreserve.gov/BoardDocs/Speeches/2000/20000113 2.htm

23 See, for example, Scott and Weingast (1992) to see the "economic propellants" and "political impediments" to the U.S. banking reforms.

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