Syncretism: Politics and Interest Groups in Japan's Financial Reforms

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Introduction

Over the last two decades, cloaked in a cocoon of lackluster growth, Japan's economy has transformed from a closed system actively managed by the state to a more diversified and open rules-based system. The financial system, which lies at the core of the economy, was once dominated by banks under the heavy hand of the Ministry of Finance (MOF); today, the financial industry has a range of participants that are both foreign and domestic. What is most surprising about this reconfiguration of both the cast and their roles, however, is that the drivers of change were not the traditional interest groups that dominated Japan's postwar economy. Instead, reform came from political leaders seeking electoral support during a prolonged economic slump. As a result, the financial system today is best described as *syncretic* – a form of diversity in which new, old, and hybrid players coexist.[3] While this syncretic form implies persistent inefficiencies, it insulated Japan's financial sector from most of the damage caused by the 2007–2008 global financial crisis, since its exposure to the US "shadow banking" system – non-deposit taking financial institutions at the heart of the crisis – was limited, and Japan did not develop its own such institutions.

Syncretism: the observed outcome in Japan's financial system

For a long time Japan's financial system was bifurcated into a "developmental" or "strategic" side entailing commercial and policy bank systems and a "clientelistic" or "pork-barrel" side involving the massive postal banking system.

Commercial and policy bank systems were central to Japan's strategic, developmental politics. Households' and firms' deposits provided the funds for loans to industry, with MOF and the Bank of Japan deploying various formal and informal measures to shape the country's investment profile towards economically strategic sectors such as heavy industries.[4]

The postal banking system, containing the world's largest deposit-taking financial institution, was historically at the core of Japan's clientelistic postwar politics. Deposits from households throughout the country, gathered through post offices, were largely invested in infrastructure projects. The postal bank acted as the government's "second budget," enabling politicians to allocate capital to electorally important sectors and public works projects in their local districts. The payoff was votes; the fact that the Liberal Democratic Party (LDP) enjoyed over fifty years in power was greatly facilitated by the postal banking system.

This post-war Japanese financial system was closed to new entrants and carefully segmented into subcategories such as banking, insurance and securities industries, each with strictly limited business models. Individual asset investment opportunities were essentially limited to domestic deposit-taking institutions and kept within the country. This segmentation also operated as the functional equivalent to the US 1933 Glass-Steagall Act that separated commercial banking from securities.

Since the 1980s, Japan's financial system has transformed extensively, becoming far more open and diverse. By the late 2000s, bond and equity markets had matured, and new entrants, both domestic and foreign, introduced various new business models. The banking system's role shrank, foreign insurers and securities

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[3] For an extended version of the arguments about syncretism and institutional change in Japan, see Kushida and Shimizu (2013).

[4] MOF used its licensing authority over bank branches to informally shape commercial banks' investment decisions. Policy banks, including the Developmental Bank of Japan and the Long-Term Credit Bank, were mobilized to lend to target industries. The Bank of Japan, particularly during periods of tight monetary policy, used "window guidance" to guide the lending of major city banks (Hoshi, Scharfstein and Singleton 1993).

firms became major players, and the postal savings system became corporatized, en route to full privatization and participation in market competition. Japan's financial system became vastly more complex, a trend also seen worldwide.

We contend that Japan's new financial system is best characterized as *syncretic*, due to the coexistence of new, old and hybrid forms of practices, norms and modes of organization. The old were not simply replaced by the new, nor entirely morphed into hybrid forms. While the breadth of the new has expanded, and significant hybridization is occurring, large portions of very traditional organizations, norms and practices remain. Syncretism, therefore, is a specific form of diversity. It is not simply hybridization, which is a melding of the old and the new, but instead represents the continued coexistence of old, new, and hybrid elements as distinct forms.[5]

The "new" elements are best represented by foreign investment banks, securities firms, insurers and some new Japanese entrants. They introduced new business models (for example, derivatives and annuities), practices (particularly regarding employment and inter-firm relations) and norms (for example, profit maximization and short-term shareholder returns).

The "hybrid" players, fusing traditional and new elements, are exemplified by the three major financial groups, Mizuho, Mitsubishi UFJ and Mitsui Sumitomo, centered on their respective mega-banks. The mega-banks were created by mergers between historical main banks organized into holding companies, and were allowed to expand into previously restricted areas such as securities, trust banking, and insurance. The financial groups embrace a combination of new and old business models (ranging from traditional deposits to foreign currency-denominated accounts and a variety of annuities and insurance products), multiple forms of employment practices (traditional seniority-based banks alongside performance-oriented securities subsidiaries, for example), as well as new and old inter-firm relations (acting as relational "main banks," but also entering into joint ventures and tie-ups with foreign financial institutions).

The "old" are exemplified by regional banks, which overwhelmingly retain traditional strategies (continued heavy reliance on retail banking), organizational structures (main bank relationships, seniority-based hierarchies), and norms (regionally based with close ties to local governments and an emphasis on relationship banking as a key source of client information).

The postal banking system has also become a combination of the new, old, and hybrid. The corporate form is new, with the corporatized Japan Post Holding Company fully owning the bank, insurance, and postal services as subsidiaries. Private sector businessmen, appointed as top management, introduced new concerns about profitability. Employees – including postmasters – are no longer public servants. Postal companies can offer new products and services, such as mutual funds and credit cards, and tie-ups to foreign firms' insurance and annuity products. At the same time, Japan Post Bank is hybrid; the government still wholly owns the parent holding company, and plans to retain one-third of the shares.[6] However, its core business remains traditional: the Japan Post Bank takes retail deposits through its nationwide network, and it is a significant buyer of Japanese government bonds – about one-third of the JPY 700 trillion Japanese Government Bond (JGB) market.

Syncretization: the pattern and process of change

How and why did this observed syncretism in Japan's financial sector occur?

The pattern of change entailed a period of gradual adjustment, with incremental regulatory reforms driving marginal changes in industry dynamics, followed by a burst of regulatory reforms that significantly reshaped the actors, business strategies, and patterns of interaction. In the case of Japan Post, partial longer-term retrenchment followed the burst of reforms.

The *driver of change* was political – a particular pattern of interest group politics we call *syncretization*. The prolonged gradual adjustment period was driven by traditional interest group politics; large, domestic financial institutions, mediated by the bureaucracy, dominated. At the junctures of rapid change, however, major political thrusts for reform were driven by the ruling party's acute electoral concerns. Traditional political bargains and historical industry-level policy processes were overridden by the political leadership's calls for structural reform – their platform for survival.

[5] Our concept of syncretism is simpler and captures the dynamics of change more easily than Aoki et al. (2007) who show Japanese firms clustering around the traditional J-firm model (with three subcategories), and multiple subtypes of two hybrid models (Aoki et al. 2007; Aoki 2010).

[6] This hybrid ownership form has precipitated calls of unfair competition from private sector and foreign competitors.

Table 1

Japan's banking system – developmental and clientelistic sides, ranked by deposit size (trillion JPY)

	City Banks	Regional Banks	Postal Savings
Deposits			
1995	209.0	217.7	-
2000	230.6	235.0	-
2005	255.7	245.9	200.0
2010	270.3	272.6	175.8
Assets			
1995	346.9	194.7	-
2000	373.0	200.5	-
2005	395.5	216.7	194.7
2010	419.4	240.1	264.9

Postal Savings adapted from Japan Post Bank Co. non-consolidated financial data.
Source: The authors, based on Bank of Japan, Financial Institutions Account, http://www.stat-search.boj.or.jp/ssi/cgi-bin/famecgi2?cgi=$nme_a000_en&lstSelection=3.

Critically, *the actors pushing for reform were not the incumbent, traditionally powerful interest groups most affected by reform*. The impetus for reform came, instead, from strong political leadership, particularly the prime minister's office, spearheading reform as a critical electoral strategy for the party's survival. Since the incumbent major financial firms were not spearheading reforms, only some rushed to embrace the new possibilities enabled by the reforms. Hence, the coexistence of old, new, and hybrid elements.

Despite the rise of new elements, the traditional and hybrid still remain as significant, distinct forms. Table 1 shows the roughly similar deposit amounts in the developmental/programmatic and clientelistic/pork-barrel sides. It is worth noting that the total amount of deposits in Japan's sixty-odd regional banks slightly exceeded that of city banks (including mega-banks and some others) by 2010. The Japan Post Bank, a single financial institution, still dwarfs the mega-banks (see Table 2).

Reform of the "developmental" private sector financial system

From the late 1970s, as finance liberalized globally, MOF carefully managed a gradual liberalization of the private sector financial system. The dominant pattern of interest group politics consisted of bureaucracy-mediated compromises pushed by intense lobbying from large Japanese financial institutions.

In the mid-1990s, however, a set of sweeping financial reforms known as the financial "Big Bang" reforms substantially reformed the sector. When implemented in the late 1990s and early 2000s, sectoral compartments were removed, enabling cross entry – most notably, banks could now enter securities, insurance, and other previously restricted businesses through holding companies. New entrants were welcomed, including foreign investors taking control of ailing Japanese banks, and financial institutions were allowed to offer new products such as derivatives. MOF itself was broken up, sharply curtailing its discretionary authority. The Financial Supervisory Agency was created to monitor financial institutions' activities on an *ex post* basis, rather than the previous *ex ante* coordination style of regulation under MOF.

The Big Bang reforms were spearheaded by Prime Minister Hashimoto's Cabinet, driven by electoral concerns, in an effort to appeal to voters hungry for change. The LDP faced unprecedented vulnerability; several years after the bursting of Japan's economic bubble in 1990, shared expectations of LDP's continuing electoral victories no longer held, an institutional change in the realm of norms (Toya 2006). As such, the Big Bang reforms departed from long-held patterns of bureaucracy-mediated compromises pushed by intense lobbying by large Japanese financial institutions. Nor did they result from political pressures by the reforms' greatest beneficiaries – foreign financial institutions. Instead, Japan's political leadership overrode intense opposition from the domestic financial industry. The reforms were broader and more drastic than previous reforms. MOF lost control of the reform agenda, and by opposing industry groups it only managed to slow down the pace of reform implementation.

Table 2

Comparison of Japan's financial groups and Japan Post Bank (trillion JPY)

2005	Deposits	Total Assets	2010	Deposits	Total Assets
Japan Post	200.0	247.7	Japan Post	175.8	194.7
Mitsui Sumitomo Financial Group	71.2	99.7	Mitsubishi UFJ Financial Group	123.9	204.1
Mitsubishi Tokyo Financial Group	70.4	110.0	Mitsui Sumitomo Financial Group	90.5	123.0
Resona Holdings	33.0	40.0	Resona Holdings	34.1	42.7

Source: Kaisha Shikiho (Summer 2005); Company Annual Reports (2010); Japan Post Co. Annual Reports (2005, 2010).

The politics driving Japan's Big Bang financial reforms starkly contrasted with that of the US and UK during the 1980s. In those countries, demand and support for reforms came from the most affected actors (domestic financial firms). In Japan, because the Big Bang reforms were not driven by the interest groups most affected (large incumbent Japanese financial institutions), the latter did not rush to embrace new business models and the organizational possibilities enabled by the reforms. Since the reforms themselves did not mandate a complete abandonment of previous practices, organizations, and business models, the industry developed following a pattern of syncretism.

Market outcomes of the financial "Big Bang": syncretism

The Big Bang reforms transformed the logic of competition in Japan's financial industry to a syncretic form, with old practices coexisting with new practices and strategic adjustments being made by incumbent players against the backdrop of new rules. Foreign firms and new entrants took advantage of new opportunities to offer services and products, becoming highly profitable. Incumbent Japanese firms were disadvantaged, since their organizations and strategies were optimized for outdated regulatory conditions. While free to enter new business areas, their existing workforces lacked the necessary expertise and radical workforce reductions were legally difficult and normatively prohibitive. After years of adjustment, many incumbents adopted hybrid structures, with holding companies, multiple employment tracks and diverse market strategies. For example, mega-banks formed securities subsidiaries, staffing them with bank employees with long-term employment arrangements, as well as new recruits and mid-career hires with Wall Street-style, short-term financial incentives in exchange for low job security. Regional banks, with neither the resources nor the will to transform thoroughly, overwhelmingly adhered to traditional structures and strategies (Shimizu 2009).

Reform of "clientelistic" postal savings finance

Reform of the clientelistic side of Japan's financial system focused on postal privatization. The postal system fueled clientelistic politics in two significant ways: by providing funds to sectors and geographic areas deemed most effective in influencing votes; and by offering a nationwide network of post offices and postmasters to organize votes and influence policymaking.

Japan's postal savings system is considered the world's largest holder of personal savings; at its peak in 1999 it held JPY 224 trillion (USD 2.1 trillion in 1999 exchange rates) of household assets in savings accounts (*yū-cho*) and an additional JPY 126 trillion (USD 1.2 trillion) in life insurance services (*kampo*). Together, its assets accounted for nearly one-third of Japan's household assets. These funds fed the Fiscal Investment and Loan Program (FILP), which provided the key source of government investment in industrial development, small and medium enterprise support, public works, and other government-funded projects, enabling politicians to influence votes with public funds (Amyx, Takenaka, and Toyoda 2005; Iwamoto 2002). Given the sheer magnitude of household savings under government control through this postal system, Japan's reformers saw postal privatization as necessary for overall financial reform and liberalization.[7]

[7] In 1997, deposits in private banks and the postal savings system totaled JPY 474,629 billion and JPY 237,782 billion, respectively. By the start of the privatization process in 2007, the amounts were JPY 545,043 billion and JPY 180,843 billion, respectively (Yoshino 2008).

Politically driven reform

Postal privatization was also a politically driven reform effort. It was most closely associated with one individual – Prime Minister Koizumi – who successfully passed postal privatization bills in October 2005. Koizumi had advocated postal privatization since the issue was first raised in the 1980s. His convictions were rooted in his origins in the Mori faction of the LDP and in the party's financial tribe or *zoku*, who were closely affiliated with MOF and the commercial banks. As prime minister, Koizumi regarded postal privatization as representing broader liberalization and structural reform. He had some bureaucratic support, but he had particularly strong backing from private banks and other firms who regarded the government's postal savings and insurance as unfair competition.

Not surprisingly, opposition to postal privatization was fierce. Rooted in 130 years of history (postal savings dating from 1875 and postal insurance from 1916), the powerful postal lobby, headed by the postmasters, was both the target of this reform and its most vociferous opponent. The postal lobby was supported by both LDP and opposition party politicians who had benefitted from the lobby's activities. It also found some public support among those who associate the old postal system with Japan's bygone era of economic prosperity coexisting with social harmony.

Yet in the end, Koizumi's determination and political acumen prevailed. Despite resistance that included many from within his own party, Koizumi successfully passed postal privatization by utilizing the institutions directly under his control – in particular, the Council on Economic and Fiscal Policy (CEFP), a policy group within the Cabinet Office largely independent of traditional interest group politics. Koizumi also took an electoral gamble, linking the credibility of his opponents to passage of the postal privatization bills. By framing postal privatization as symbolic of overall reform, his message resonated with voters eager for economic revitalization. Koizumi won a landslide victory in September 2005, receiving a mandate to pass the postal privatization bills the following month.

Over the longer run, however, Koizumi's strategy to weaken his opposition by refusing to endorse LDP politicians who were against postal privatization had important implications for the bills' implementation and the opposition's ability to limit their actual effects. Koizumi failed to concurrently strengthen the proponents of postal privatization by extolling its benefits and winning greater popular support. As a result, opponents worked diligently to undermine implementation after Koizumi's departure. This suggests a more general point that changing the rules despite heavy resistance from those most affected by them can be vulnerable to circumvention or even reversal in the implementation phase.

The current status of postal privatization is a combination of old, new, and hybrid. Japan Post Bank's basic business model of taking retail deposits through its nationwide network remains intact. The state has yet to sell shares in the postal savings and postal insurance companies. Although the postal savings bank is no longer required to invest its funds in FILP, the practice continues, with Japan Post holding about one-third of the JPY 700 trillion government bond market. And even although the political influence of the postal lobby and postmasters has declined, they have largely held onto their jobs. An irony of the privatization bill is that postmasters, no longer public servants, are now free to actively participate in political activities. Yet, their electoral influence has undoubtedly declined, although they evidently retained enough clout to gain DPJ support during the latter's brief reign.[8]

Conclusion

We expect Japan's financial system to exhibit syncretism for at least the short to medium-term. Therefore, although some areas of the system are rapidly converging with the US and the UK, in their style norms, organizations and strategies, like securities and investment banking for example, others retain their traditional structures and strategies, particularly regional banks. The growth of hybrid practices also means that convergence is unlikely any time soon. Although inefficiencies remain, the current state of affairs also insulates Japan's financial system from international shocks. The 2007–08 financial crisis, for instance, damaged Japan's export sector, but left most of its financial system unscathed, since the traditional and hybrid portions of the financial system had very limited exposure to the US "shadow banking" system, also precluding Japan from developing its own such system.

The potential integration of Japan's postal savings and insurance systems into the mainstream financial system represents the entry of massive new market players.

[8] A leader of the postmasters group was quoted as saying that his group could guarantee at least 500,000 votes (Asahi Shinbun Globe 2009).

Yet, given the shifting political trajectory, with vested interests advocating a slowdown in reforms returning to political prominence, integration has been substantially decelerated. Japan Post Bank and Japan Post Insurance are still wholly held by Japan Post, itself 100 percent held by the Japanese government. In short, the reversals in the privatization process have created government-owned firms that directly compete with private firms, both domestic and international. This is another aspect of Japan's financial system that remains distinct from that of the US or the UK. However, although Japan may be blazing its own trail, these firms have the potential to create new headaches for the government as it attempts to steer Japan towards greater participation in both bilateral and regional trade agreements. In the recent negotiations for the Trans Pacific Partnership, for example, Japan met with US opposition to plan for state-owned Japan Post Insurance to enter the cancer insurance market. Syncretism may be the distinct outcome of politically led reforms, but a lack of conformity may also lead to isolation and accusations of unfair play.

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