The Slow Government Response to Japan’s Bank Crisis:  
A Principal-Agent Analysis*

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Abstract: What explains the Japanese government’s slow response to the banking crisis faced by the country in the 1990s? To explain this puzzle, this paper utilizes a principal-agent framework, focused on the relationship between Japan’s politicians and bureaucrats. We argue that Liberal Democratic Party (LDP) single party dominance led to an unusually stable and close relationship between the ruling party and administrative bureaucracy. When single party dominance came to an end, the relationship between LDP politicians and bureaucrats became more competitive, leaving the LDP disadvantaged because of the lack of formal structures to challenge the bureaucracy. Moreover, the uncertainty surrounding what party or parties would control the government made the relevant interest groups less likely to contact politicians. As a result, the LDP had few avenues available to learn more about the problem, leaving the bureaucracy free to use “smoke suppressors” to help hide the troubled state of Japan’s financial sector and delay bank reform. On top of analytical narrative that fleshes out the mechanisms involved in government (in)action surrounding the bank crisis, this paper utilizes a unique data

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set of interest groups in Japan to demonstrate the link between cabinet instability and an unwillingness by interest groups to provide information to politicians.
The Japanese government’s slow response to the country’s financial crisis in the 1990s is a puzzle. Until the final decade of the twentieth century, Japan was described as having a “miracle” economy, and Japan’s government – most notably, the bureaucratic ministries in charge of the economy – was given much of the credit for this success. With its active bureaucracy that developed economic plans and provided “administrative guidance” in conjunction with the country’s tremendous postwar growth, resilience in the face of the 1970s oil crises, and ability to act quickly to balance its budgetary books in the early to mid 1980s, the Japanese government developed a reputation for being able to recognize problems in their infancy and develop solutions before they spiraled out of control. However, in the 1990s, in the face of what turned out to be a dramatic collapse of the real estate and stock markets and general stagnation of the economy overall, the Japanese government appeared paralyzed. The most glaring example of this paralysis was in the realm of Japan’s banking crisis: Despite strong signs in the early 1990s that there was a substantial non-performing loan (NPL) problem in the banking sector, Japan’s government took very few steps to address the problem until 1998. Why was the government so slow to respond?

In this paper, we offer a new approach to understanding this problem. Other political science analyses of Japan’s banking system and its problems in the 1990s focus their explanations on increased complexity surrounding financial regulation and instability in the networks linking bureaucrats to financial institutions (Amyx 2004), the bureaucracy’s commitment to a particular form of bank regulation (Vogel 2006), and incentives generated by the electoral system (Rosenbluth and Schaap 2003). We do not take issue with the substance of these analyses, but rather argue that they do not address a critical part of the puzzle of the Japanese government’s slow response to the bank crisis: the seeming obliviousness and lack of action on the part of politicians. A common explanation for the lack of politician knowledge and activity in major policy areas in Japan is simply that politicians are not active participants in many complicated policy areas and delegate (or abdicate) discretion over them to the country’s bureaucracy. However, this explanation simply begs the question as it does not explain why politicians would behave in this way. In addition, politicians’ lack of action on the bank problem is even more puzzling given that politicians at the time were openly pinning blame for the country’s poor economic performance on bureaucrats within the Ministry of Finance (MOF).

To explain this puzzle, this paper utilizes a principal-agent framework, focused on the relationship between Japan’s politicians and bureaucrats. Most typically, the literature on principal-agent relations between politicians and bureaucrats views the relationship in zero-sum terms, with one side seeking to gain at the expense of the other. However, as noted most pointedly by Kato (2002), under the condition of a longtime stable relationship between one political party and the bureaucracy, a positive-sum relationship, founded on close cooperation between the two is likely. Moe’s (1989, 1990a, 1990b) analysis of “structural politics” leads us to expect that, in such a context, few structures will be put into place to allow politicians to challenge or constrain the actions of the bureaucracy. But Moe’s analysis does not consider what happens if the close ties between such politicians and bureaucrats suddenly become broken. We argue that a loss of power – or high certainty of power – by the longtime ruling party will alter the principal-agent context, shifting the relationship from positive-sum to a zero-sum.

The political science principal-agent literature also puts forward an expectation that even when relations between politicians and bureaucrats are less cooperative, politicians can constrain bureaucratic behavior, in part through contacts with interest groups that provide legislators with policy information (see, e.g., McCubbins and Schwartz 1987). However, the literature gives
little systematic attention to when interest groups will be more likely to contact politicians with their grievances and information rather than contacting bureaucrats directly. We argue that it is in this very area that politicians face a significant problem if working in a system that shifts from the cooperative to competitive relationship between legislators and bureaucrats. We argue that because politicians under the cooperative scenario never developed structures to help them deal independently with many key policies, bureaucrats have a major advantage in terms of information and legislative capacity in the competitive context. In contrast to the “fire alarms” that get tripped and thereby provide politicians with policy information in competitive party structures, bureaucrats in the context that we describe can actually use what we term “smoke suppressors” to hide information from the politicians who oversee them.

Speaking specifically about Japan, we argue that single party dominance – with the Liberal Democratic Party (LDP) ruling Japan without interruption over 1955-1993 – led to an unusually stable and close relationship between the ruling party and central bureaucracy. As a result, Japan’s parliament (Diet) never established structures that would allow it to obtain policy information on its own and develop legislative capacity in a number of policy areas, most notably bank legislation. Instead, single party dominance promoted great bureaucratic discretion, especially in areas such as banking policy controlled by the Ministry of Finance.

With the LDP’s temporary loss of power in 1993-94, ties between politicians and bureaucrats grew strained. With increasing concerns about the economy, once back in power the LDP sought to take away some of ministries’ discretion and jurisdiction, most notably in the area of bank regulation. In order to combat these efforts, MOF hid information from the party. At the same time, the uncertainty surrounding what party or parties would control the government made the relevant interest groups less likely to contact politicians and the troubled banks themselves certainly did not wish to notify politicians of their problems. Without structures in place to help it gain information, the LDP had few avenues available to learn more about the problem. Only once the crisis was naked for all to see in 1998 did the government finally take serious steps to address it.

The paper proceeds as follows: First, we more clearly set up the puzzle and discuss the relevant political science literature on the topic. Next, we present our principal-agent framework and apply that framework to the behavior of Japan’s government during the bank crisis. Finally, we analyze a unique data set of interest groups in Japan to bolster more systematically our argument that cabinet instability leads interest groups to be less likely to contact politicians.

Japan’s Bank Crisis

Throughout much of the postwar, Japan’s banks were noted for their solidity. Banks’ staying power was aided by actions taken by the Ministry of Finance, most notably its Banking Bureau, which maintained close – although often informal – ties with Japan’s banking sector and emphasized minimizing the risk of bank failure. During times of (usually small) bank failure, MOF coordinated mergers whereby a larger bank would rescue the failing one. The result was widely seen as aiding the success of Japan’s economy: As Amyx explains, “The implicit MOF guarantee that no bank would fail encouraged individual depositors to entrust their savings with banks, which then could direct funds into investments benefiting the economy as a whole” (2004: 108).

However, over time problems emerged. Information requirements increased in the 1980s. As capital markets liberalized, banks faced greater competition, lost many large corporate borrowers, and therefore were forced to lend to smaller firms outside of their established
networks. Risk grew, making it particularly important to gain additional information on borrowers. As a result, MOF sought to impose more formal mechanisms for monitoring banks, but these efforts were rejected by both banks and the Diet, forcing MOF to rely at least as much as ever on informal relations to gain information (Amyx 2004: 32). Meanwhile, feeling that there was something of a safety net given MOF’s history of finding ways to help rescue failed financial institutions, banks extended massive – albeit significantly riskier – loans during the 1980s economic bubble years (Vogel 1996: 194), founded in large part on pumped up real estate collateral. As the real estate and stock bubbles burst in the late 1980s and early 1990s, numerous borrowers were unable to repay their loans. Banks also had speculated in real estate, so they too were hit hard by the collapse of the market (Vogel 2006).

Estimates vary on exactly how costly the NPL crisis was, but it is widely considered the costliest bank rescue operation in history (Amyx 2004: 3), with nonperforming loans totaling at least $600 billion (Amyx 2004: 3, Pempel 1998: 142). In many ways, this number understates the true impact of the bank failures as it does not also tell the story of how the cost of bailing out the banks harmed the Japanese (and Asian regional) economy in a myriad of ways, including raising public debt, depressing economic output, weakening consumer demand, and slowing credit flows from Japan.

Throughout the 1990s, the bank problem was frequently noted, but Japanese authorities were exceedingly slow to respond to the crisis: In 1992, LDP Prime Minister Kiichi Miyazawa explicitly suggested the possibility of using public funds to combat the problem (Amyx 2004, 158). And in 1995, Moody’s downgraded its average rating of the credit worthiness of Japanese banks to “uncertain” (D rating) (Pempel 1998: 142-3). However, the NPL problem did not take a major place on the public agenda and MOF was reluctant to bail out the banks. As a result, no serious steps were taken for years to address the problem. Indeed, it was fall 1998 before politicians finally stepped in, passing legislation that used public funds to help clear the red, and establishing new financial regulatory structures. Economists widely agree that Japanese authorities moved far too slowly to get the banks to take care of their NPLs and Vogel notes that the NPL crisis would have been resolved more effectively and at lower cost if Japan had acted more quickly and decisively in the 1990s (2006: 25-6).

What explains the lack of action? Amyx argues that, when buttressed by government guarantees of rescue, financial institutions have incentive to hide negative information from regulators in the hopes that high-risk high-return investments may save them in the meantime (2004: 28). Given this context, she argues that it is likely that MOF lacked information on just how systemic the NPL problem was and the ministry continued to maintain its ad hoc and informal approach to regulation and rescue (Amyx 2004: 161). In contrast, Vogel (2006: 49) argues that the biggest reason for MOF’s lack of responsiveness was the ministry’s overwhelming faith in its long-held model of bank regulation that maintained financial stability without a large deposit insurance fund or publicly financed bank bail outs (Vogel 2006: 49).

Amyx and Vogel present competing views of why MOF was unwilling to respond to the crisis, but neither tackles the broader question of why no one at all in the government attacked the crisis. Most striking, why did politicians stay out of the fray? One possibility is simply that during the 1990s, politicians were distracted by numerous other major events, most notably major political reform, shifting party dynamics, the 1995 Kobe earthquake, and the 1995 Tokyo sarin gas attack. Nevertheless, politicians during this time were clearly not wholly distracted, as they were willing to push other issues such as administrative reform and a hike in the consumption tax. Also, to be sure, the decision was not due simply to total faith in the efficacy
of MOF policies: The LDP during much of this time actually sought to blame the country’s economic problems on MOF.

Another possibility is presented by Rosenbluth and Schaap (2003), who argue that bank regulatory regimes are a direct result of the incentives generated by the electoral system. The 1998 bank reform, they argue, was a result of a change in Japan’s lower house electoral system. The implication, therefore, is that the earlier lack of action by Japan’s politicians was a result of the incentives created by the prior electoral system. However, Japan instituted its new electoral system more than four years earlier and held its first election under the new system in 1996. It wasn’t until a slight shift in the partisan balance of power after an election held for the Diet’s less important Upper House, which had not reformed its electoral system, that bank reform was seriously pushed. In this way, an electoral system model can offer no more than a partial explanation for why Japanese politicians took so long to deal with the bank crisis.

Perhaps the most straightforward explanation is simply that politicians never want to engage in a costly and unpopular act of using public funds to bail out of banks. In many ways, though, it was politicians like Prime Minister Miyazawa who actually first pushed for the use of public funds, but were talked out of it by MOF on the basis of “superior” information – that using public funds would create an unnecessary panic when the crisis was likely to be resolved without it.

This last point, though, helps push us toward an answer: That is, it appears that much of the reason for politician inactivity in Japan’s bank crisis was due to their reliance upon MOF for information on the state of the country’s banking sector. It turns out that this reliance was tragically flawed, as MOF during this time actually worked with financial institutions to hide information about the weakened state of Japan’s banks (Amyx 2004: 258, Vogel 1996: 194). For many observers of Japanese politics, this point – that politicians rely heavily upon bureaucrats for important information – is self-evident, but in reality it pushes us toward the real question: Why were politicians so reliant upon bureaucrats for information on matters such as the health of the country’s banks?

**Principal-Agent Relations: Delegation and Information**

To explain the slow response of Japan’s government to the bank crisis in the 1990s, therefore, we must explain politicians’ reliance upon bureaucrats for their information. It is this very sort of issue that political science principal-agent analyses of legislator-bureaucratic relations seek to address. Principal-agent frameworks are developed to address problems that supervisors (principals) inevitably face in seeking to get their subordinates (agents) to do their assigned tasks. The problem arises because principals can not do everything required of them and therefore need agents to acquire expertise and do much of the necessary work. In any complex society, legislators must delegate large amounts of work to the bureaucracy. A central issue for any legislature, therefore, is determining mechanisms that make it possible to trust the information provided by the bureaucracy and maintain control over the work bureaucrats do.

**Uncertainty**

Uncertainty is central to delegation, as greater uncertainty over the political environment makes it more likely that legislatures will write detailed, constraining legislation to tie the hands of bureaucrat agents. This last point is similar to Moe’s (1989, 1990a, 1990b) discussion of “structural politics,” which indicates how the current political context structures legislation and delegation. For example, where uncertainty exists about who will control a particular policy in
the future, policy makers may write more specific and detailed legislation to remove the possibility of control by future legislative rivals and constrain the behavior of bureaucrats. Among parliamentary systems, legislation of this kind is most likely in countries with coalition or minority governments, where those controlling legislation today are very uncertain about their ability to maintain their dominant position in the future (Huber and Shipan 2002, Moe and Caldwell 1994).

However, a total lack of constraining structures is especially likely in what Moe (1990a) points to as a hypothetical “extreme case”: where there is a single dominant and secure majority coalition. De Figueiredo (2002) modifies Moe’s conceptualization, arguing that it is electoral strength and not uncertainty that matters most in terms of shaping the level of policy insulation and constraints. However, for our purposes, a common point can be drawn from these analyses: A ruling party that is electorally strong, with a high likelihood of remaining so in the future will avoid constraining structures and rules that would tie its own hands.

We should therefore expect that a party that maintains stable majority control of a legislature for significant period to be especially unlikely to formalize constraints on the bureaucracy. Stable longtime control of the legislature by a single party with the attendant longtime relationship between that party and the bureaucracy helps overcome the “hold-up problem”: Epstein and O’Halloran explain that “given that delegation implies surrendering at least some residual rights of control over policy, legislators will be loath to relinquish authority in politically sensitive policy areas where they cannot be assured that the executive will carry out their intent” (1999: 48). But when it is widely assumed that the same political party will be in power for a considerable period, both party and bureaucracy will be aware that politicians will be able to be available to punish current bureaucratic abuses in the future. Longtime single party dominance should lead politicians and bureaucrats to develop a close relationship where bargaining and flexibility can be a great advantage. In such a context, strict structures and statutory constraints tie the hands not only of the bureaucrats, but of politicians as well. As a result, there is much less incentive for politicians to establish structures or rules that do so, especially as they – as part of the stable party in power – will most likely be able to take necessary steps to fix problems with the policy (or bureaucrats’ behavior) in the future.

In their comprehensive analysis of the factors that shape the degree to which politicians write detailed legislative statutes that constrain bureaucratic execution of policy, Huber and Shiped (2002) give particular weight to the level of policy conflict between politicians and bureaucrats and the legislative capacity of politicians (i.e., the extent to which they can write complex legislation on their own). We should add that our discussion here suggests an endogenous relationship between these two factors. That is, reduced policy conflict leads politicians to develop fewer structures that will give them the capacity to engage in policy-making on their own. And weakened legislative capacity creates a greater need to rely on the bureaucracy, thereby reducing conflict between the two groups.

Positive-sum vs. Zero-sum

In many ways, this discussion stands in sharp contrast to much of the conventional principal-agent analysis of politician-bureaucrat relations. Much of the classic work in the area emphasizes the competitive side to the politician-bureaucrat relationship, explaining either how bureaucrats can wield power over politicians (e.g., Niskanen 1971) or politicians could use institutional arrangements to influence the behavior of bureaucrats (e.g., Kiewiet and McCubbins 1991).
In reality, though, a simple dichotomy does not usually exist in policy-making. For example, as Huber and Shipan point out, “appointment powers, budget authority, monitoring mechanism, and...the design of legislation itself provide political actors with considerable opportunities to treat bureaucrats as allies rather than as foes in the policymaking process” (2002: 42). Moreover, as Kato (1994, 2002) explains, when politicians and bureaucrats work together, each can increase the ability of the other to have an impact on the policy-making process. By helping politicians develop greater expertise in areas of concern to the bureaucracy, bureaucrats improve their own chances of passing legislation (Kato 1994). And as bureaucrats share more information with politicians, the views and attitudes of the two groups grow closer together, which makes it easier to pass legislation (Kato 2002). However, as suggested above in the discussion of structural politics, the close relationship and positive-sum context is much more likely under certain scenarios, with the most likely scenario being where a single party securely controls the government for a considerable period.

Interest Groups

Moe (1990a) points to interest groups as the driving force in policy-making, and irrespective of the relationship between politicians and bureaucrats, interest groups and their relationship to governmental actors are critical to the process of policy-making, in large part through the information they provide. Without indicating where the information comes from, any description of policy change lacks a mechanism. By pointing out the important role interest groups play in providing information to political principals, Bendor and Moe (1985) demonstrate the external feedback mechanism is necessary for politicians to influence bureaucratic agents. Without information from interest groups, it is difficult for political principals (politicians) to judge the behavior of their agents (bureaucrats) and the efficacy of their agents’ actions.

Most commonly cited in the legislature on the U.S. Congress, interest groups provide information by pulling “fire alarms” (Lupia and McCubbins, 1994; McCubbins and Schwartz, 1987; McCubbins, Noll, and Weingast, 1987). As McCubbins and Schwartz explain, upon enacting legislation the legislature does not typically examine a sample of administrative decisions, looking for violations. Such behavior (“police patrols”) would simply be too time-consuming. Rather, the legislature “establishes a system of rules, procedures, and informal practices that enable individual citizens and organized interest groups to examine administrative decisions (sometimes in prospect), to charge executive agencies with violating congressional goals, and to seek remedies from agencies, courts, and Congress itself” (McCubbins and Schwartz, 1987: 427).

At the same time, though, without information from interest groups, it is also difficult for bureaucrats to judge the efficacy of their own actions. Brehm and Gates (1997) note that in many cases, interest groups are more likely to go directly to the policy implementer and therefore provide “smoke detectors,” providing information to the bureaucratic agency rather than politicians.

Considering Additional Dynamics

In short, we learn from the literature that the level of certainty surrounding the party composition of the government is critical to the relationship between the legislature and the bureaucracy. For example, where it is highly likely that the same party will remain in office, it is expected that close ties will develop between the party and the bureaucratic ministries and there will be substantial delegation of policy-making control. And, the additional information that gets
shared in this context in fact helps facilitate the legislative process. The literature also indicates that even in contexts where close ties do not exist between politicians and bureaucrats, the legislative branch is more than capable of reining in the behavior of bureaucrats: in large part through fire alarms tripped by interest groups, politicians are able to acquire the information necessary to monitor and control bureaucratic behavior.

*Dynamics left unexplained*

However, there are static elements to the literature that leave important questions unanswered.

First, what happens if the level of certainty regarding party control of the government changes? More specifically, what happens to the dynamic between the legislature and bureaucracy when the party context changes from one in which there is great stability to one in which there is more uncertainty?

Second, what shapes interest groups’ use of fire alarms? More specifically, if there is a change in the relationship between the legislature and the bureaucracy, will interest groups change their patterns of whom they contact in the government? The literature notes the presence of both fire alarms (interest groups providing information to politicians) and smoke detectors (interest groups providing information to bureaucrats). When is one more likely than the other?

*A new view on the problem: The rise of smoke suppressors*

We extend the earlier analyses to offer a framework to understand behavior under these dynamics. We argue that a shift away from electoral stability to uncertainty should affect the principal-agent relationship in a number of important ways. More specifically, if a longtime ruling party was to lose power, its relationship to the bureaucratic ministries would undoubtedly change. Even if the party were to return to power, the relationship would likely be less close, reducing the ability of each side to trust and work with the other. Less certainty would surround the party’s likelihood of maintaining office, raising questions about the party’s ability to correct future bureaucratic ministerial failures or transgressions. For this reason, a structural politics analysis of politics would expect the legislature in this situation to establish greater constraints on bureaucratic behavior.

However, because of the longtime close ties between politicians and bureaucrats, as well as the significant grants of discretion given to the administrative branch, the legislature would have never developed structures to help it act more independently, gain information on its own, and stand as a counter to the bureaucratic ministries. No longer as likely to share information with politicians, the bureaucratic ministries in this scenario would maintain a sizeable informational advantage over the legislature.

Where do interest groups fit into the dynamic? To be sure, in a system where substantial discretion is delegated to bureaucrats, interest groups are likely to deal with bureaucrats – the people working most closely with most policies – directly when they want to raise issues with the workings of a particular policy. But under a situation of longtime single party dominance, interest groups would also be likely to deal with politicians extensively. As Moe and Caldwell notes, “Parties and groups, as ongoing organizations, transact with one another again and again over time. All stand to benefit from informal norms and strategies of cooperation…that protect political deals from subversion” (1994: 180).

We argue that a shift to a situation in which there is great political uncertainty – such as cabinet instability – would be likely to alter this dynamic. In such a context, interest groups will
have much greater incentive to contact the bureaucracy directly, as bureaucrats will be likely to maintain their position of influence irrespective of the events that follow in the political world.

This creates a potential irony for the politicians: Interest groups are more likely to contact them when they, the politicians, are less in need of information because of their already close ties to the bureaucracy. But interest groups are less likely to contact them when they need them most, which is the case in the less electorally stable context where politicians and bureaucrats are less likely to cooperate with one another.

This outcome would be likely to raise special problems for politicians in the dynamic scenario. That is, the scenario above discusses a party that, during years of government stability, never needed to establish structures to help it rein in the bureaucracy, but, under a new scenario of electoral uncertainty, suddenly finds itself on more confrontational terms with the bureaucracy and has few structures in place that it can use to constrain or counter the ministries. On top of this, the parties will be likely to face an additional disadvantage because, in the more electorally unstable and uncertain environment, interest groups ought to be less inclined to trip fire alarms by contacting politicians to provide information on governmental policy. Instead, interest groups in this context have a greater incentive to work directly with the relevant bureaucratic ministries (smoke detectors).

This situation leaves politicians with far less information than if they had put into place structures designed to acquire information on their own or if interest groups were reporting to them. And it leaves bureaucrats with a substantial informational advantage over politicians. In this context, where politicians and bureaucrats may be adversaries, bureaucrats may even choose to hide information from politicians, in effect, creating what we call “smoke suppressors” that allow bureaucrats to protect their own interests from politician interference.

**Applying the Framework to Japan**

Like a significant portion of the American politics literature, much work in English on Japanese politics paints the relationship between politicians and bureaucrats in zero-sum terms. The literature is most often characterized by the debate between Johnson (1982), who puts forward a bureaucrat-dominance argument, and Ramseyer and Rosenbluth’s (1993) who emphasize the dominance of politicians. The debate centers on the question of whose policy preferences were being represented in legislation. We should note that irrespective of whose policy preferences are actually being put into legislation, it is widely agreed that in Japan national level bureaucrats are extremely active in the policy-making process. Indeed, relatively few formal restrictions have been placed on bureaucrats’ activities in Japan.

To be sure, much of the bureaucracy’s power in Japan has been due to path dependency growing out of the original modern state development. Beginning in the late nineteenth century, bureaucrats were the leading actors in the development of the modern Japanese state. Acting within a pre-democratic structure, these bureaucrats were able to control state resources and powers. In addition, during the post World War II Occupation of Japan, Western authorities worked extensively through the existing Japanese bureaucracy, further maintaining the bureaucracy’s power. Nevertheless, under a number of conditions, one would expect national politicians to attempt to restrict the discretion held by bureaucrats. The fact that such efforts were rarely made pushes us to look for reasons other than path dependency to explain bureaucrat-politician relations in Japan.

Particularly striking, Japan matches very closely the “extreme case” laid out by Moe (1990a): Perhaps the defining feature of postwar Japanese politics has been the longtime state of
single party dominance, which, as Moe predicts, made it more likely for politicians to avoid “hard wiring” policy and the activities of bureaucratic agents. The LDP dominated Japanese politics over 1955-1993, with little serious threat to its control of the government. The close relationship between the LDP and bureaucracy was major feature of this period (Amyx 2004, Okimoto 1989). Given this close relationship and the relative certainty of continued LDP control, LDP governments did not need to develop greater legislative capacity. It is frequently pointed out that bureaucrats acted as legislative support for LDP politicians and, as a result, Diet members in Japan are allotted only very small staffs and few independent resources to legislate on their own. And, with weakened legislative capacity, LDP politicians needed to work all the more closely and cooperatively with the bureaucratic ministries. This highlights the endogenous relationship that can exist between Huber and Shipan’s (2002) policy conflict and legislative capacity variables. Indeed, the close relationship between the LDP and bureaucracy gave the LDP the freedom to reshuffle cabinets regularly without seriously harming overall policy-making expertise. In other words, conditions in Japan encouraged LDP politicians to leave policies vague and offer substantial grants of flexibility and authority to bureaucratic ministries.1

This all suggests that it makes much less sense to talk about the power of one (e.g., politicians) occurring at the expense of the other (e.g., bureaucrats). In fact, either “side” (politicians or bureaucrats) can create greater power for the other simply by increasing its own ability to influence legislation. Kato’s (1994, 2002) analysis makes explicit how an increase in the policy expertise of incumbent politicians by no means runs counter to the influence of bureaucrats. It is often the knowledgeable politicians who most welcome information from the bureaucracy and therefore are most likely to work with bureaucrats. As Kato (1994) points out, by helping politicians develop greater expertise in areas of concern to the bureaucracy, bureaucrats improve their own chances of passing legislation. And Kato (2002) notes that, as bureaucrats share more information with politicians, the views and attitudes of the two groups grow closer together, which makes it easier to pass legislation.

How do interest groups fit into the overall policy-making scenario here? The bureaucracy has traditionally held numerous meetings with key interest groups in Japan. Evidence offered by Uriu (1996) suggests that, while Japanese interest groups frequently do tell legislators about problems with the bureaucracy, it has been at least as common for groups in society to deal directly with the bureaucracy. In short, smoke detectors (interest groups contacting bureaucrats) may be at least as prevalent as fire alarms (interest groups contacting politicians) in Japan.

However, the LDP lost power in 1993 and did not return to the government until 1994 – how did this alter the dynamic described here? To be sure, certain features remained in place even when the LDP was out of power. For example, under the brief Hosokawa non-LDP coalition government (1993-94), the bureaucracy frequently worked with non-LDP politicians who were familiar with the policies under consideration (Kato 2002). Nevertheless, the relationship was clearly changed: The 1993-94 Hosokawa coalition government also took steps to assert its power over the bureaucracy, most notably taking the highly unusual step of forcing bureaucrats to act indirectly on behalf of the ruling party as a check on bureaucratic behavior, there was less need for politicians to write constraining legislation.

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1 Although not as important as the close relationship between politicians and bureaucrats that emerged from the stable longtime period of LDP rule, the Japanese court system – in Huber and Shipan’s terms, a non-statutory factor – no doubt also encouraged greater grants of discretion to the bureaucracy. Japan’s court system follows civil (as opposed to common) law practices and courts in Japan tend to have relatively little independence from the ruling party (Johnson 2003, Ramseyer and Rosenbluth 1993). Given that Japanese courts are more likely to act relatively reliably on behalf of the ruling party as a check on bureaucratic behavior, there was less need for politicians to write constraining legislation.
at least one high ranking senior bureaucrat from office. Indeed, as Pempel notes, “This explicitly partisan effort by the new, non-LDP government, shattered one of the key institutional arrangements of the previous conservative regime, namely, the “nonpartisan” treatment of all bureaucratic promotions” (1998: 141).

In the next section, we argue that the shift away from the highly stable, positive-sum context dramatically altered the nature of politician-bureaucrat-interest group relations. Much of the shift was due to the newly competitive relationship between the legislature and bureaucracy. And much was due to the fact that decreased political certainty and government stability made the bureaucrats an even more inviting contact point than before, increasing the likelihood of smoke detectors (and, therefore, smoke suppressors) at the expense of fire alarms. In turn, the new dynamic hindered Japan’s capacity to deal with the banking crisis that emerged.

Japan’s Lack of Responsiveness to the NPL Problem

For years, Japan’s Ministry of Finance maintained close ties with Japan’s banking sector. A number of factors contributed to MOF’s ability to gain information about and cooperation with the banking sector. As a result of its budgeting and taxation role, MOF had a great deal of information about the economy overall, the banking sector specifically and changes within them. As Grimes notes, “By watching out for the interests of well-placed Diet members in microbudgeting, the ministry can expect cooperation on matters more central to its missions” (2001: 43). In addition, as with most policy in Japan, MOF’s decision making centered in large part on policy councils (shingikai), where ministry and industry officials, who had been chosen specifically by the ministry, met to work out government policy for the sector. As a result, the banking sector usually knew what MOF was planning to implement even before it acted (Vogel 1996: 171-2). Much of the interaction between MOF and the banking sector worked through informal networks as well (Amyx 2004). Among other things, when MOF suspected weakness in a particular bank, it would advise the bank on how to proceed and sometimes even have a retiring official from the ministry take over management of the bank (Vogel 1996: 170).

This created enormously close ties between the ministry and the banking sector and gave each substantial information on the activities of the other, but it is noteworthy that information requirements were lower prior to the 1980s. Japan’s insulated (especially financial) market reduced a great deal of uncertainty. As Amyx notes, close relational ties between banks and borrowers meant that banks could make loans with relatively little uncertainty about the solvency and activities of those borrowing. And the insulation of the Japanese financial market kept capital scarce and ensured that loans went to relatively high worth, low risk projects (Amyx 2004: 31).

However, with capital market liberalization in the 1980s, it became much more difficult to monitor and control the banking sector. Larger numbers of banks extended risky loans, founded in large part on collateral that was grossly overvalued given Japan’s bubble economy. With the bursting of the bubble at the end of the decade, billions of dollars worth of loans became unrepayable.

For reasons raised earlier in the paper, MOF was reluctant to bail out the failing banks, and the full extent of the problem was largely kept hidden. A few politicians did raise questions about the NPL problem. LDP Prime Minister Kiichi Miyazawa in 1992 was a unique premier in Japan in that he actually had policy experience in the realm of financial politics. Miyazawa grew concerned in 1992 about the NPLs. In August of that year, he became the first politician to suggest explicitly the possibility of using public funds to combat the problem. However, his
suggestion was quickly dismissed as fellow LDP members rejected the idea. Key electoral supporters, construction, real estate and, especially agricultural cooperatives “comprised many of the clients whose loans had become nonperforming. The party therefore had little interest in seeing a state-backed institution recover delinquent loans” (Amyx 2004, 158). Miyazawa was also reassured against using such measures by Japan’s leading business association, Keidanren (Amyx 2004: 159). He was also persuaded by MOF’s argument that using public funds could evoke panic in the economy, when in fact it was likely – as explained by MOF – that the economic cost of disposal would be greater than the potential benefits.

In 1993, the Yomiuri Shinbun newspaper alleged that the Nippon Credit Bank (NCB), which MOF had granted forbearance, had engaged in questionable accounting. In response, a committee in the House of Councillors (HC) questioned MOF officials about their NPL policies with respect to NCB. However, the HC members did not push the issue any further as they accepted MOF’s explanation that NCB’s financial difficulties would simply disappear when land prices rebounded. Politicians’ willingness to follow MOF’s suggestions on the matter seem partly to be a result of the fact that the problem was not thought to be systemic (Amyx 2004: 158-9). Moreover, as Grimes notes, although many doubted the rosy economic forecast offered by MOF, there was a general unwillingness “to challenge the more knowledgeable Ministry of Finance on such a sensitive issue, one it had little independent ability to discredit” (2001: 160).

Moreover, politicians soon became distracted away from the problem. As 1993 progressed, scandals – such as Sagawa Kyubin involving LDP big wig Shin Kanemaru – helped push the Diet to focus on political reform. When reform failed, the LDP split, new elections were held and an anti-LDP coalition took power, further distracting the political world away from the activities of the economy.

When the LDP returned to power, a new dynamic existed between the party and the bureaucracy. Much to the LDP’s surprise, during the party’s time out of power, the Japanese bureaucratic ministries served their new masters, the anti-LDP coalition, and kept the longtime ruling party at arms length. As a result, when the LDP returned to power in 1994, there were bitter feelings between the longtime collaborators. In addition, despite its return to power, the LDP – now part of a coalition government – faced substantial electoral uncertainty. Not surprising, with greater information emerging about the NPL problem, the LDP used MOF as the scapegoat.

Despite greater awareness of the NPL problem, the government remained slow to act, in large part as MOF muddied the waters surrounding the issue. The use of public funds to rescue the NPLs would highlight MOF’s failures on the matter. With the Diet looking to punish MOF for its incompetence, MOF worked with financial institutions to hide their losses (Vogel 1996: 194). As long as it could, the ministry hid information from the public in order to protect its regulatory autonomy (Amyx 2004: 258). As a result, the truth about the massive levels of nonperforming loans in the banking sector were concealed for a number of years.

Analysis

Given the very high probability throughout the 1955-93 period that the LDP would continue to dominate Japanese electoral politics, there was very little need for it to formally tie the hands of bureaucrats in policy-making. This became problematic when ties between the LDP and MOF became strained after the LDP’s return to power in 1994 after nearly a year away. In fact, much of the LDP’s inability to develop a source of information independent of MOF was due to the lack of formal rules governing the inspections and reporting of the banking sector and
the resulting emphasis on informal relations. Amyx explains: “The very opacity of these ties and information exchanged within them meant, however, that the Diet and general public were less than fully aware of the extent of dysfunction present as time went on” (2004: 32).

In addition, the lack of legislative capacity – also undoubtedly a result of the LDP’s longtime dominance and, hence, reliance upon bureaucratic service – harmed the LDP’s ability to act when its government dominance came into question and it could no longer wholly trust MOF. This was particularly the case in the highly specialized and technical field of banking policy. According to Amyx, in most industrial countries direct oversight of the banking sectors by elected officials – that is, what the principal-agent literature refers to as “police patrols” – is common, irrespective of constitutional type – i.e., whether presidential or parliamentary system (2004: 29). However, the work of Amyx and others studying Japanese financial policy make clear that no such “patrols” existed in Japan. It was not unusual for powerful Diet members to establish personal think tanks to deal with important issues, but private sector finance rarely received much attention in them (Amyx 2004: 302, fn. 54). In part, this was due to the lack of electoral incentive for Japanese Diet members to monitor their activities. In general, politicians had tighter links to business sectors other than the banking industry, in part because of “the nation-wide scattering of bank branches and the fact that the business base even of regional banks encompassed numerous electoral districts” (Amyx 2004: 56). While finance specialists and committees existed within the LDP, they focused on government revenues and expenditures. Meanwhile an LDP Financial Affairs Research Council, which focused solely on private sector finance, did exist, but it held a far more informal position within the party and was given much lower status (Amyx 2004: 57).

The failure of the government to respond well to the bank crisis also suggests a great deal about the means by which information was transmitted from society to the government. Fire alarms appeared typically absent in the banking sector. Vogel notes that the LDP generally preferred to have MOF handle financial policy because of a lack of legislative staff and knowledge of financial sector policy. Politicians would become involved if financial institutions appealed for their help, but such appeals were quite rare in the area of financial policy (Vogel 1996: 172). But the lack of fire alarms was due to the preferences of the financial sector as much as to weak legislative capacity. Banks preferred to avoid asking politicians for policy favors as such requests risked drawing in political interference in lending decisions (Amyx 2004: 57).

Smoke detectors were far more common. Grimes notes that “from 1985 to 1997 leadership was often taken by the Ministry of Finance, with politicians’ roles usually at the margins, and only occasionally at the center” (2001: 221). Moreover, as discussed above, a very clear set of ties emerged over the postwar period between ministry and the banking industry. As a result, banking sector officials tended to focus their lobbying efforts on MOF (Amyx 2004: 57).

Not only were smoke detectors the norm in bank policy in Japan prior to 1997-98, but MOF also spent great energy on what we call “smoke suppressors” as well. In many cases, it was clear that the smoke detectors were not working as they should: The increased informational requirements in financial markets in the 1980s and 1990s simply made it difficult for MOF to acquire accurate information on the functioning of the Japanese banking sector. Given the fact that politicians had little means to gain much independent information – because police patrols and fire alarms were largely non-existent in the sector – the ministry was able to conceal the true state of Japan’s financial markets. In short, the greater contact between bureaucrats and interest groups after the 1970s may have had devastating consequences, as the
bureaucracy was able to use this advantage to keep parties in the dark about Japan’s fiscal problems in the 1990s (Amyx, 2002).

Quantitative Analysis

To sharpen our point, we also conduct more systematic analysis of the general issue using a unique set of surveys of Japanese interest groups. Although we can not use the data here to get directly at the bank problem, our quantitative analysis demonstrates the shifts in the pattern of the relationship between interest groups and both politicians and bureaucrats in Japan. Our quantitative analysis of interest group patterns of contacting the government supports our argument that the LDP was less able to monitor both bureaucrats and events in the society and economy during the 1990s period of government instability because interest groups were less willing to provide politicians with information.

Data

The data are drawn from surveys conducted with representatives of major interest groups in Japan. The surveys query interest groups on numerous features of their organization, including their opinions about political parties and the administrative bureaucracy and their relationship with governmental bodies. The data set contains these surveys for interest groups in 1979 (252 respondents), 1994 (247), and 2003-04 (222). The timing of the surveys is very useful in helping us to test our conceptual framework here. Although admittedly not the height of LDP dominance, 1979 rests solidly within the period of the LDP’s longtime dominance. The 1994 survey occurred during frequent cabinet turnover and party uncertainty in Japan and, in fact, we are able to distinguish between respondents according to which of three 1994 cabinets held office at the time that they participated in the survey: Hosokawa (which included all non-Communist, non-LDP parties), Hata (the minority non-LDP government formed after the Socialist Party left the coalition), and Murayama (the Socialist Party-LDP coalition). The 2003-04 survey was conducted during the Koizumi administration, after the LDP was more firmly back in power, having now controlled the government for an additional ten years since 1994.

Dependent Variable

We use these surveys to test the main ideas in our theoretical framework. To do this, we utilize as the dependent variable the responses to a question “When your group wishes to make a claim or protect their rights, opinions, and profits, which out of the following do you believe to be the most effective in approaching: political parties (or assemblies) or the administrative bureaucracy?” Respondents were asked to list which was “most important” and “number 2.” We code the dependent variable based on the answer to whether parties or the bureaucracy was “most important,” as groups will undoubtedly place their greatest effort into contacting the actors they find most effective. We expect responses to represent whom interest groups will in fact approach when needing help from the government and code the variable 1 for those who approach parties and 0 for those who approach the administrative bureaucracy. For reasons laid out in the appendix, we use a heteroskedastic probit model to analyze the data.

Model Specification and Hypotheses

Heteroskedastic probit models are made up of a choice model and a variance model. Our principal concern here is the choice model, which estimates the relationship between our explanatory variables and the likelihood of lobbying the bureaucracy or politicians. Our
principal hypothesis flows from the theoretical discussion we laid out earlier in the paper: During times of great political uncertainty – in particular, uncertainty over either the stability of the government or the likelihood of the ruling party remaining in power in the future – interest groups will be more likely to approach the bureaucracy and less likely to approach politicians. In order to test the relative impact of uncertainty on the likelihood of approaching politicians rather than bureaucracy, we use the different cabinet periods as proxy measures of uncertainty and therefore pool the three surveys into a single data set.

As noted above, we create a 0-1 dummy variable for each of the five cabinets in our data: Ohira (1979), Hosokawa, Hata, Murayama, and Koizumi, but then combine Hosokawa and Hata into one variable (“No LDP Government”) since they both represent periods in which the LDP was out of power. With Ohira as the base category, we expect the coefficient on each of the other cabinet variables to be negative, especially for the period in which the LDP was out of power (No LDP Government) and the period in which the LDP joined its longtime enemy, the Socialist Party, in a coalition government (Murayama): With multiple parties – all with little government experience – joined together in the messy anti-LDP coalition government, uncertainty was undoubtedly high with regard to the experience and competence of the government and the ability of the government to stay in power. In the Murayama government, the LDP and Socialist Party made strange bedfellows, and generated great uncertainty about just what the coalition stood for and the coalition’s ability to stay together. As a result, we expect that interest groups looking to protect their interests during these two periods were on average less likely to contact politicians. We expect the least difference from the Ohira cabinet during the (2003-04 years of the) Koizumi administration: Presumably, uncertainty surrounding the stability of the LDP government had declined substantially after the LDP had been back in power for roughly a decade, but it was still probably higher than during the era of longtime LDP dominance that had come prior to 1993.

We also offer in the model a test of our claim that the period of LDP dominance prior to 1993 was one of great cooperation between the LDP and bureaucracy, but later years were based on greater competition between them. Presumably, during times of great cooperation between LDP and bureaucracy, interest groups that support the LDP would expect to find the bureaucracy a helpful ally. That is, insofar as the bureaucracy was an ally of the LDP, an interest group that supported the LDP would expect to find the bureaucracy willing to help it (the interest group) as well. Therefore, interest groups that supported the LDP during the Ohira cabinet would be more likely than those in later years to approach the bureaucracy. In contrast, when there is less cooperation between the LDP and bureaucracy, we expect interest groups that support the LDP to be more likely to approach the politicians.

To test these hypotheses, we first use LDP Support, a variable running from 0 (do not support the LDP) to 4 (extremely high support), to indicate the interest groups’ support for the LDP. We expect the coefficient on LDP Support to be positive: More support for the LDP should lead to a greater propensity to contact politicians. Next, we create a series of interaction terms between LDP Support and each cabinet. We expect the coefficient on each of these interaction terms to be positive, indicating that, relative to the earlier period of longtime LDP dominance (Ohira), interest groups that support the LDP will be less likely to approach parties or the Diet, whereas those who do not support the LDP will be more likely to approach the bureaucracy.\(^2\) We expect support for the LDP to have an especially large impact during the

\(^2\) One approach to the general problem here would be to measure government party support, rather than support for the LDP. We do not do this for two reasons. First, on the survey there are no party support questions about a
Murayama cabinet: If competition between the LDP and bureaucracy was at its highest point during this period, interest groups supportive of the LDP would be even more likely to contact LDP politicians during this time, whereas those who did not support the LDP would be particularly likely to contact the bureaucracy.

We also utilize a number of controls variables: (1) Trust in Bureaucracy: a variable running from 0 (do not trust the bureaucracy at all) to 4 (extremely high trust in the bureaucracy).\(^3\) We expect its coefficient to be negative, as more trust in the bureaucracy ought to lead to more contact with the bureaucracy. (2) Current Diet Member, a dichotomous dummy variable coded 1 when a member of the interest group is currently a representative in Japan’s Diet. We expect groups with such a member to be more likely to contact members of the Diet, and so expect a positive coefficient. (3) \textit{Amakudari}, a dichotomous dummy variable coded 1 for interest groups that offer employment to retired members of the bureaucracy.\(^4\) We expect groups that provide \textit{amakudari} landing sites to be more likely to lobby the bureaucracy (negative coefficient). (4) We also control for prominent \textit{types} of interest groups with three 0-1 dummy variables: Agriculture, Labor, and Economics. Representatives of different types of groups may be more or less likely to lobby bureaucrats rather than politicians.

\textbf{Results}

The core results match our expectations. (See Table 1.) Most important, the coefficient on each of the cabinet variables is negative and statistically significant, with the largest coefficients associated with the 1993-94 coalition governments. (The Koizumi cabinet variable reaches significance only at the .093 level.) In other words, as we expected, during the years of greatest uncertainty, interest groups were less likely to lobby politicians. Also, all of the LDP Support variables are positive, but only those interacting with No LDP Government and the Murayama cabinet are statistically significant. As expected, the coefficient on the LDP Support * Murayama cabinet interaction term is particularly large.

Figure 1 indicates more concretely just what these results mean. Derived from the results from Table 1, the figure indicates the probability of a given type of respondent citing politicians as the most effective to appeal to. We break the figure into three types of groupings: those who don’t support the LDP (score of 0 on LDP support), those with the mean level of support for the LDP (score of 1.93) and those with high support for the LDP (score of 4). Within each of these groupings, we break down the probabilities by cabinet period. All other variables are held at their means.

The figures indicate, first, by way of illustration, that the mean respondent during the Ohira administration had a 50 percent probability of contacting politicians (and, hence, a 50 percent chance of contacting bureaucrats). Second, all else equal, the mean interest group and those that did not support the LDP were much less likely to contact politicians after 1993 than during the Ohira cabinet. Most striking, the mean respondent had only a 32.5% and 40.44% likelihood of contacting politicians during, respectively, the No LDP Government and the number of the key parties in the government coalition in 1994. (Most notably, there is no question about support for the new LDP-splinter parties.) Second, approaching the problem the way that we do allows us to see how interest groups associated with the LDP deal with the LDP being out of power.

\(^3\) A similar question is available about trust in political parties. However, we choose not to include it because of potential ambiguity in how to interpret it: Respondents who trust opposition parties may be likely to contact the bureaucracy because of their lack of ties to the ruling parties, whereas respondents who trust the LDP may be more likely to contact conservative members of the Diet.

\(^4\) \textit{Amakudari} ("descent from heaven") refers to this practice in Japan.
Murayama cabinet periods. Moreover, the mean LDP Support among those surveyed during the Murayama cabinet was only 1.26. Using this measure, rather than the 1.93 mean from all surveys, we find that the mean respondent during the Murayama administration had only a 27.5% likelihood of contacting politicians rather than the bureaucracy.

Third, there are substantial differences from one administration to the next in terms of the impact of LDP support on the likelihood of contacting politicians. Not surprising, the probability of contacting politicians is always high – at least 60% - for those with high levels of support for the LDP. As we expected, support for the LDP had the smallest impact – 20.5 percentage point difference between those with no and high support for the LDP – during the Ohira administration. This makes great sense as the high level of cooperation between the LDP and bureaucracy during the pre-1993 period should have left interest groups with the sense that an appeal to one (e.g., a politician) was in many ways akin to an appeal to the other (e.g., a bureaucrat). As expected, the greatest difference between those with no and high support (70 percentage points) is during the Murayama administration, the period in which we assumed that competition between the LDP and bureaucracy would be at its highest. During a period of a zero-sum power between politicians and bureaucrats, interest groups would presumably have a stark choice of contacting either politicians or bureaucrats. Those with no support for the LDP had only a 10.3% likelihood of emphasizing contacts with politicians during this period. In contrast, those who strongly supported the LDP had an 80.4% likelihood, the highest probability of any of the administrations.

The level of LDP support clearly had an impact during the period of No LDP Government (difference between no and high support is 40.3 percentage points) and the Koizumi cabinet (difference of 33 percentage points), but the impact was also less substantial than during the Murayama administration. For the No LDP Government period, the difference is undoubtedly capped somewhat by the fact that those with high levels of support for the LDP probably saw less utility in lobbying LDP politicians, since the party was out of power. For respondents during the Koizumi cabinet, it is striking that the difference in likelihoods between those not supporting the LDP and those with high support is not much higher than for those during the Ohira cabinet (33 percentage points in the former to 20.5 in the latter). Indeed, the LDP Support * Koizumi interaction term is non-significant. This suggests that by the Koizumi administration interest groups perceived that ties between the LDP and bureaucrats had been substantially mended and a shift had occurred away from the competitive relationship back toward a more cooperative one.

What do the results tell us about the larger story, the ability of the LDP to gain information during the bank crisis? First, during 1993-4, when concerns emerged about the state of Japan’s banks, the results of the choice model indicate a clear dichotomy in terms of the likelihood of interest groups contacting politicians. Much more than in other years, interest groups that did not support the LDP were more likely to contact the bureaucracy, whereas those that strongly supported the party contacted politicians. We see this as evidence that the relationship between politicians and bureaucrats had become competitive and strained. And this competitive relationship undoubtedly made it more difficult for politicians to get needed information from the bureaucracy. Second, during this period, interest groups were less likely to contact politicians, most likely because of the high levels of uncertainty surrounding the stability of the government. As a result, politicians were much less likely to gain important information –
such as about the bank crisis – from interest groups. Third, the results of the variance model indicate that not only were interest groups less likely to contact politicians during the Murayama cabinet, they were very consistent in doing so.\(^5\)

In short, the results indicate that the decline in the LDP’s dominance of the government in 1993 (a) helped bring about a shift from a highly cooperative to a competitive relationship between the LDP and bureaucracy and (b) reduced the likelihood of interest groups contacting politicians. As a result, the LDP had much greater difficulty getting reliable information from either the bureaucracy or interest groups about the bank problem. This is all the more problematic as economics-related interest groups were less likely to contact politicians in the first place. Holding the values of all other variables at their means, the model predicts that economic groups had only a 39% chance of contacting politicians during the Ohira administration, 32% under Koizumi, 30% under Murayama, and 23% during the anti-LDP governments.

**Conclusion**

We should be clear about what we seek to explain in this paper: This paper is not about explaining the success and failures of Japan’s economy. Also, our explanation is not about why the government will respond or not respond to any economic problem. For example, we do not try to explain the Japanese government’s willingness to accept the growth of the bubble in the 1980s. Rather, we seek to explain the lack of action in the 1990s, when the LDP was in fact looking to blame the bureaucracy for the problems of the economy.\(^6\)

We argue that the inability of the Japanese government to respond to the bank crisis was in large part a result of the loss of power of the longtime dominant LDP. The party’s multi-decade stranglehold on the government made it possible for the Japanese Diet to hold close ties to the country’s bureaucracy and grant substantial discretion to bureaucratic agencies, without creating many structures to counter the ministries’ informational advantages. With the temporary loss of power of the LDP in 1993-4, ties between politicians and MOF weakened substantially and the relationship became more competitive. And with few formal structures in place to monitor and verify bureaucratic information and behavior, the LDP was in a difficult position to challenge the bureaucracy. Moreover, with the onset of party realignment and unstable cabinet governments in 1993, interest groups looking to provide information on policy to the government had more incentive to contact bureaucrats, whose tenure in power appeared much more secure than politicians in the government. The LDP, therefore, in many ways lacked the interest group “fire alarms” available to legislators in many other contexts.

As a result, when presented by the bureaucracy with information that did not disclose the true extent of the financial crisis, the LDP was not sufficiently equipped to act against the advice of the Ministry of Finance. And, not surprisingly, the party took no serious action to address the nonperforming loan problem. The outcome was governmental paralysis in the face of a major economic crisis.

On top of this new explanation for the slow response by the Japanese government to the bank and economic crises of the 1990s, in this paper we make four principal contributions. First, unlike most studies of the relationship between interest groups and the government, we are able

\(^5\) See the appendix for additional support for the substantive analysis here along with a discussion of the variance model.

\(^6\) This is in contrast to the 1980s, when the LDP and bureaucracy had close ties with one another and politicians had every reason to trust the bureaucracy.
to bring quantified data to test our claims. To our knowledge, we offer the first systematic quantitative analysis of interest group’s decision to lobby politicians or bureaucrats. Second, we use these data to help illustrate the concept of smoke suppressors. Whereas the most prominent work on politicians’ capacity to control the behavior of their bureaucratic agents notes the critical role of fire alarms – whereby interest groups provide politicians information – we argue that in many cases interest groups will be less likely to contact politicians. In such a case, if relations between politicians and bureaucrats are strained, the result will often be that bureaucrats are especially able to hide information about policy from politicians. Third, in contrast to the most prominent debate on policy-making in Japan, we emphasize the importance of viewing politics throughout much of the postwar period in positive-sum terms, with high levels of cooperation between politicians and bureaucrats leading to particular types of political behavior. Finally, we demonstrate how policy-making patterns in Japan have been dynamic, with systematic and predictable shifts occurring from a cooperative politician-bureaucrat relationship to a competitive one (and – according to the results of our statistical analysis – possibly back to cooperative again) over time.

We close with some speculations and thoughts on future research. As suggested by Huber’s (2000), Huber and Shipan’s (2002), and Moe’s (1989, 1990a, 1990b) work, under a more competitive scenario – such as emerged in Japan after the LDP briefly lost power – one would expect the legislature to create structures to better monitor bureaucrats and access information. Indeed, the reforms enacted by the Japanese Diet in 1998 to deal finally with the NPL and banking sector problem were an effort to alter the governmental structures related to financial regulation. As would be predicted by Moe’s structural politics, the new legislation created substantially more formal networks to inspect banks and respond to different financial sector conditions. MOF’s role in inspecting banks was reduced substantially, but gaining information was at the heart of the new rules. Inspectors were given greater latitude than those in the past. At the same time, however, the new structures appeared to promote the use of smoke detectors: For example, the Financial Reconstruction Agency (FSA), which was created to act as the primary inspecting agent soon became staffed with a number of officials from the banking sector (Amyx 2004: 213), thereby encouraging close ties between bureaucratic inspectors and banks.

A future area of research would continue the analysis of the bank reform legislation with an eye toward understanding how it fits into the structural politics lens. Moreover, since the mid-1990s, the Japanese government has enacted substantial reform in other areas that affects not merely the “substance” of policy, but the structure of policy-making as well. In this way, it is possible that the LDP’s efforts to enact administrative reform and centralize policy-making in the cabinet were in part a result of the dynamics highlighted in this paper.
Appendix: Heteroskedastic Probit

In order to test the relative impact of uncertainty on the likelihood of approaching politicians rather than bureaucracy, we use the different cabinet periods as proxy measures of uncertainty and therefore pool the three surveys into a single data set. When pooling data in this way, it is important to control for possible unobserved time-specific factors affecting survey responses. Unfortunately, because of the small number of surveys/time periods in the data, we can not use most standard approaches (such as clustering) to correct the standard errors. One approach to handling this problem of lack of independence is to use a multi-level model. But with only three time periods in the data, this approach does not offer much help here.

Instead, we utilize a heteroskedastic probit model. Because the surveys are conducted at different times, it is possible that heteroskedasticity will be present, with systematic differences between responses (and, hence, variance in the model’s error) from one survey to the next. If so, the estimates drawn from a standard probit model here will be inconsistent (Greene 1993). However, by running a heteroskedastic model, we address this problem by directly taking into account and modeling the likely heterogeneity (see, e.g., Alvarez and Brehm 1995). Heterogeneous choice models like heteroskedastic probit are a prominent and useful approach (see, e.g., Alvarez and Brehm 1995, 1997, 1998, 2002) to problems of this kind.

The heteroskedastic probit model is useful not just because it addresses the methodological problem of heteroskedasticity, but also because it allows us to interpret its substantive meaning as well. That is, the results of the heteroskedastic probit are divided into two parts: the choice model and the variance model. The variance model indicates the extent to which particular variables are associated with greater or lesser levels of error variance in the model – i.e., how closely observed outcomes match the predictions of the model. From a substantive perspective, in the most well known use of the heteroskedastic probit model in political science, Alvarez and Brehm (1995) argue that positive coefficients (indicating greater error variance) on variables within a variance model predicting support for or against abortion rights indicate respondents’ ambivalence about abortion.

Similarly, we argue that in our analysis of interest group lobbying of politicians or bureaucrats the variance model indicates respondents’ level of certainty about whom to lobby. We use dichotomous dummy variables that indicate the cabinet in place at the time of the survey as the explanatory variables in the variance model. We expect that during the pre-1993 period of a positive-sum relationship between the LDP government and the bureaucracy, interest groups will be ambivalent about whom to lobby, as the LDP and bureaucracy worked so closely together. In contrast, we expect that in the zero-sum period emerging after the LDP’s 1994 return to power, interest groups will have a sense of the more competitive atmosphere surrounding LDP-bureaucratic relations, and therefore will recognize a greater need to lobby on one side or the other. For this reason, we expect a lower error variance during the cabinets from 1994 on, so the coefficient on the Murayama and Koizumi cabinet dummy variables ought to be negative.

We are less certain of what to expect during the non-LDP coalition governments (1993-4). On one hand, one might expect low levels of error variance, as a result of a potentially competitive

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7 The principal concern regarding heteroskedastic probit focuses on the importance of specifying the model correctly (Keele and Park ND).
8 We use the 1979 (Ohira government) survey as the unlisted base category and lump the Hosokawa and Hata cabinets into a single variable, which we call “No LDP Government.”
9 We expect the impact to be smaller during the Koizumi administration, after the LDP had been back in power for roughly 10 years, thereby probably re-introducing greater cooperation between the LDP and bureaucracy.
relationship between the new governments and the bureaucracy. On the other hand, the introduction of an entirely new set of parties in the government might have shaken up the landscape so dramatically that interest group behavior became less systematically predictable.

The results of the variance model are largely as expected. The negative coefficient on the Murayama and Koizumi cabinet variables indicates that the error variance is lower in those two periods (with the Murayama coefficient significant at the .05 level and Koizumi at .105). In other words, observed patterns of contacting politicians or bureaucrats match the predictions of the model much more closely during the Murayama and Koizumi administrations than under Ohira. This suggests less ambivalence on the part of respondents with regard to the choice of contacting bureaucrats or politicians from 1994 on. This lends evidence to the argument that in the earlier, more cooperative period (Ohira), interest groups did not need to “pick sides,” and could benefit from contacting either group. In contrast, with the emergence of a more competitive relationship between politicians and bureaucrats in 1994, interest group contacts became more predictable, especially during the Murayama administration. Interestingly, the coefficient on No LDP Government in the variance model is very small (and not statistically significant), indicating no marked difference in the error variance between the Ohira and non-LDP cabinets. As suggested above, the lack of certainty in the No LDP Government period is most likely a result of the confusing political landscape created by the cabinets created by so many (very different) parties.

10 The likelihood ratio test of the variance model is on the border of statistical significance (.071), perhaps leaving some readers questioning whether heteroskedasticity exists in the model. To be on the safe side, therefore, we also re-run the model with a standard probit model and do not see a major change in the results.
References


Table 1: Heteroskedastic Probit Model of Correlates of Appealing to Politicians (rather than Bureaucrats)

<table>
<thead>
<tr>
<th></th>
<th>Coefficient</th>
<th>Standard Error</th>
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<td><strong>Choice Model</strong></td>
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<td></td>
</tr>
<tr>
<td>No LDP Government</td>
<td>-0.869</td>
<td>(0.345)**</td>
</tr>
<tr>
<td>Murayama Government</td>
<td>-1.014</td>
<td>(0.323)***</td>
</tr>
<tr>
<td>Koizumi Government</td>
<td>-0.354</td>
<td>(0.211)*</td>
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<td>LDP Support</td>
<td>0.130</td>
<td>(0.093)</td>
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<tr>
<td>LDP Support * No LDP Government</td>
<td>0.216</td>
<td>(0.114)*</td>
</tr>
<tr>
<td>LDP Support * Murayama</td>
<td>0.400</td>
<td>(0.133)***</td>
</tr>
<tr>
<td>LDP Support * Koizumi</td>
<td>0.086</td>
<td>(0.081)</td>
</tr>
<tr>
<td>Trust in Bureaucracy</td>
<td>-0.260</td>
<td>(0.076)***</td>
</tr>
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<td>Current Diet Member</td>
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<td>(0.116)</td>
</tr>
<tr>
<td>Amakudari</td>
<td>0.016</td>
<td>(0.122)</td>
</tr>
<tr>
<td>Agriculture</td>
<td>-0.661</td>
<td>(0.267)**</td>
</tr>
<tr>
<td>Labor</td>
<td>0.854</td>
<td>(0.231)***</td>
</tr>
<tr>
<td>Economics</td>
<td>-0.252</td>
<td>(0.133)*</td>
</tr>
<tr>
<td>Constant</td>
<td>-0.888</td>
<td>(0.362)**</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Variance Model</strong></th>
<th>Coefficient</th>
<th>Standard Error</th>
</tr>
</thead>
<tbody>
<tr>
<td>No LDP Government</td>
<td>0.189</td>
<td>(0.396)</td>
</tr>
<tr>
<td>Murayama Government</td>
<td>-1.069</td>
<td>(0.533)**</td>
</tr>
<tr>
<td>Koizumi Government</td>
<td>-0.489</td>
<td>(0.302)*</td>
</tr>
</tbody>
</table>

**Heteroskedasticity Test**

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Likelihood Ratio Test</td>
<td>7.02</td>
<td></td>
</tr>
<tr>
<td>Prob &gt; chi-sq</td>
<td>0.071</td>
<td></td>
</tr>
</tbody>
</table>

*p<.1, **p<.05, ***p<.01

Dependent variable is generated from answers to the question, “When your group wishes to make a claim or protect their rights, opinions, and profits, which out of the following do you believe to be the most effective in approaching: political parties (or assemblies) or the administrative bureaucracy?”

Bureaucracy is coded 0, parties is coded 1.
Figure 1: What is the probability of contacting politicians (rather than bureaucrats)? Predicted probabilities based on the heteroskedastic probit results.