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Comment Youngjae Lim

The mainstream view in economic history is that Japan had a bank-based financial system since the late nineteenth century. The early history of postal banking system in Japan could provide a good example to support this view. Since it had been established in the late nineteenth century, the Japanese postal banking system played an important role in mobilizing national savings and channeling them into the corporate sector. On the other hand, recent empirical studies show that the prewar Japanese economic system was different from the postwar system. In particular, it is shown that the Japanese financial system before World War II was characterized by the large and active stock market. It could be implied that shareholders rather than bankers played a central role in corporate finance and governance in the prewar Japanese economic system.

With this background in mind, this chapter shows how and why the Tokyo Stock Exchange suddenly took off while it stayed stagnant during the first forty years since 1878. The authors pay a special attention to an important change in the Tokyo Stock Exchange's policy toward listing in 1918. Stocks began to be traded in the Tokyo Stock Exchange without explicit applications from the firms. It made it possible for the Tokyo Stock Exchange to integrate the trades outside the Tokyo Stock Exchange. Then the chapter empirically studies the listing decisions of cotton spinning firms during 1905 to 1936 and documents that the Tokyo Stock Exchange's policy toward listing in 1918 had an important impact on the growth of the Tokyo Stock Exchange afterward. The authors' argument is based on the idea of multiple equilibriums. The stock market has two equilibriums. An increase in the number of listed stocks leads to an increase in the market liquidity. In turn, it results in the number of listed stocks. The chapter shows that the market liquidity is, in general, an increasing function of the number of firms listed in the market using a standard model of stock market microstructure. The authors provide a theoretical basis for their empirical result.

In summary, the authors construct a plausible story of the Tokyo Stock Exchange's takeoff in the 1920s and then confirm empirically their hypothesis. Another important contribution of the chapter lies in the compilation of valuable data sets. First, the authors constructed a comprehensive list of the companies listed on the Tokyo Stock Exchange for each year from 1878 to 1936 from the raw data scattered around in various places. This data set makes it possible for the authors to compare the Tokyo Stock Exchange before and after 1918. The authors also built up another panel data set. It has basic financial information for the all the cotton spinning

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companies for the period of 1905 to 1936. This data set enables the authors to empirically study the listing decision of the firms in the Tokyo Stock Exchange.

The chapter discusses the funding patterns of Japanese corporations during the period of 1902 to 1940 (cited from Hoshi and Kashyap 2001). The share of the paid-in capital and reserves was about 60 to 80 percent of the total capital and liabilities. On the other hand, the share of bank borrowing was less than 20 percent of the total funds in the corporate sector. Given this information, one could ask the following questions. Who were the shareholders of the corporate sector in Japan then? Were they a large number of small individual investors? Were they a small number of wealthy families or firms? It is known that the Zaibatsu firms dominated the Japanese economy before World War II. What were the main sources of funding for the Zaibatsu firms? Were the paid-in capital and reserves also important sources of funding for the Zaibatsu firms?

Given the patterns of corporate finance in the prewar period of Japan, it would be interesting to know how the failing firms were treated in the prewar economic system. Were the failing firms allowed to be bankrupt freely in the capital market? Were they mostly liquidated? Or were there any interventions from the government? What if one of the Zaibatsu firms was to fail?

According to the authors, the share of bank borrowing in the corporate sector in the prewar Japan was at most 20 percent. What roles did the banking sector play in the prewar period of Japan? As in the case of postal banking system, did the government have influences on the banking sector? Then what roles did the private banks belonging to the Zaibatsu families play? All these interesting questions arise because the stock markets and the banking sector should have competed with each other to attract the savings in the private sector.

The authors imply that the prewar Japan was closer to a stock market based financial system rather than a bank based financial system. Then one could ask how the Japanese economy made the transition from a stock market based financial system in the prewar period to a bank based financial system in the postwar period. Here, presumably the role of the wartime economic system in Japan would be critical. Still then, the theoretical argument that the authors employed in the chapter poses a puzzle. Will only an increase in the number of listed firms in the stock exchange be sufficient for the growth of the stock market relative to the banking sector?

Reference

Hoshi, Takeo, and Anil Kashyap. 2001. *Corporate financing and governance in Japan: The road to the future.* Cambridge, MA: MIT Press.