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Stabilize the peasant economy: Governance of foreclosure by the shogunate

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Abstract

Regulation of foreclosure in a financial crisis has been a centuries-long conundrum to authorities. Japan in the fifteenth and sixteenth centuries had free financial, land and coercive labor markets. It raised the growth but resulted in recurrent financial crises. Therefore, the Edo shogunate, 1600–1868, banned coercive labor, protected peasants' property right and regulated the farmland-collateral loans. Seeking an appropriate degree of regulation, the shogunate first banned foreclosure and invited a credit shrink. Then the shogunate introduced legislation to legalize foreclosure of pledged farmland as clarifying the rights of borrowers. The regulation asymmetrically lowered interest rates for timely repayment.

JEL classification: O12; G18; K11; K12; Q15

Keywords: Farmland-collateral loans; Farmland foreclosure; Free labor; Peasant ownership; Early modern Japan

1. Introduction

To regulate foreclosure or not. The decision depends on how to measure the benefit of stabilizing the society and the cost of congealing the financial market. This was the challenge facing state governments in the US after the financial crisis, for instance, because a rush of foreclosure could have a substantial adverse spillover through the rise in crime rate and the fall in property prices

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(Alm, Buschman, & Sjoquist, 2014; Cui & Walsh, 2015; Gerardi, Rosenblatt, Willen, & Yao, 2015; Hartley, 2014; Ihlanfeldt & Mayock, 2015; Schuetz, Been, & Ellen, 2008; Zhang & Leonard, 2014). Furthermore, a foreclosure tends to be costly, regarding the transaction cost, to both the lender and the borrower (Posner & Zingales, 2009; White, 2014). With the justification, regulation of and intervention in foreclosures are often politicized (Agarwal, Amromin, Ben-David, & Dinc, 2018).

The challenge is a conundrum to authorities. In the first place, a more borrower-friendly foreclosure law might not decrease the number of default (Demiroglu, Dudley, & James, 2014). Furthermore, regulations of foreclosure increase the loan losses of lenders (Clauretie & Herzog, 1990). Thus, protection of borrowers by the regulations on foreclosure, being internalized by lenders, might raise borrowing costs of riskier borrowers in particular (Goodman & Levitin, 2014) or check the supply of derivative finance (Milonas, 2017). Furthermore, the lenders' loss due to regulations of foreclosure might contain the credit supply and involve the welfare reduction (Cordell & Lambie-Hanson, 2016; Dagher & Sun, 2016; Gerardi, Lambie-Hanson, & Willen, 2013; Jou & Lee, 2016; Li & Oswald, 2017; Xu, 2014). A foreclosure regulation is thus inevitably accompanied by a trade-off between the economic growth and the social stability. Due to these entangled elements, the foreclosure process has evolved being often driven by case laws rather than statute laws (Ghent, 2014), except for emergencies like the 1930s or the late 2000s.

If possibly foreclosed assets are production inputs, i.e., farmland, the trade-off could be even more complex. Foreclosures largely depend on the gap between farmers' optimistic expectation of business cycles and the realized ones (Alston, 1983). While a possibility of foreclosure gives a discipline to farmers, it might trigger an unrest in a contagion (Stock, 1984). Also a more extended tenure or a better legally protected tenure tends to provide cultivators with stronger incentives for investment (Fenske, 2011; Place & Otsuka, 2001; Smith, 2004). The most extended tenure, and hence, the most effective to provide the incentives, is the infinite one, secured property right (Toumanoff, 1984). These visions often prompt authorities to intervene in the private agricultural financial markets (Alston, 1984).

Factoring in all these elements, institutional arrangements of farmland-collateral loans directly affect significance of cultivators' claim (Johnson, 2001). Peasants' property right without access to the farmland-collateral loans would diminish the significance of the property right itself. Meanwhile, thoroughly deregulated farmland-collateral loans might hurt the long-term growth and the social stability (Guinnane & Miller, 1997). A practical and endogenously formed solution is coexistence of formal and informal financial sectors. The existence of informal sector that tends to avoid collateral foreclosure lowers the rate of foreclosure of the formal sector through the competition (Guirkinger, 2008). Another common way is the intervention in the formal financial market as mentioned above. The shogunate of Japan in the eighteenth century was faced with the challenge when it sought a better regulation of agricultural financial markets to balance the economic growth with the financial stability.

In the last millennium, Japan saw three distinctive phases of growth in per capita gross domestic product. The first was from the late fourteenth century when Japan's par capita gross domestic product began to catch up with China's. The second one was from the eighteenth century when Japan's par capita GDP surpassed China's and caught up peripheral Europe (Fig. 1). After outperforming Eastern Europe, it saw the third phase from the late nineteenth century, which continued to the 1970s when Japan's par capita GDP caught up with those of ordinary advanced economies such as the UK, though the US and Nordic countries are still far ahead. We focus on the institutional arrangement of property right protection by the shogunate in the eighteenth century, a critical moment for Japan to rise beyond China and to catch peripheral Europe.

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