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# THE POLITICAL ECONOMY OF FINANCIAL REFORM IN JAPAN: THE BANKING ACT OF 1982

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## I. INTRODUCTION

The Banking Act of 1982 was the first comprehensive revision of Japanese banking legislation since 1927. In spite of the years, indeed decades, of debate that preceded the new law, only two provisions stand out. First, banks are now permitted to retail and deal in government bonds. Second, in an affirmation of the status quo ante, banks do not face substantially stricter disclosure requirements than they did before.

These two provisions in the Banking Act of 1982 are remarkable, if not in substance, then certainly for what they tell us about financial policy-making in Japan. While the stage was set within the same political and economic environment and the same configuration of interest groups, the processes leading to enactment of the two provisions were dramatically different.

This article will examine these two provisions in the Banking Act as separate case studies, tracing their respective historical roots before focusing on the legislative process. In examining variations in the policy-making process, this article will attempt to explain the conditions under which active involvement by politicians is likely to take place in financial policy-making in Japan.

We will see from one of the cases that the Ministry of Finance (the MOF) is institutionally capable of equilibrating among clashing interests under its jurisdiction. This ostensibly bureaucracy-led type of policy-making process, however, is often misinterpreted as evidence of Japan's powerful bureaucracy and correspondingly weak parliament and political parties. A more accurate interpretation is informed by the visibly political policy-making pattern of the second case: whether the bureaucrats or the politicians are orches-

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trating the policy-making process, they follow an expressly political score.

## II. BANKS AND SECURITIES FIRMS

Though hardly significant in terms of votes, the financial sector is an important contributor of political funds. From different points of origin, the banking and securities industries have become interest groups of roughly equal political strength. While their political resources and strategies continue to differ, making precise comparison impossible, there has been, as we shall see, a noteworthy degree of convergence in political strategies in recent years.

### A. The Banking Industry

Banks have been consistent contributors to conservative politicians, dating back to the close relationships in the prewar era between Mitsui Bank and the Minseitō Party, and between Mitsubishi Bank and the Seiyūkai Party. Although the Minseitō had a slightly more pro-business orientation and the Seiyūkai was perhaps more closely tied to the local elites, the two parties were actually not very different and competed for funds from the same businessmen and landed gentry. After World War II, the Minseitō, which had become the Minshutō, kept its ties to big finance and big business. The Seiyūkai, larger than the Minseitō, became the Jiyūtō and had factions that were close to local elites, including local banks.

Since the formation of the Liberal Democratic Party (the LDP) in 1955, banks, at least the big banks, have made large contributions to the LDP. Throughout postwar Japanese politics, the banking industry has traditionally been among the "Big Three" (*Gosanke*) private sector funders of the annual contributions to political parties, with nearly all of their money going to the LDP. Banks' publicly reported political contributions consistently have amounted to roughly 20% of private industry's combined (reported) contributions, and, in 1983, for example, the banks accounted for 18.4%, construction and real estate for 13.3%, and steel for 6.3% of political funding, with the *Gosanke* together giving 31.7% of the total. However, because a large portion of political campaign contributions are never reported, these figures are only rough indicators of financial support to the LDP by these groups.<sup>1</sup>

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1. Asahi Shinbun, Sept. 4, 1984; The *Gosanke* is not a stable configuration. The electric power companies, which used to be in the triad with the steel and banking industries, were replaced by construction/real estate only in the mid 1970s. The steel industry's contribution has dropped off substantially since its more prosperous and generous days during the rapid growth period, and reported contributions of life insurance companies and securities firms are on the rise. G. CURTIS, *THE JAPANESE WAY OF POLITICS* 265-68 (1988).

Despite their apparent generosity, banks have not contributed more than what they perceive to be the necessary minimum. The big banks have kept politicians at arm's length insofar as possible, because politician-friends can be expensive to cultivate. Not only do politicians have exorbitant campaign financial needs themselves, but they also have friends who want loans at low cost. Therefore, as long as the Ministry of Finance was capable and willing to protect banks from domestic and foreign competition, banks could afford to remain politically aloof. The large banks paid a retainer's fee, as it were, through lump sum contributions to the LDP. However, at the same time, banks generally avoided becoming too close to individual politicians. Only when the MOF was unable to protect them have the banks switched to a strategy of giving to individual, influential politicians.

The distinction between lump sum contributions to the LDP and support for individual politicians is important for two reasons. First, because there are usually two to four LDP men running from the same election district for one to three slots, the toughest battle for LDP politicians is at the faction and individual level. The second reason concerns the increasing division of labor within the LDP, as reflected in the growing prominence of policy caucuses in the LDP known as *zoku*.<sup>2</sup> Much as in the United States, ranking committee members have more authority in their chosen areas of specialization, though in Japan, it is the LDP committees rather than the parliamentary ones that wield the greatest influence.

At several junctures in the postwar years, when the MOF attempted to introduce financial reform, banks did resort to giving funds to individual politicians. This change in banks' political strategy toward funding individuals and smaller groups within the LDP has in recent years become more prevalent. Small banks have always given the bulk of their contributions to Diet members from their districts, since much of these banks' concern was at the local level. As Japan's changing economic environment fundamentally weakens the MOF's ability to protect banks, even the city banks have called upon the LDP for more special favors beyond the generally favorable environment provided by the LDP's conservative, stable rule.

Rather than continue making large lump sum contributions to the LDP, banks have begun giving more to individual politicians for three reasons. First, the rise in importance of *zoku* enhanced the

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2. Literally "tribes," *zoku* refer to groups of LDP members with expertise in particular policy areas institutionally centering around related committees of the Policy Affairs Research Council (PARC), the LDP policy-making organ. See Muramatsu & Krauss, *The Conservative Policy Line and the Development of Patterned Pluralism*, in *THE POLITICAL ECONOMY OF JAPAN, VOLUME 1: THE DOMESTIC TRANSFORMATION* 540-41 (Yamamura & Yasuba eds. 1987).

role of individuals or small groups of politicians in the disposition of issues in their respective areas of policy specialization. Second, banks had to match the effective lobbying of the securities industry, which was already, by virtue of the securities firms' means of donating funds, largely aimed at individual Dietmen. Third, the 1975 revision of the Political Contribution Law (*Seiji Shikin Seihō Ichibu Kaisei An*) placed lower ceilings on the sum private sector corporations or other groups could contribute to political organizations.<sup>3</sup> As a result, LDP politicians began raising a sizeable portion of their financial support by selling tickets to campaign parties (*hagemasu kai*). Most businesses, including banks, have taken the liberty of reporting the cost of these tickets as business expenses rather than as political campaign contributions.<sup>4</sup>

"Big Finance" in the postwar era primarily refers to the twelve city banks with close ties to large industrial enterprises and with a nationwide network of deposit-taking branches. The top four commercial banks, Sumitomo, Daiichi Kangyō (the product of a 1971 merger between Daiichi and Kangyō), Fuji (formerly of the Yasuda zaibatsu), and Mitsubishi, have indisputably the strongest influence among the city banks, and they rotate the chairmanship of the National Federation of Bankers Associations annually among themselves.

Another informal grouping of the top six city banks, the City Bank Roundtable (*Toshi Ginkō Konwakai*), includes Mitsui and Tokai Bank and is a key forum for forging common positions vis-à-vis the MOF on matters of financial administration.<sup>5</sup> However, Big Finance also includes the remaining city banks and the three long-term credit banks, which are permitted to issue debentures of five to seven years maturity in exchange for lending long-term to industry; the trust banks, which accept large denomination trust accounts and pension funds from business, issue long term debentures, and make long term loans to industry; and the Bank of Tokyo, which issues three-year debentures and specializes in foreign exchange and international finance.

On the other end of the scale are the smaller banks, including: 1) the 64 regional banks, one or more in each prefecture; 2) the 69 mutual banks; 3) the 456 even smaller credit associations (*shinkin*); 4) the 448 yet smaller credit cooperatives (*shinyō kumiai*); and 5) the agricultural cooperatives (*nōkyō*).<sup>6</sup> Though capitalized at much

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3. H. FUJITA, *NIHON NO SEIJI TO KANE* 116-22 (1980); G. CURTIS, *supra* note 1, at 269-70.

4. H. FUJITA, *supra* note 3, at 116-22; G. CURTIS, *supra* note 1, at 269-70.

5. S. GOTŌ, *TOSHI GINKŌ*, 13-31 (1985).

6. THE FEDERATION OF BANKERS ASSOCIATIONS OF JAPAN (ZENGINKYŌ), *JAPANESE BANKS 1986* (1986); M. MIWA, *KINYŪ JIYŪKA TO NŌKYŌ KINYŪ*, 112-15 (1984).

lower ratios, these small financial institutions have political influence by virtue of their strong ties to the local elite in politics, government and industry. Their primary clientele is one of the bulwarks of the LDP support base, small and medium-sized businesses.

The National Federation of Bankers Associations (*Zenkoku Ginkō Kyōkai*) is the umbrella organization for the banking industry, but each subgroup of banks has its own association with its own distinct interests. In its disputes with the "outside," including the securities industry, the postal system, and the MOF, the banking industry attempts to forge a unified stance under the Federation's auspices when possible. However, in the slower growth years since the mid-1970s, differences among the groups have widened on issues affecting the distribution of market share within the banking industry itself. Small financial institutions, for example, opposed the introduction of automatic teller machines, which were championed by the larger banks in the early 1980s as a way to meet competition from the postal system. The expense would be felt more heavily by the smaller, weaker institutions. Ultimately, the small institutions bought time for themselves by means of a MOF-enforced compromise delaying the timetable for mechanization.

## B. The Securities Industry

The securities houses are relative newcomers on the political scene. The industry is dominated by the "Big Four," as Nomura, Daiwa, Nikkō, and Yamaichi are collectively known. The largest, Nomura Shōken, had been the securities division of Nomura Bank before the war. Nomura's commercial banking division became Daiwa Bank upon enactment of the Securities Exchange Act of 1948.<sup>7</sup> The other securities houses were much smaller and began to develop strong ties to politicians only as a defense against the banks' assault upon the separation of banking and securities activities during the Occupation period.

Unlike small banks, small securities houses are not rooted in local communities. They center in urban areas. This accounts in part for the lesser political power of the small securities houses relative to their counterparts in the banking industry. The large securities firms gained in political influence during the Occupation years because of their ability to make sizable political contributions, but the small houses were less well-positioned. The evidence is clear; the MOF's success in reducing the number of securities companies from 1,152 in 1949 to 212 in 1986 through mergers stands in stark

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7. SENGO KINYŪ ZAISEI RIMEN SHI 168-75 (Kinyū Zaisei Jijō Kenkyū kai ed. 1980).

contrast to the MOF's inability to do the same in the banking sector.

Since the banking community had long been a major source of political contributions, it would have been difficult for politicians to take the side of the securities houses in the battle over the boundary line between banking and securities activities had it not been for the clear directive from the Supreme Command of Allied Powers ("SCAP") to build up the securities industry. Viewed from the General Headquarters, the banks' grip on finance was anti-competitive and therefore inured to the detriment of corporations and depositors alike. The stock and bond markets should be developed into viable alternatives for fund raising and investment. From the Japanese politicians' point of view, particularly those in the ruling Liberal Party (*Jiyūtō*) who had distanced themselves from big banks, SCAP provided a convenient "inevitability" argument. To the banks, the politicians could disclaim any responsibility for the separation of banking and securities businesses; from the securities firms, they could accept credit and, of course, campaign contributions.

The Big Four continue to dominate their industry. Together they account for three-fourths of all stock and bond underwriting, and they are also the largest traders and retailers of securities.<sup>8</sup> These four securities firms set the agenda for the rest of the industry in policy matters as well. The Big Four have numerous joint working committees, and no decision is made by the Council of Securities Organizations (*Shōken Dantai Kyōgikai*) without their prior agreement.<sup>9</sup>

Securities firms give less than banks in publicly reported annual donations, but more through the back door. While there is no official record of back door giving, it is widely alleged in Japan that securities companies tip politicians as to good stock purchases, then effect a price increase through concentrated sales efforts, and tell the politicians when to sell for a handsome capital gain before the stock drops back down. There are several pieces of circumstantial evidence of this type of activity. Politicians, for example, have consistently refused to tax capital gains, and support freedom for stock owners not to register. Thus, there is no way to trail stock ownership.<sup>10</sup>

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8. Iwata, *Kisai Chōsei ni kansuru Shomondai*, 24 JŌCHI KEIZAI RONSŌ no. 2 at 12-16 (1982).

9. Onuma, *Yonsha Shudō de Seijiryoku o Jiku ni Gyōeki no Kakuho ni Binsō*, KINYŪ JANARU, May 1987, at 74-77.

10. Repeta, *Declining Public Ownership of Japanese Industry*, 1984 LAW IN JAPAN 153-84; K. HIROTA, SEIBI JIKEN: KOHAN DOKUMENTO (1984); K. TSUGAWA, KABUTOCHŌ NO CHIBU TO HIBU (1979); *Japan's Drug Stocks Fluctuate on Rumor*, Asian Wall St. J., May 3-4, 1985; *The Place for Everybody To Be*, Far E. Econ. Rev.,

### III. SECTION 65 AND A NEW BANKING ACT

#### A. The Shifting Profit Structure and Government Debt

Although banks had dominated the financial landscape in both prewar and postwar Japan, the situation began to change during the mid-1970s, not because of waning political influence, but rather because Section 65 of the Securities Exchange Act of 1948 guaranteed securities firms a monopoly of certain lines of business that in time proved to be highly profitable.<sup>11</sup> Banks, by contrast, began to hit upon new limits to the growth of their traditional banking operations. With slower economic growth after the oil shock, firms pared down bank debt and began to increase their financial flexibility. The loss to the banking industry was exacerbated by the increasing burden of government debt.<sup>12</sup>

In 1965, to combat a tenacious recession, the Diet passed a special one-year law permitting deficit financing to supplement the general account budget. It is somewhat ironic that Takeo Fukuda, a former MOF bureaucrat known as a fiscal conservative, was the Finance Minister who presided over this historic departure from a balanced budget. By contrast, Kakuei Tanaka, the previous Finance Minister, had kept tight reins on the budget. The difference in the economic environments they faced goes far in explaining their respective choices. Unlike Tanaka, Fukuda was responding to a serious budget shortfall due to a business down-swing.<sup>13</sup>

A Government Bond Syndicate was formed in the fall of 1965 to function as an alternative to an open market for the issuance of government bonds. Every December, when the outline of the government budget received the Liberal Democratic Party's stamp of approval, leaders of the banking community would negotiate with the Manager of the Debt Division of the Finance Bureau. Once they decided on a mutually acceptable size of the government bond issue for the entire year, the *Buchō Sewanin Kondankai*, a group of mid-management level bankers, met once a month to discuss the schedule for the issuances over the year. Each month after this group reached an agreement, officials from the Bank of Japan (the BOJ) and MOF met with representatives of the Syndicate at the BOJ to make the schedule official. In this way, the MOF was able to place bonds at below market cost, keeping its debt service burden

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April 9, 1987, at 67 (Bruce Roscoe says " 'Political' stocks stick out like a goldfish in a clear pond about six months before every general election. ").

11. On the enactment of the Securities Exchange Act of 1948, see Y. ABE, GINKŌ SHŌKEN KAKINE RONSŌ OBOEGAKI 51-86 (1980).

12. Dosse, *The Position of Banks and Securities Companies in the Japanese Financial Market and Its Effect on International Capital Flows*, in DIRECTION DES ETUDES (Banque de France, Working Paper, Fall 1985).

13. Y. ABE, GINKŌ SHŌKEN KAKINE RONSŌ OBOEGAKI (1980).



at a minimum. The cost to financial institutions was also relatively low, since the BOJ reabsorbed about ninety percent of the bonds at par one year after issuance. In any case, the amount of bonds placed with the Syndicate each year was small. The greater cost was to investors, who could have been earning higher rates of return.<sup>14</sup>

In the United States, by contrast, over sixty percent of the government debt is financed in the short-term market in the form of Treasury Bills. The Treasury Bill market is highly liquid and reflects the market supply and demand for short-term funds. Consequently, the Federal Reserve's open market operations in Treasury Bills is an important tool of monetary policy in the United States. In Japan, banks have opposed short-term government instruments that would compete with their deposits. The MOF, moreover, prefers the stability and predictability of long-term debt. Until the mid-1970s the original Syndicate arrangement proved quite workable, and long-term bonds accounted for roughly sixty percent of the annual government issuance.

Soon after the Syndicate was formed, banks signed a memo with the securities firms ceding, for the time being, the banks' right to deal in government bonds.<sup>15</sup> Although banks were allotted 51.5% of the issuance (this dropped to 42.2% in 1968), the BOJ agreed to absorb 90% of the bonds after a one-year maturation period. Banks were not, therefore intent upon engaging in the retailing of bonds. The majority of banks felt that selling bonds over-the-counter would merely shift funds out of deposits into government debt.<sup>16</sup>

Only the largest banks were eager to deal in government securities. Kurokawa, the chairman of Mitsubishi Bank, argued strongly in 1965 for banks' freedom to sell government bonds to the general public. Mitsubishi was one of a handful of banks large enough to handle the securities business, and had been advocating bank *sōgōka*, or the offering of comprehensive services. However, the smaller banks sided with the securities firms against bank involvement in retailing government bonds.<sup>17</sup>

Scholars had been calling for small denominated bonds to be

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14. R. AKANE, TOSHI GINKŌ KONWAKAI 64-94 (1984); Interviews with Ministry of Finance officials and bankers (June - Oct. 1986).

15. Tsuchida (then director of the Banking Bureau Research Division), *Shōken Sangensoku wa Kinyūkai no Zenshin e no Bunseki*, KINYŪ ZAISEI JIJŌ, Feb. 23, 1981, at 14-19; Muramatsu, *Ginkōhō Kaisei Sōdō no Haikei ni Aru Mono*, EKONOMISUTO, Apr. 14, 1981, at 28-34.

16. Nor did the MOF want banks to sell government bonds over the counter because that would have encouraged a secondary market in government bonds, with market-determined interest rates higher than the artificially low rates for new issues.

17. T. MATSUZAWA, WATAKUSHI NO GINKŌ SHŌWASHI 108-09 (1985); Y. ABE, *supra* note 13, at 107.

sold on an open market where consumers could take advantage of market rates. Hiroshi Kawaguchi, an economist from Chuo University, pointed out that small savers should have access to viable and attractive alternatives to both low-yield bank deposits on one hand, and the volatile stock market on the other.<sup>18</sup> However, these rhetorical stones could bring down the regulatory glass house only if joined by a mass movement. If aroused, the public could have pressured their representatives in the Diet with their voting power, for losses to the public from low-yield bank deposits were indeed substantial. Yet, at the individual level, losses to each saver were insufficient to feed a time consuming, costly, and cumbersome grass roots campaign for reform.

The first oil shock of 1973 gave even the smaller banks reason to reconsider. On the one hand, the issuance of government bonds took a quantum leap to battle the recession that ensued, giving the banks large portions to hold. In 1975, banks held ¥4.5 trillion in government bonds. The amount rose to ¥11 trillion in 1977 and ¥18.4 trillion in 1978. On the other hand, the Bank of Japan was no longer willing to buy back such large quantities for fear of fueling inflation. The absorption of government bonds by the BOJ had heretofore been carried out as part of its routine money supply operations because the amounts were so small. Once Japan's economic growth slowed, there was less need to provide "growth currency."<sup>19</sup>

Banks were left holding growing quantities of government bonds and became concerned about the profitability of their portfolios. A debate quickly ensued as to the legal basis for bank retailing of government bonds in order to get the bonds out of their portfolios quickly and at minimum loss, and for trading government bonds in the secondary market to earn additional income. In defense of its monopoly, the securities industry cited Section 65 of the Securities Exchange Act of 1948. Banks countered that the law was unclear as to the disposition of government bonds. Since the law's complexity and ambiguity left the issue open to various interpretations, the two sectors remained in deadlock for some time.

It was not until banks began to show significant losses from holding government bonds that they began to push seriously for new rules. In a historic turnabout, Nomura Securities reported higher earnings in 1978 than the top banks, Fuji and Sumitomo. The others of the Big Four securities houses, Nikkō, Daiwa and Yamaichi, also were gaining rapidly on the banks. The banks

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18. Kawaguchi, *Kokusai no Kinri Jiyūka to Kinyū Baibai ni Fumikire*, KINYŪ ZAISEI JIJŌ, May 1, 1978.

19. M. MATSUNO (Director of the Debt Division, Finance Bureau), KOKUSAI 28 (1983).

would not wait passively to be swept into obsolescence by the global wave of securitization that was driving the profits of the securities firms.<sup>20</sup>

TABLE 1: Profitability of the Top Banks and Securities Firms, 1965-1985; percentages and billions of yen.

Year	Return on Equity		Operating Profits	
	City Banks <sup>1</sup>	Big Four <sup>2</sup>	City Banks <sup>1</sup>	Big Four <sup>2</sup>
	(Avg.)	(Avg.)	(Avg.)	(Avg.)
1965	18.4%	5.4%	25.9 bil.	7 bil.
1975	16.1	14.2	51.1	15.8
1985	20.4	33.6	142.0	137.3

<sup>1</sup>“City Banks” refers here only to the top six city banks

<sup>2</sup>The “Big Four” securities houses.

Source: Sato, *Gyōmu Kisei no Kanwa wa Naze Hitsuyō Ka?*, KINYŪ ZAISEI JIJŌ, Dec. 8, 1986, at 22.

Securitization, or the substitution of papers sold and traded on the market for bank loans, was precisely what the banks in the Bond Arrangement Committee had worked to fend off for many decades. However, in the 1970s, it was the government bond market, not the corporate one, that began to eat into bank profits. While securities firms were profiting from buying and selling government bonds on the secondary market, banks were holding large chunks of each issue, only to experience a loss when selling them after the mandatory one-year holding period.<sup>21</sup>

On December 12, 1977, the City Bankers' Club (*Toginkon*) petitioned not only for over-the-counter sale of bonds, but also for the opportunity to trade bonds in the secondary market. The banks argued that the projections of government bond issuance in the following year exceeded the banks' ability to absorb without booking losses of ¥10 trillion. Therefore, the banks recommended that the MOF's Fiscal Investment and Loan Program (FILP)<sup>22</sup> should undertake more of the debt burden than its current fifteen percent or so and that individuals should have a right to buy government bonds. Banks were now requesting a change in regulation that they originally opposed. Their losses from the status quo were judged to

20. *Honban ni Totsunyūsuru Ginkō-Shōken Sensō*, DAIYAMONDO, Dec. 1, 1981, at 16-18.

21. Kusano (President of Mitsui Bank), *Shōken to no Nyūkai Bubun no Chōsei*, KINYŪ ZAISEI JIJŌ, May 2, 1983, at 18-22.

22. The FILP (*Zaisei Tōyūshi*), sometimes called “the second budget,” refers to the enormous pool of funds drawn from the postal savings system and public pension system, which is disbursed by the MOF's Finance Bureau to special governmental financial institutions, such as the Japan Development Bank, the Japan Export Import Bank, and the People's Finance Corporation.

exceed the losses they might suffer from the shift of some depositors into government bonds. Banks were faced with a dilemma. Their accounts were suffering precisely because government bonds were issued at rates below the market level. Yet, if government bond yields were too attractive, depositors would shift en masse. The banks' second recommendation, then, was a smokescreen for what they really wanted, namely, the freedom to sell not-too-attractive bonds to individuals so as to avoid seriously undermining their deposit base. Since bonds would be financed out of deposits anyway, the banks wanted at least to earn the retail commission in the process.<sup>23</sup>

The General Committee of the Federation of Bankers' Associations restated this set of concerns on December 15, 1977. As changes in Japan's economy have wrought an unlevel playing field among different types of financial institutions, the Federation has had difficulty presenting a unified position to the MOF and to politicians. Most initiatives for regulatory revision came from the big banks, which were more prepared to diversify their activities, while small, specialized banks appealed for a slower pace of change. However, by 1977, there was general agreement among the banks as to the desirability of their selling newly issued government bonds over the counter.<sup>24</sup>

The Ministry of Finance was not ill-disposed to the banks' suggestion. More precisely, if the MOF did not act on the banks' losses, the banks would take their cause to the politicians. However, the securities industry met these developments with dismay, and argued that rather than increasing the retail network of bonds, the better solution would be to issue the bonds at a market price through the securities companies. In the fall of 1977, the Securities Business Council petitioned the MOF for an auction system for newly issued government bonds.<sup>25</sup>

The MOF's Finance Bureau, which is responsible for managing government bond issuances, staunchly opposed an auction for long-term bonds because it enjoyed the stability, predictability, and below-market interest rates of the syndicate system. This left the Banking Bureau and the Securities Bureau with a narrower margin

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23. Testimony of Muramoto Shūzō, representative of the Government Bond Syndicate and Managing Director of Daiichi Kangyō Bank, before the House of Representatives Budget Committee (Feb. 9, 1978) reported in *KINYŪ ZAISEI JIJŌ*, Feb. 20, 1978.

24. *Kokusai no Ōryō Hakkō ni Kansuru Iken*, *KINYŪ ZAISEI JIJŌ*, Jan. 1978, at 22-23; *Zenginkyō no Shin Taisei*, *KINYŪ TO GINKŌ*, June 8, 1981 (special supplement to *TŌYŌ KEIZAI*), at 8-9.

25. Y. ABE, *supra* note 13 at 110-13; *Kokusai Hakkōkon de Zengaku Shichū Shōka o Yōsei*, *KINYŪ ZAISEI JIJŌ*, Jan. 2, 1978, at 10; Abe, *Madohan Mondai to Hōritsu Yōgō no Futōitsu*, *KINYŪ ZAISEI JIJŌ*, Jan. 16, 1978, at 5; *Kinmonken de Shōken ga Kokusai Madohan ni Surudo Hanron*, *KINYŪ ZAISEI JIJŌ*, Feb. 27, 1978, at 6; Fujiyama, *Kokusai Shōka no Genjitsuteki Kaiketsu*, *KINYŪ TO GINKŌ*, Feb. 17, 1983, at 84.

for maneuvering. If long-term bond issuance had been set on an auction system, the rancorous government bond problem may have been resolved short of legislative change.

Though the Finance Bureau preferred the syndicate system as long as the BOJ reabsorbed the bonds, the large issues of government bonds after 1975 outpaced the syndicate's absorption capacity. A secondary market matured spontaneously, which in turn set parameters for the price of new issues. So for the Finance Bureau, the benefits of the syndicate diminished rapidly. Even stability was threatened as the banks continued to balk at the subscriptions. The Finance Bureau, therefore, began leaning toward the idea of bank participation in the retail and secondary markets of government bonds as a way of smoothing issuance. This is a clear example of the changing costs of regulation to the bureaucracy. However, the solution was not that simple, for the MOF still had to deal with the controversy over Section 65 of the Securities Exchange Act.

Faced with a fierce deadlock between the banking and securities industries, and dissension within its own ranks, the MOF took a conservative step. It adopted, in 1978, a quasi-auction system that offered the syndicate a range of terms for medium term bonds. The securities firms were permitted to offer "Medium-term Bond Funds" (*Chūki Kokusai Fund*) to the general public to help retail this new type of government bond. In the first year, Nomura alone sold ¥562 billion in these funds. In the second year, the figure doubled, despite the MOF's limit on the yields at 5.5% to 5.6% just between banks' six-month deposit at 5.25% and one-year deposit at 6%. Unlike the American financial authorities, the MOF continued to limit the competition between banks and securities houses assiduously.<sup>26</sup>

The banks remained worried that medium-term bonds, with a maturity of three years, would compete with bank deposits rather than ease their debt burden. Banks would have much preferred government bonds with longer maturities, since these would compete with the postal savings ten-year deposit and not with bank deposits. The MOF had suggested two, three, and four-year bonds. The two-year bonds were vetoed by the banks as too competitive with deposits, and the four-year bonds were vetoed by the Industrial Bank of Japan and the Long-Term Credit Banks, which issue four-year debentures.<sup>27</sup>

Banks also made their displeasure known on the matter of low

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26. *Kokusai no Shichū Baiyaku Kaku Kimaru*, KINYŪ ZAISEI JIJŌ, Jan. 23, 1978, at 7; *Kokusai no Tentō Kakaku Nehaba Seigen Teppai e*, KINYŪ ZAISEI JIJŌ, Mar. 6, 1978, at 7; *Ginkō vs. Shōken*, KINYŪ TO GINKŌ, Feb. 15, 1980 (special supplement to TŌYŌ KEIZAI), at 20-23; *Honban ni Totsunyū suru Ginkō-Shōken Sensō*, DAIYAMONDO, Dec. 1, 1981, at 17.

27. *Atarashii Chūki Kokusai, Rokugatsu kara Hakkō e*, KINYŪ ZAISEI JIJŌ, May

yields and losses. In July 1978, for the first time in the history of the syndicate, banks boycotted the entire issue of long-term government bonds. Meanwhile, the Federation of Bankers Associations held its thirty-fifth annual meeting on July 4, 1978, where banks reiterated their desire to sell government bonds to the public. Prime Minister Suzuki, Finance Minister Watanabe, EPA Director Komoto, and all of the MOF officials present prudently avoided mention of the problem.<sup>28</sup> The syndicate continued to bid for the new-medium term bonds, but the amount absorbed was far short of the MOF goal. At this pace, the MOF would face a sizable funds shortage at the end of the fiscal year.<sup>29</sup>

The MOF wasted no time in giving another inch. On July 30, the MOF announced that banks would be allowed to set aside a reserve fund with tax advantages for use in smoothing out fluctuations in bond prices, effective September 1978. Still, this was not enough. Bank losses persisted, as did their demand for change.<sup>30</sup> Banks were particularly vexed in 1978 when the new ten-year government bonds issued at 6.1% fell to a lower price on the secondary market because of the market expectation of higher interest rates in the near future. City banks alone reported losses of ¥400 billion from government bonds, or twice the amount of the previous year.

In December 1979, the MOF announced an additional measure. Banks would be permitted to choose an alternative accounting method in order to screen some of their book losses from their shareholders and depositors. Given the choice in accounting methods, then, most banks chose to report government bonds at the original purchase price (*genkahō*) instead of the lowest price, be it book or market (*teikahō*), so their financial statements would not look so bad to shareholders and depositors. Although an editorial in *Tōyō Keizai* decried this measure as a sleight of hand meant to fool the public, there was no general outcry.<sup>31</sup> In another policy change, the MOF began using its Fiscal Investment and Loan Program (FILP) in 1979 to absorb a much greater portion of the government debt.<sup>32</sup>

29, 1978, at 7; *Shin Chūki Kokusai o Keiki ni Chōkisasi mo Nyūsatsusei ni seyo*, KINYŪ ZAISEI JIJŌ, May 22, 1978, at 42.

28. *Shichi Gatsu Kokusai, Hajime no Kyūsai*, KINYŪ ZAISEI JIJŌ, July 20, 1978, at 9; *Hachigatsu Kokusai no Jōken Mondai mo Shinkokuka*, KINYŪ ZAISEI JIJŌ, July 20, 1978, at 4.

29. *Shinkokusai Fuyasu Kokusai no Shōkanan*, KINYŪ ZAISEI JIJŌ, Oct. 9, 1978, at 5.

30. *Okurashō, Kokusai Kakaku Hendō Hikiatekin o Shinsetsu*, KINYŪ ZAISEI JIJŌ, Aug. 7, 1978, at 7.

31. Okubo (Assistant Director of the Banking Division of the Banking Bureau), *Kokusai Kakaku Hendō Hikiatekin no Sōsetsu ni Tsuite*, KINYŪ ZAISEI JIJŌ, Aug. 21, 1978, at 12-14. Nearly 90 percent of the local banks and seven city banks opted for the purchased price method; six stayed with the lowest-price method. M. MATSUNO, *supra* note 19, at 30-33; TŌYŌ KEIZAI, Mar. 22, 1980, at 50-51.

32. Fujiyama, *supra* note 25, at 82-85.

The FILP's share of new bond issues was 10.5% in 1977, 2.8% in 1978, 19.8% in 1979, and 28% in 1980.

TABLE 2: Amount of Government Bonds Outstanding and FILP's Share in Underwriting; in billions of yen and percentages; 1973 to 1983.

Year	Government Bonds (A)	FILP-Underwritten Share (B)	B/A
1973	1,766.2 billion	294.0 billion	9.6%
1974	2,160.0	420.0	19.4
1975	5,280.5	840.0	15.9
1976	7,198.2	1,013.8	14.1
1977	9,561.2	1,000.0	10.5
1978	10,674.0	300.0	2.8
1979	13,472.0	2,664.1	19.8
1980	14,170.2	3,968.4	28.0
1981	12,899.9	4,424.0	34.3
1982	14,044.7	3,400.0	26.3
1983	13,345.0	3,700.0	27.0

Source: Michihiko Matsuno (Director of the Debt Division, Finance Bureau) *Kokusai*, (Tokyo: Okurashō Zaimu Kyōkai, 1983), p. 133

## B. The New Banking Law

In 1976, the MOF commissioned a special subcommittee of the Public Finance Advisory Council (*Zaisei Seido Shingikai*) to examine the government's debt financing problem. The MOF's proposed solution, as voiced through this subcommittee in the fall of 1978, was to reduce the budget deficit by increasing revenues and cutting spending. The MOF's problems with the syndicate would then be over. The final word on public finance, however, belonged to the LDP rather than to the MOF, and Prime Minister Fukuda had just promised domestic constituents and the Western world at the Bonn Summit in June that Japan would prod its economy into seven percent growth. Rather than cut the budget, the LDP had plans to increase the 1979 budget by seventeen percent over the previous year.<sup>33</sup>

Given the political constraints, the MOF was thus not free to pursue its preferred policy of reducing deficit spending. Furthermore, banks were still dissatisfied with the MOF's various palliative measures. All things being equal, the MOF and the Finance Bureau in particular would gladly have allowed banks to retail government bonds. Since the buyers would be small savers who had few alternatives to low-yield bank deposits, the Finance Bureau would not have to worry about the cost of government bonds climbing much higher. The larger the market, the better. However, it was, of course, the securities industry that objected to new entrants into

33. *Zaizeishin de Kokusai Hakkō no Hadomesaku Kentō*, KINYŪ ZAISEI JIJŌ, Oct. 23, 1978, at 8.

its corner of the market. The securities industry's position was troublesome for banks. Namely, securities firms would have no difficulty whatsoever in selling government bonds, provided that the rates were based on market conditions and a secondary market could provide needed liquidity.

The Banking Bureau's own advisory board, the Finance Research Group (*Kinyū Mondai Kenkyū Kai*), had already reached a conclusion in support of new legislation permitting the banks to retail government bonds. The group argued that bank income would have to rely increasingly on international business and securities transactions. On the other hand, the Securities Exchange Advisory Council, a group of scholars and private sector leaders attached to the Securities Bureau, continued to argue that bank entry into the government bond retail market could and should be avoided.<sup>34</sup>

Deadlock between the two held the MOF motionless while it searched quietly for a compromise. Ignoring the banking-securities dichotomy was never an option for the MOF. Since it was a matter that would have to be addressed in the New Banking Law that the MOF was in the process of drafting, the matter was all the more pressing. The MOF was eager to defuse the conflict before politicians became involved in making promises to one side or the other. In May 1980, in another small concession to the banks, the MOF shortened the mandatory holding period for government bonds prior to resale from one year to six months.<sup>35</sup>

Later in 1980 the debate resurfaced. On October 15, 1980, the Securities Industry Association issued a statement opposing banks' retailing of and dealing in government bonds. Already, by way of the securities firms' sales network, individuals bought an average of twenty percent of the government bonds issued annually. Moreover, it declared that the secondary market was flourishing with no help from the banks. In short, there was no reason for bank entrance into the bond market save for the banks' greed.<sup>36</sup> The statement's rhetoric thinly disguised the securities industry's key concern that banks had an advantage in the retail business because they had more branches and customers.

On October 22, 1980, the City Bankers Club responded to the October 15th statement. The Club charged that banks had suffered a capital loss in 1979 from government bond holdings, despite the new accounting system. In a veiled threat to the MOF, the banks warned that from the standpoint of sound bank management, they

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34. *Madohan wa Benign Neglect ka, Jukushi ka*, KINYŪ ZAISEI JIJŌ, Nov. 13, 1978, at 10-11.

35. City Banks' Club, *Kokusai no Banyaku Seigan Teppai ni Kansuru Yōbōsho*, KINYŪ ZAISEI JIJŌ, Nov. 3, 1980, at 69.

36. Japan Sec. Indus. Assoc., *Ginkō ni yoru Kokusai nado no Madohanbai oyobi Dealing ni Tsuite*, KINYŪ ZAISEI JIJŌ, Oct. 27, 1980, at 62-64.



simply might not be able to absorb many government bonds in the future.<sup>37</sup>

Meanwhile, in late October 1980, the Public Finance Committee (*Zaisei Bukai*), the Financial Issues Research Committee (*Kinyū Mondai Chōsakai*), and the Securities Market Study Group (*Shōken Shijō Kondakai*) were reviewing the matter. It was these LDP committee deliberations, rather than those of the House Finance Committee, that caught the attention of financial sectors and the MOF. However, the LDP ultimately returned the problematic issue to the MOF without making any pronouncements on the dispute between banks and securities firms. Even Minister of Finance Michio Watanabe, who was a rising figure in the Nakasone faction, kept his silence, leaving the details of the solution to his bureaucratic subordinates. "If we (the LDP) play this one badly," said Watanabe, "we're likely to get burned."<sup>38</sup>

In late November 1980, the Banking Bureau and Securities Bureau finally negotiated a proposal they felt might reasonably satisfy both the banking and securities industries. The Securities Bureau first approached the securities industry before making any commitments within the Ministry because they were essentially agreeing to allow banks into retailing and trading government bonds. The concessions to the securities industry, however, were four-fold: 1) banks' securities activities would be limited to government bonds and would legally be considered among banks' "other activities," rather than as a normal part of their business; 2) banks would have to apply individually to the Securities Bureau for a securities license under the Securities Exchange Act; 3) banks would be required to wait an unspecified length of time before being granted licenses; and 4) securities firms would be allowed to trade the short-term securities issued in the Euromarket, including certificates of deposit and commercial paper, once the MOF gave its approval for them to be traded onshore.<sup>39</sup>

Under the existing laws, certificates of deposit and commercial paper were not defined as securities, and therefore were off limits to securities houses. The Securities Exchange Law would be revised to categorize certificates of deposit and commercial paper as "quasi-securities" so that, conceivably, either banks or securities houses could handle them.<sup>40</sup> This concession was an important victory for

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37. City Banks' Club, *supra* note 35.

38. *Ginkō Shōken Hyakunen Sensō*, KINYŪ ZAISEI JIJŌ, Oct. 27, 1980, at 10-11.

39. *Ginkō no Shōken Gyōmu Kitei no Kōbō*, KINYŪ ZAISEI JIJŌ, Jan. 12, 1981, at 16-17.

40. Yoshimoto, *Madohan ni Taisuru Ginkōken no Shisei*, KINYŪ ZAISEI JIJŌ, June 22, 1981, at 26. When certificates of deposit were finally introduced in October 1987, the conditions of issuance and underwriting reflected a carefully balanced consideration of the interests of both the securities and banking industries. *Ministry Outlines CD*

the securities industry.

When banks learned what the conditions were and that the Securities Bureau had already been in consultation with the securities industry, they were livid. Hajime Yamada, Chairman of the National Federation of Banks and Chairman of Mitsubishi Bank, said that the Director of the Banking Bureau had assured him back in July that he would look out for the banks' best interest. Yet this, said Yamada, was a betrayal. Under the existing Banking Law, banks argued that they were already authorized to engage in securities activities as part of their "attendant business."

This new proposal would represent a step backwards for banks, particularly if banks would be blocked from trading in the commercial paper market once it was allowed onshore. Banks insisted on strict limits on the nature of the certificates of deposit and commercial paper to be traded, lest they lose both depositors and borrowers to these more attractive alternatives. Commercial paper would have to be denominated at ¥200 million or more, and only those issued by the strongest firms could be traded in Japan. Certificates of deposit would have to be denominated at ¥500 million increments or more, and only those issued by the top 150 banks in the world could be traded in Japan.<sup>41</sup>

Banks also argued it would be decidedly unfair to be licensed by the Securities Bureau since that Bureau would surely be influenced by the securities industry's urgings to stall. Banks wanted to get into the business immediately.<sup>42</sup>

On December 30, 1980, the General Committee of the Federation of Bankers Associations decided, by majority vote, to reject MOF's draft of the New Banking Law with its proposed settlement of the government bond issue.<sup>43</sup> The securities industry had accepted the deal, but the banking community had not.

On January 8, 1981, the Securities Activities Committee of the Federation of Bankers Associations again rejected the proposal. The syndicate met on January 12, 1981 and hinted that the government might have trouble issuing any bonds in February 1981. From the beginning there was some disagreement among banks as to how stubbornly they should resist. The only "court of appeal" was the LDP, and that Party had made it clear that it did not want

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*Rules*, Japan Econ. J., May 23, 1987, at 10, col. 1; *Shi-pi Ruru Sakusei Ozume*, NIKKEI, Apr. 7, 1987, at 5.

41. Yamada, *Ginkohō Kaiseian ni Igi ari*, EKONOMISUTO, Feb. 17, 1981, at 36; *Ginkō vs. Shōken: Koko ga Senba*, KINYŪ ZAISEI JIJŌ, Feb. 17, 1981, at 36-39.

42. *Ginkō no Kaotate*, KINYŪ ZAISEI JIJŌ, May 26, 1980, at 10-11; *Ginkohō Kaisei ni Kansuru Ōkurashō Ginkōkyoku no Kangaekata oyobi Zenginkyō Iken*, KINYŪ ZAISEI JUŌ, Jan. 19, 1981, at 14-20.

43. The banks were also unhappy about the MOF's proposed disclosure rules, as will be discussed in Section IV of this article.

to become embroiled in that dispute.<sup>44</sup> Other avenues for bank resistance were closed off; neither the MOF nor the LDP would hear more. The MOF did, however, voluntarily use the Fiscal Investment and Loan Program to absorb 34.3% of the government issue for 1981, the highest percentage in history.<sup>45</sup> On the other hand, the MOF knew that the syndicate would not boycott bonds indefinitely lest the banks undercut their own desire to retail and trade government bonds.<sup>46</sup>

On March 2, 1981, Finance Minister Michio Watanabe called in four leaders of the banking community: Hajime Yamada, Chairman of the Federation of Bankers Associations; Ichirō Yoshikuni, Chairman of the Association of Regional Banks; Kisaburō Ikeura, President of the Industrial Bank of Japan; and Takuji Matsuzawa, Managing Director of Fuji Bank. Of these men, Matsuzawa was the only one who was not representing an association of banks, but it was not a mistake that he was invited. Matsuzawa was known to be basically in favor of the new law, even though the terms for entry into the government bond market were not ideal. The MOF hoped that Matsuzawa would quell any attempt to gut the law altogether. "The matter has been decided," Watanabe declared. "We cannot entertain any further revisions on the banking-securities issue," he stated. When the meeting was over Watanabe stated that he would not meet with bankers again until the law had been enacted.<sup>47</sup>

The banks' failure to induce political intervention on their behalf attested not to the banks' lack of political leverage on an absolute scale, because banks were and continue to be key supporters of the LDP, but to their rough parity with securities firms in political influence. For either the banks or the securities firms to have attempted to outbid the other would have been to invite an intolerably expensive competitive spiral of campaign contributions for a policy decision that would likely be much the same as the cheaper compromise proposed by the MOF. The LDP, for its part, preferred to delegate to the bureaucracy decisions that were destined to invite more resentment than gratitude.

On March 5, 1981, the Securities Industry Association issued a statement warning that if any additional compromises were made with the banking industry, the securities industry would return to

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44. *Yodan Yurusanai "Shōken Gyōmu" no Chaku Jiten*, KINYŪ ZAISEI JIJŌ, Jan. 19, 1981, at 10-11; *Ginkō no Kokusai Madohan Mondai*, DAIYAMONDO, June 1, 1981, at 92-94.

45. *Ginkōkyoku vs. Togin Rengō Kessen*, KINYŪ ZAISEI JIJŌ, Feb. 16, 1981, at 10-11.

46. Shimura, *Ginkōhō Kaisei ni Sessoku wa Sakeyo*, EKONOMISUTO, Nov. 18, 1980, at 34-39.

47. *Dohyōba de Motsureru Ginkōhō Kaisei Geki*, KINYŪ ZAISEI JIJŌ, Mar. 9, 1981, at 14.

the original starting point of the disagreement and fight the entire battle over again. The securities houses had already given all the concessions that they were willing to tolerate.<sup>48</sup>

Although fierce rhetorical jabs between the banking and securities industries continued through April of 1981 when the New Banking Law passed the Diet, the initial compromise proposed by the MOF endured.<sup>49</sup> A neutral "Committee of Three" was appointed by the MOF, and approved by the banking and securities industries, to decide upon the timing and other details of banks' commencement of government bond retailing and dealing. The members of the Committee of Three, all retired MOF officials were Shōichirō Morinaga, once Managing Director of the Tokyo Stock Exchange and once Governor of the Bank of Japan, Naoru Sasaki, Chairman of the MOF's Financial System Research Council and also former Governor of the Bank of Japan, and Michikazu Kōno, chairman of the Securities Activities Advisory Council attached to the Securities Bureau.

The Committee deliberated in guarded secrecy for two years, assisted by the Research and Planning Division of the MOF's Secretariat, but the basis for a compromise solution had already been established in the initial MOF proposal. Banks were permitted to sell government bonds over the counter beginning in April 1983. In June 1984, banks were permitted to deal in government bonds in the secondary market and profit on price fluctuations. In the interim, however, banks were unhappy about the delay and boycotted long-term government bonds for three consecutive months in the summer of 1981 and again in February 1982.<sup>50</sup> The Securities industry, on the other hand, had been hoping for more of a delayed bank entry and for fewer participating banks. The MOF deemed a further tradeoff to be necessary: early bank permission in exchange for allowing securities firms to lend money to customers using government bonds as collateral.<sup>51</sup>

Banks had succeeded in lobbying efforts with the LDP for get-

48. Nihon Shōkengyo Kyōkai, *Ginkōhō oyobi Shōken Torihikihō no Kaisei ni Kansuru Shokenkai no Iken*, SHŌKEN GYŌHŌ, May 1981, at 60.

49. Saijo, *Shiginkōhō to Ginkō no Shōken Gyōmu*, INBESUTOMENTO, Aug. 1981, at 18.

50. *San Chōrō o Kujitsu no Enmaku ni Nitatsu Ginkō Shōken*, KINYŪ ZAISEI JIJŌ, Nov. 23, 1981, at 10-11; *Nendonai Keisuron e Kakyō no Michi O Saguru Sannin Iinkai*, KINYŪ ZAISEI JIJŌ, Jan. 18, 1982, at 12-13; *Sannin I no Sakaki o Mae ni Hyakkai Yakōsuru Shōken Ginkō*, KINYŪ ZAISEI JIJŌ, Feb. 8, 1982, at 10-11; *Nagabiku Kokusai Hikiuke Kosho*, KINYŪ ZAISEI JIJŌ, June 15, 1981, at 10-11; *G-Card go Fujōsaseta Madohan Ninka 57 Nen Setsu*, KINYŪ ZAISEI JIJŌ, July 13, 1981, at 10-11; *Shibo Kokusai, 8.2% de Ketchatu*, KINYŪ ZAISEI JIJŌ, Aug. 17, 1981, at 9; *Nishimura, Kokusai Hakkō Jōken no Seijōka*, KINYŪ ZAISEI JIJŌ, Aug. 1, 1981, at 14-15; *Kokusai Zōhatsu de Kuzureyuku Chōki Kinri Taikai*, TŌYŌ KEIZAI, Mar. 19, 1983, at 76-79.

51. *Ginkō Shōken Teikei no Tane*, KINYŪ ZAISEI JIJŌ, Apr. 18, 1983, at 14-15; *Senju Bōei Kara Sekkyoku Tenkai*, KINYŪ TO GINKŌ, Aug. 12, 1983, at 12-15.

ting concessions on other points of the law, but on the entire problem of bank involvement in the government bond market, the LDP would not budge.

#### IV. BANK REGULATION: THE BATTLE OVER THE COST OF PROTECTION

The second noteworthy component of the New Banking Law is the treatment of bank disclosure. In fact, the disclosure requirements prescribed therein are lenient, akin to licensing for self-advertisement. Among the industrialized countries, disclosure of a bank's books is one of the most important resources the public has for evaluating a bank as an equity investment or as a reliable depository institution. It could be argued that the MOF's implicit guarantee against bank failure is the functional equivalent in Japan of full disclosure. This is precisely the problem for the MOF. The MOF is the caretaker of a greenhouse that is becoming quite drafty and difficult to nurture. It would be hard to find clearer evidence of bank protection. Is the MOF indeed so assuredly captured? Is the MOF the mindless servant of the banks?

Contrary to first appearances, the MOF has consistently sought an efficient, streamlined, internationally competitive banking sector. A financial system with a few powerful banks would be a regulator's dream; the MOF's job would be relatively easy, and the bureaucrats would look good. The story line to follow, however, is one of bank success in obtaining protective regulation despite the MOF's efforts to introduce market discipline. This greenhouse environment fostered the dozen or so powerful, world-class banks, while simultaneously nurturing the over one thousand small, local financial institutions.

The financial panic of 1927 led to greater consolidation of Japan's banking sector, strengthening the hand of the great *zaibatsu*<sup>52</sup> banks in particular.<sup>53</sup> The number of commercial banks, 1,697 in 1905, was down to 424 by 1936. Over 950 banks closed their doors, and even more, 1,333 were merged.<sup>54</sup> Looming in size over the new financial landscape were the big city banks, which had branches

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52. *Zaibatsu*, literally "financial clique," is a term used to describe the great family holding companies that emerged with rapid industrialization in Meiji Japan. The *zaibatsu* were distinguished by their enormous size and the wide reach of their operations, which typically included manufacturing, finance, and trade.

53. SHŌWA KEIZAI SHI 60 (H. Arisawa ed. 1977). The Ministry of Commerce and Industry used the same market disruption to tighten up the small business sector, despite labor's opposition to what it saw as an invitation to greater management control of labor. Labor cynically dubbed the Ministry's "Temporary Bureau of Industry Rationalization" the "Bureau of Irrationalization."

54. Patrick, *Japanese Financial Development in Historical Perspective, 1868 - 1980*, in *COMPARATIVE DEVELOPMENT PERSPECTIVES* 312 (1984).

throughout the country. Of the seven big banks, all but Sanwa were *zaibatsu* institutions. Four top *zaibatsu* banks held forty-eight percent of the capital in the financial sector just before World War II.<sup>55</sup>

In the 1930s, the military began mobilizing the economy for war, operating at first through *zaibatsu* institutions to gain greater control of economic activity. The *zaibatsu* banks, particularly Mitsubishi and Mitsui, benefitted from industrial concentration and from the boom in heavy industry. In 1941 the seven largest banks had 58% of the deposits, 66% of the loans, and 47% of the securities holdings of the 245 ordinary banks. During the war the big banks became even more important by the absorption of smaller institutions.<sup>56</sup>

In February 1942, the Bank of Japan Law was abolished and was replaced with a law that robbed the BOJ of its autonomy from the MOF regarding monetary policy. At the same time, the new law charged the BOJ with the authority to make unsecured loans to companies as demanded by the military, without limit.<sup>57</sup> The new law also gave the BOJ greater powers over private financial institutions. In May of 1942, the Banking Control Association, the Local Finance Control Association, and the Short-Term Market Control Association were established under BOJ and MOF auspices.<sup>58</sup>

By 1943, the military's need for money was so great that it enacted a law strengthening its authority to draw funds from private banks. At first, 149 companies were on the military's list for acquiring loans upon demand, but within a year more than 3,000 firms were similarly privileged. Banks, in turn, could not have kept the money flowing without steady loans from the BOJ. The money supply soared unchecked, and prices were restrained by price controls.

In 1945, regional banks were forced to merge, leaving one regional bank in each prefecture. Seventeen of these banks were then formed into a finance corporation for funneling their deposits to the cash-poor city banks. Under military rule, the financial industry had become streamlined in such a way that the MOF could never have achieved on its own. The number of ordinary banks, 377 in 1937, had diminished to 61 by 1945.<sup>59</sup>

After the war, banks recovered more rapidly than other sectors of the economy, in part because of their exemption from strict anti-monopoly provisions. Moreover, the BOJ's disinflation policies placed a great deal of market power in the hands of banks.

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55. SHŌWA KEIZAI SHI, *supra* note 53, at 297.

56. Ehrlich and Tamagna, *Japan*, 538-39; SHŌWA KEIZAI SHI, *supra* note 53, at 517.

57. SHŌWA KEIZAI SHI, *supra* note 53, at 216.

58. *Id.* at 217.

59. Patrick, *supra* note 54, at 315.

At first, the SCAP had spoken of "democratizing finance," breaking the strong *zaibatsu* control of the financial sector by splintering the mammoth *zaibatsu* banks into more numerous medium-sized institutions. The "Corporation Deconcentration Act" was enacted in December of 1947, forcing firms with monopoly power to divide into smaller segments.<sup>60</sup> Banks were targeted along with other large firms. Mitsubishi, Yasuda, Teikoku, and Sumitomo were slated for dismemberment. However, in July of 1948, pursuant to a policy change at SCAP, banks were exempted from the law. Only Teikoku Bank was split, undoing the wartime merger of Mitsui Bank and Daiichi Bank. The rest of the *zaibatsu* banks were ordered to change their names, but even this directive was revoked after two years.<sup>61</sup>

In the fall of 1948, SCAP commissioned a Detroit banker, Joseph Dodge, to craft economic policies that would strengthen Japan's weak public finances. Japanese industry would have preferred a stimulative path to recovery rather than the fiscally stringent one chosen by Dodge. In the summer of 1950, for example, the *Jiyūtō* was eager to lower interest rates before the upcoming elections in order to win greater support from industry. SCAP would not allow a rate cut. Banks, on the other hand, had no qualms about SCAP's tight money policy that increased their bargaining power over corporate borrowers.

In 1948, SCAP ordered the government's Reconstruction Bank (*Fukkō Kinyū Kinko*) to be scaled back, blaming it for fueling inflation. The Reconstruction Bank, a brainchild of Finance Minister Tanzan Ishibashi and established in January 1947, was to provide funds to basic industries that private banks would be reluctant to support. In 1947, the Reconstruction Bank's loans, sixty percent of which went to the coal and steel industries, surpassed the total loans of all private banks. Even in 1948, when private banks had more money to lend, Reconstruction Bank loans amounted to over a third of the private banks' total. All the while, the Bank of Japan cautioned against the rampant inflation. Dodge's position was as much boon to the BOJ as it was bane to the mining and steel industries. However, the private banks benefited from the scaling down of Reconstruction Bank lending as they took over the bulk of corporate finance.<sup>62</sup>

Of even greater import to banks was SCAP's intent, announced in August of 1948, to revamp the Japanese banking system on the

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60. See, e.g., T. NAKAMURA, *THE POSTWAR JAPANESE ECONOMY* 23-25 (1981).

61. See, e.g., T. MATSUZAWA, *supra* note 17, at 25-29.

62. *Fukkin Kashidashi Kinri Hiksage Sainen*, KINYŪ ZAISEI JUŌ, July 3, 1950, at 7-8; *Kinyū Kikan no Jiyūsei o Ikase*, KINYŪ ZAISEI JUŌ, Aug. 28, 1950, at 19.

American model.<sup>63</sup> The plan was to establish a Banking Board, much like the Board of Governors of the Federal Reserve. The Board would be independent of the Ministry of Finance to ensure well-managed monetary policy beyond the reach of the Cabinet.

The banking community was as delighted as the MOF was chagrined. Banks applauded the separation of fiscal and monetary policies, charging the Cabinet with sacrificing monetary policy to its political need for fiscal stimulation or allocation of credit to small business. However, representatives of industry, more concerned about the possibility of recession than about inflation, expressed concern about being controlled by a strong, independent monetary authority.<sup>64</sup>

The MOF responded quickly in defense of its control of financial policy. "The American suggestion cannot be accepted in Japan without modification," the Minister of Finance, Kitamura, stated. He also stated, "Monetary policy cannot and should not be separated from fiscal policy." A three-man committee was assembled to study the problem. The committee was made up of Minister of Finance Kitamura, BOJ Governor Ichimada, and the Director of the Economic Stabilization Board, Kuritsuka.<sup>65</sup> Following two weeks of deliberation, the committee members reached a conclusion. They would demote the Banking Board to an advisory body of the MOF. Yet, two on the committee were politicians, and the third, Ichimada, was to become one year later. They and their fellows in the Diet would not have passed a bill removing monetary policy from political grasp.<sup>66</sup>

In August 1950, the MOF announced plans to present a new banking law and a new Bank of Japan law before the Diet. SCAP's scheme for a Banking Board was deftly avoided. Instead, interest rates were to be determined by the MOF upon the advice of the Monetary Policy Committee. Secondly, to ensure sound banking, bank deposits would be subject to a reserve requirement and a margin-risk reserve. Thirdly, the MOF would have the right to demand changes in commercial bank management if it deemed it necessary.<sup>67</sup>

Banks reacted strongly to the MOF's version of the laws. Em-

63. *Kinyū Seido Minshuka no Hōkō*, Asahi Shinbun, Aug. 20, 1948, at 1, rows 6-14; C. SAKAIRI, *KINYŪ SEIDO RON* 186-87 (1977).

64. *Nikkei Shimbun*, Sept. 19, 1948; *KINYŪ ZAISEI JIJŌ*, July 11, 1950, at 1. For an account of the heated dispute between the MOF and the BOJ over the control of monetary policy, see *JITSUROKU: SENGO KINYŪ GYŌSEISHI* 265-74 (M. Takamoto ed. 1985). T. YOSHINO, *CHŪŌ GINKŌ SEIDO NO KAIKAKU* 236-39 (1959).

65. *Kinyū Chō ni Shūsei Iken*, Asahi Shimbun, Aug. 22, 1948, at 1, rows 6-10.

66. *Kinyū Seido Kaikaku Inikai Kenkai Naru*, Asahi Shimbun, Sept. 4, 1948, at 1, rows 12-14; *SEKAI KEIZAI*, Oct. 12, 1948.

67. *Yokinbu Shikin Riyō*, *NIKKEI*, Oct. 11, 1950, at 1, rows 7-10; *SANKEI*, Oct. 30, 1950; *JUI*, Nov. 8, 1950.



ploying the rhetoric of the day, banks decried the MOF's appropriation of monetary policy and other administrative powers as undemocratic. Tatsu Amaya, Director of Operations of the Tokyo Bankers Club Secretariat, declared, "We object to MOF's phrase 'as we deem fit.' This sort of bureaucratic arrogance is out of keeping with the times."<sup>68</sup> Using another argument, the Federation of Bankers Associations stated that "because the Japanese economy has not yet recovered, adopting the American system is premature."<sup>69</sup> Ichirō Machida, Director of the Research Division of Chiyoda Bank (now Mitsubishi), insisted that the only condition for a controlled economy, save imminent national extinction, was that the government fully compensate the private sector for intrusion.<sup>70</sup> Though they employed a variety of arguments, banks were in agreement that the Banking Board should be strengthened, and MOF's overweening control reduced. Note, however, that banks never asked for free competition, instead, in the financial markets. Their complaints were directed against those regulations, such as the deposit and risk reserve requirements, that would transfer some of the costs of protection onto the banks themselves.

The MOF knew its only chance for tightening up the banking system lay in borrowing SCAP's authority, all in the name of reform.<sup>71</sup> However, with banks' hackles up, the MOF had to abandon its plan for submitting the draft to the Diet in November 1950. Dodge had stated his approval of the new law, but because the Occupation was soon to end, Dodge felt that this was an issue the Japanese should work out themselves. Besides, his suggestions had already been "modified" beyond recognition. The MOF badly wanted Dodge's extra push for this piece of legislation, but he did not oblige. Dodge returned to the United States in December 1950 without giving any new orders, leaving the MOF to face the banks and the politicians alone.

Neither the *Jiyūtō* nor the Democratic Party (*Minshutō*) were prepared to anger the entire banking community just before the upcoming April 1950 elections. The *Minshutō*, having close ties to the banks, would not have moved against their supporters in any case, and the *Jiyūtō* could not afford to allow the *Minshutō* any pre-election points from playing the role of white knight against the *Jiyūtō* administration. The MOF, then, was back where it started, recon-

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68. Amaya, *Shin Kinyū Gyōhō ni taisuru Iken*, KINYŪ ZAISEI JIJŌ, Aug. 28, 1950, at 19.

69. MAINICHI, Sept. 23, 1950.

70. KINYŪ ZAISEI JIJŌ, Nov. 13, 1950, at 30; Ichirō, *Keizai Tōsei no Mitōshi*, KINYŪ ZAISEI JIJŌ, Feb. 26, 1951, at 3.

71. *Ginkōhō Daigo Shian o Dodge-shi ni Teishutsu*, KINYŪ ZAISEI JIJŌ, Oct. 23, 1950, at 8-9.

sidering the disputed points.<sup>72</sup>

The politicians found another avenue of election support in the financial sector, although it was the *Minshutō* that was reluctant this time. *Mujin* were small, credit-union-like financial institutions that desired licensing from the MOF so they too could enjoy the MOF's protective umbrella. However, the MOF was eager to streamline the banking industry, not expand it. Finding *Jiyūtō* and Socialist politicians more sympathetic, the *mujin* successfully lobbied for a law, over the MOF's objections, which transformed them into mutual banks for small business.<sup>73</sup>

In September 1951, the MOF tried its hand again at a new banking law. This time the MOF clarified its authority, as the banks had requested. Administrative guidance would be restricted, but the MOF would have legal authority to ban compensating balances, to establish ceilings for bank dividends and for bank employee salaries, to increase banks' mandatory capital ratio, and to prohibit bank lending to any one borrower in excess of twenty-five percent of the bank's net worth.

Again, the banks fought back, taking their grievances to the politicians. This time, they also had allies in various industries. The twenty-five percent net-worth ratio on loans would have left steel, shipbuilding, and textile companies, as well as their many sub-contractors, short on funds.<sup>74</sup>

On September 25, 1951, Finance Minister Ikeda invited leaders in the banking world to discuss the MOF's latest draft, but his conciliatory gesture was too little, too late. Already, a growing group in Ikeda's own party, the *Jiyūtō*, was joining the side of the banks. Kiichi Aichi, later to become Finance Minister himself, joined this movement.<sup>75</sup> Ikeda gave up.

Ikeda was replaced by Mukai as Finance Minister in 1952, but the MOF continued to study the new banking law and a new Bank of Japan law for a number of years in its newly established advisory organ, the Financial System Research Council (*Kinyū Seido Chōsakai*). However, upon the merger of the two conservative parties into the Liberal Democratic Party in 1955, the MOF began to have second thoughts about legislation that would place monetary

72. *Ginkō Hōan no Isshōten*, KINYŪ ZAISEI JIJŌ, Nov. 27, 1950, at 5; *Ginkō Hōan, Kokkai Teishutsu Konnan*, KINYŪ ZAISEI JIJŌ, Dec. 18, 1950, at 3-4; *Shin Ginkō Hōan no Yukue*, KINYŪ ZAISEI JIJŌ, Feb. 19, 1951, at 7-8; TOKYO SHIMBUN, July 20, 1951; *Ginkōhō Kaisei*, NIKKEI, Aug. 18, 1951, at 1, rows 1-5.

73. *Ginkō Hōan o Isshōten*, KINYŪ ZAISEI JIJŌ, Nov. 27, 1950, at 7-8; KINYŪ ZAISEI JIJŌ, Dec. 4, 1950, at 29-31; KINYŪ ZAISEI JIJŌ, Feb. 26, 1951, at 6, 39-44.

74. Suzuki, *Ginkō wa Sensen no Kenzensei o Torimodose*, KINYŪ ZAISEI JIJŌ, Sept. 2, 1951, at 3; SANKEI, Sept. 17, 1951; MAINICHI, Sept. 26, 1951; *Daikigyō no Daiginkō Izon no Jōkyō*, KINYŪ ZAISEI JIJŌ, Oct. 8, 1951, at 20-21.

75. *Tairitsu Gekika*, KINYŪ ZAISEI JIJŌ, Oct. 1, 1951, at 10-12; *Ikeda-Ichimada Kyōen*, KINYŪ ZAISEI JIJŌ, Oct. 8, 1951, at 8-9.

policy more squarely in the hands of the Cabinet. Changing their position, MOF officials said, "Neutrality of the BOJ is critical now that parties are making a row over government bond issuance and credit control."<sup>76</sup> What they meant was that the MOF already had control of monetary policy through its influence over the BOJ. Bringing the formal mechanism for monetary policy under Cabinet control would rob the MOF of influence given that there was a dominant party in the Diet.

Ichimada, the Governor of the Bank of Japan, wanted revisions in the BOJ law for different reasons. First, corporations were strengthening relative to banks, making the Temporary Interest Rate Control Law unnecessary in preventing lending rates from skyrocketing. Second, because bank borrowings from the Bank of Japan were decreasing, the BOJ was considering a change in emphasis from window guidance to open-market operations and reserve requirement manipulation in the direction of monetary policy. Ichimada was not to have his way.<sup>77</sup>

In 1956, the MOF presented yet another version of the banking law, this time dropping the Bank of Japan law revisions altogether. The MOF's focus was now on small problem banks. The MOF sought widened powers to change bank management in cases of legal offense, disobedience of the Minister's directives, and actions against the public interest. With many allies in the Diet, however, the small banks successfully blocked the bill from passage. Not for nearly another decade would the issue resurface.

This is not to say that all else was quiet in financial policy-making. Two recurring debates on the floor of the Diet concerned, first, banks' "overloan" problems, and secondly, the compensating balances banks required of corporate borrowers. On the first point, Dodge had been critical of banks' excessive indebtedness to the Bank of Japan upon which banks relied for making corporate loans. In the early postwar years, city banks lent more than they had in deposits. However, throughout the 1950s, banks fought off legislation that would have limited the proportion of assets they could lend to any one customer. On a second point of controversy, corporations were sore about compensating balances, but they acquiesced as long as they received access to a steady stream of loans. The MOF's Banking Bureau promised the Diet that it was limiting the extent of these forced deposits, but when it was discovered that banks were vastly underreporting the balances, the Democratic Socialists suggested legislation to compel stricter compliance. Noth-

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76. *Kinyū Seido Kaisei ni Ōkurashō Shinchō*, NIKKEI, Sept. 11, 1955, at 1, rows 1-8.

77. *Id.*

ing came of their proposal.<sup>78</sup>

The 1960s brought a new wave of attempts at financial reform. At a New Year's party of the National Federation of Banks in 1964, Finance Minister Kakuei Tanaka stated, "We welcome bank mergers in a consolidation effort to make the financial system more compatible with an open economy."<sup>79</sup> In 1964, the MOF planned accession to Article 8 of the International Money Fund and to join the Organization for Economic Cooperation and Development, pledging allegiance to the industrialized world's principles of free trade and capital flows. The MOF skillfully employed this foreign pressure, as it would again, in its domestic struggle to streamline the banking sector. The real problem was a domestic recession that was putting pressure on the financial system, starting with the weakest links.

Finance Minister Tanaka was willing to float the MOF's balloon, but he had his own political reasons. The LDP was also wooing small businesses, which happened to be the group most hit by banks' compensating balances. "If there are banks that cannot survive without demanding compensating balances," Tanaka stated on the floor of the Diet, "they will have to be absorbed by stronger banks."<sup>80</sup> Tanaka was also attempting to woo large banks from his rival faction leader, Takeo Fukuda. Indeed, Tanaka succeeded in drawing several banks closer to his camp, including Sanwa, Saitama, and even Mitsubishi.<sup>81</sup>

Not a great deal actually happened. There was little incentive for small banks to give up their independence as long as the MOF was behind them with an implicit guarantee of solvency. Nor could the MOF revoke its guarantee; small banks were well-organized and politically influential. It was this power that had prevented the MOF from passing the costs of protection onto the banks themselves by way of a more robust deposit insurance system paid for by the banks. In August, 1964, Daiichi Bank did absorb an affiliated institution, Asahi Bank, and in the following year, Sumitomo acquired Kawauchi Bank, of which it already had partial ownership. However, this was far from being the massive spate of mergers and acquisitions that the MOF would have liked to see.<sup>82</sup>

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78. See, e.g., *Ginkōhō no Kaisei*, NIKKEI, May 2, 1956, at 1, rows 1-8; address by Kasuga in KINYŪ ZAISEI JIJŌ, Oct. 19, 1964, at 46.

79. T. MATSUZAWA, *supra* note 17, at 116.

80. Tanaka's statement, intentionally or unintentionally, misconstrues the nature of compensating balances. The balances were a way to equilibrate demand and supply of credit by raising its effective cost, despite regulations on ceiling loan rates—that is, a market response to regulation. T. MATSUZAWA, *supra* note 17, at 117.

81. T. MATSUZAWA, *supra* note 17, at 116-17; *Ginkō Gappei no Taitō to Saihen no Hōkō*, KINYŪ ZAISEI JIJŌ, Jan. 4, 1965, at 56-57; S. NAKAJIMA, ARU GINKŌ GAPPEI NO ZASETSU 143-44 (1979); *Kakuei Kinyū Kōsō*, ZAIKAI, Oct. 1, 1972, at 34-37.

82. T. MATSUZAWA, *supra* note 17, at 116-17.

## V. THE MOF'S EFFICIENCY CAMPAIGNS

In 1967, the MOF's Banking Bureau launched its first Efficiency Campaign. By "efficiency," the MOF was referring not to Pareto-optimal credit allocation, but to stability of the financial system, which the MOF bureaucrats needed for their work to proceed smoothly. In the aftermath of the 1965 recession, corporate bankruptcies threatened a large number of small banks, but in the absence of a strong deposit insurance system and strict bank disclosure requirements, allowing a bank to go under was unthinkable. The alternative was to get rid of the weakest banks through mergers.

Arguing that greater market discipline was needed in the financial system, Director General Sumita guided two laws through the Diet that facilitated bank mergers by providing material incentives for consolidation. Plums included tax breaks, exceptions to the Antimonopoly Law, and the prospect for small institutions to move up the ladder to become full-fledged banks. Although small financial institutions received some preferential treatment, such as tax exemptions on their real estate holdings, there were ceilings on the size of corporations to which they could lend. Some of the stronger credit institutions were therefore eager to become full-fledged banks. Banks, on the other hand, opposed granting the appellation of "bank" to small institutions.<sup>83</sup>

Small financial institutions were remarkably successful in using the political process, appealing to LDP politicians to thwart MOF efficiency measures against their interests. Over the next five years, there were 121 mergers, in a number of which smaller institutions graduated into higher asset categories to become bonafide banks.<sup>84</sup> However, that is about as far as the Efficiency Campaign went. In February of 1968, Tetsugorō Obara, Chairman of the Credit Institutions Association (*Zenshinren*), warned that small institutions would not sit back idly and watch themselves become prey to the big banks. They would use their political clout to the extent necessary. Indeed, most of the mergers that occurred were between small credit institutions willing to forego autonomy in exchange for full bank status. Two mergers between large financial institutions also

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83. "Chūshō Kigyō Kinyū Seido no Seibi Kaizen no tame no Sōgō Ginkōhō, Shinyō Kinkōhō nado no Ichibu o Kaiseisuru Hōritsu" and "Kinyūkikan no Gappei oyobi Tenkan ni Kansuru Hōritsu", T. MATSUZAWA, *supra* note 17, at 118; M. ŌKURA, ŌKURASHŌ GINKŌKYOKU, 34-42 (1985); S. NAKAJIMA, *supra* note 81, at 138-39.

84. T. MATSUZAWA, *supra* note 17, at 118; S. NAKAJIMA, *supra* note 81, at 226-27, *Ugokidasu Kinyū Saihensei*, Asahi Shinbun, Feb. 8, 1968, at 7, rows 1-3; *Kinyū Kikan ni Miru Gappei Tenkan Mūdo*, KINYŪ ZAISEI JIJŌ, Feb. 19, 1968, at 33-38; *Isshū Kinyū no Gappei Tenkan*, KINYŪ ZAISEI JIJŌ, Mar. 11, 1968, at 25; KINYŪ TO GINKŌ, Apr. 18, 1980, at 32.

took place. In 1971, Taiyō Mutual Bank merged with Kobe Bank, a city bank, to become Taiyō Kōbe, one of twelve city banks. In 1973, two city banks, Daiichi and Kangyō, merged to become Daiichi Kangyō, the largest of the city banks.

Rigid entry barriers, branch restrictions, separation of types of financial institutions, and the fixed interest rate structure still protected the weakest banks. Granted, all banks, weak and strong, benefited from these constraints on competition, and particularly on low deposit rates. Yet this would remain true only insofar as depositors had no preferable alternatives to bank accounts. For the time being, the MOF was able to maintain equilibrium among the financial institutions under its umbrella.<sup>85</sup>

Change was slow in coming, but the MOF did not give up its deliberations. In July 1968, the MOF's Financial System Research Council issued a report entitled *Interest Rates and the Scope of Activities of Financial Institutions*, in which the Council proposed upgrading the deposit insurance scheme. It specified no timetable.<sup>86</sup>

The MOF's next attempt to tighten up the banking industry did not come until nearly a decade later, when the recession after the oil shock rippled through the banking community. In 1977, the new Director General of the Banking Bureau, Hiroshi Tokuda, promptly launched the New Efficiency Campaign. Tokuda had served as the Chief of Secretariat for the MOF's Financial System Research Council, and in that capacity was largely responsible for the report calling for efficiency, more mergers, and a stronger deposit insurance system. Tokuda's zeal earned him such nicknames in the banking community as "Mr. Consolidation," "His Unsmiling Highness," and "Mr. Loss (*Sonda*)," the latter being a pun on this name that indicated how banks viewed his financial policies. Then, in 1977, Tokuda stated without apology, "There are too many financial institutions. Even thirteen city banks are too many. Small institutions in particular should consider market conditions more seriously."<sup>87</sup>

To assist him in his work, Tokuda hand picked members for a private brain trust for the Banking Bureau, the Finance Study Group. In June 1978, this group issued a report giving Tokuda's consolidation plan total backing with arguments for economic efficiency and the public good, but these were small arrows with which

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85. Horiuchi & Iwata, *Nihon ni okeru Ginkō Kesei*, KEIZAIGAKU RONSHŪ, Apr. 1984, at 2-33; Suzuki, *Nihonno Kinyū Jiyūkan—sono Seiji Keizaigaku*, KINYŪ TO GINKŌ, Dec. 12, 1984, at 22-29.

86. T. MATSUZAWA, *supra* note 17, at 121.

87. S. NAKAJIMA, *supra* note 81, at 139, 147; *See also* KINYŪ ZAISEI JIJŌ, Apr. 17, 1978, at 27 (statement by Tokuda before the Upper House Budget Committee on April 4, 1978 advocating bank mergers).

to fight a battle with the banks.<sup>88</sup>

Not surprisingly, the small banks fought Tokuda the hardest. They accused him of favoring the strong, and of advocating the survival of the fittest, which was the truth. When the chairman of Sumitomo Bank approached Tokuda about possible absorption of the smaller Kansai Mutual Bank, an entity that was not interested in merger, Tokuda promised his full support. Others in the MOF were less enthusiastic. The former Directors General of the Banking Bureau, who meet two to three times annually, cautioned Tokuda about acting too rashly. "Don't ignore the political clout of the mutual banks and the credit institutions," they warned.<sup>89</sup> Choosing not to heed their advice, Tokuda proceeded with the merger plans; the warnings of his seniors, however, were portentous. The merger scheme floundered, and Tokuda's campaign more or less ground to a halt along with it.

The chain of events began when the National Mutual Bank Association rallied to the aid of Kansai Mutual Bank. The Association maintained a united front against the expansionist ambitions of the big banks, which were without exception aimed at the biggest, healthiest mutual banks. After all, allowing the strongest mutual banks to be taken over would increase the threat of acquisition to the rest of those in the mutual bank industry.

Moreover, most small banks were managed by fiercely independent entrepreneurs who naturally have a particular aversion to being bought out by bigger institutions. In addition, they have considerable political clout by virtue of their importance in local communities, close ties with local businesses, and relationships with politicians from their district. Unlike big banks that give campaign contributions to the LDP as a whole, the small banks give to individual Diet members and to faction leaders, thus enhancing their influence over key policy makers. They also have more vote-gathering power than do big banks by virtue of their community role and the importance of personal ties at that level of financial transaction.

In September 1978, the Association held a two-day series of meetings (*Sōgin Kondankai*) to plan its line of defense. Of the seventy mutual banks present, sixty-nine opposed the merger and only one favored it. The mutual banks also enlisted the support of the other small financial institutions in opposing the merger. Tetsugorō Obara, chairman of the Credit Institution Association (*Shinyō Kinko Kyōkai*) stated to the press on September 21 that the merger posed a threat to the entire financial community. The MOF was

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88. S. NAKAJIMA, *supra* note 81, at 146-47; Interviews with Tokuda (June 1985 and June 1986); *Okura Jinmyaku no Kyōi*, SHŪKAN GENDAI, Sept. 24, 1981, at 52-56.

89. S. NAKAJIMA, *supra* note 81, at 148-150; Interviews with Tokuda (June 1985 and June 1986).

attempting to bulldoze them into making more room for the big banks.

Later, on November 16, Prime Minister Fukuda gave the keynote address at the annual Mutual Banks convention, indicating his support for their cause. Once it was clear how strongly opposed small financial institutions were to the merger, it did not take long for the talks between Sumitomo and Kansai Mutual to break down. On November 25, 1978, Tokuda informed Sumitomo's chairman that further discussion would be fruitless.<sup>90</sup>

To conclude from this serious setback that Tokuda achieved none of his goals during his tenure as Director General would, however, be a careless overstatement. In 1978, under his directorship, banks were permitted to issue certificates of deposit at market rates. As expected, there was opposition from thinly capitalized banks to this decision since this would raise the cost of capital generally and attract large deposits away from them, weakening their already fragile balance sheets. Instead, it was the large banks that welcomed the measure as a means of recapturing the corporate funds they had been losing to the repurchase securities (*gensaki*) offered by securities firms. Thus, the compromise solution was to permit certificates of deposit, while requiring that they be issued in large denominations so as to minimize the damage to weaker banks.<sup>91</sup>

Three decades, a foiled banking law, and two efficiency campaigns later, the MOF was not appreciably closer to a consolidated, easily managed banking sector. Granted, Japan's top banks had become world-class banks in the 1970s, 18 were in the top 100 and 62 in the top 500 by 1986.<sup>92</sup> Yet it was the many weaker banks that concerned the MOF because the MOF was trapped in the position of being guarantor for all. Operating a convoy was difficult enough when Japan was largely a closed economy. Now there were numerous leaks in the system, the largest being Japanese corporations' fund-raising abilities abroad. Domestic banks no longer had a corner on the market, which meant that banks had to compete on a global scale. The MOF, then, was more eager than ever to introduce some market winds into the greenhouse. The MOF would not let the small financial institutions pass away, but it could at least have an easier time consolidating the industry.

Since 1975, the MOF had been considering another banking law. Finally, in March 1979, after four years of deliberations, the Financial System Research Council produced a report stating that a sound banking system required further consolidation, stronger

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90. S. NAKAJIMA, *supra* note 81, at 153-212.

91. J. HORNE, JAPAN'S FINANCIAL MARKETS: CONFLICT AND CONSENSUS IN POLICYMAKING 193-211 (1985).

92. Lim, *The World's Top Banks*, EUROMONEY, June 1986, at 105.



MOF oversight powers with sanctions, higher net worth ratios, and stricter disclosure rules. Moreover, the Council recommended interest rates should eventually be market-determined, following a gradual transition period.<sup>93</sup> True to form, the banking community reacted promptly. Takuji Matsuzawa, speaking as chairman of the National Federation of Banks, stated that the only thing the industry really needed was the legal authority to engage in government bond retailing and dealing. Expanded MOF powers were not welcome; financial soundness should be based on banks' self-responsibility. Nor were more disclosure rules needed; banks should be free to present their books to investors and depositors as each bank sees fit.<sup>94</sup>

There were also those who were critical of the Financial System Research Council report for the opposite reason. Bunkichirō Horiga, a finance professor at Waseda University, argued that even with the new law as proposed, there would still be inadequate competition in the system. The MOF, Horiga felt, should take more decisive measures introducing market discipline into the financial system. In an editorial, *Nikkei* also criticized the council for being too timid. The Council, *Nikkei* suggested, should have urged the development of a short-term government bill market to speed the deregulation of interest rates. However, these voices of opposition did not resonate sufficiently throughout the public at large to launch a grassroots campaign for change.<sup>95</sup>

Despite the chilly reception by the banking community, Finance Minister Kaneko announced that the MOF hoped to submit within the year a draft of the new banking law to the Diet based on the Council's recommendations. In the general elections of September, 1979, however, the LDP suffered serious setbacks in both houses of the Diet. From the MOF's vantage point, the LDP, with its ties to various interest groups, was difficult enough to maneuver past. A stronger Opposition, however, would make matters worse. The Opposition, also tied to small business, was even more hostile towards the MOF's efficiency campaign than was the LDP. The MOF feared the Opposition would attempt to attach riders unfavorable to big business and big finance and otherwise obstruct the efficiency goals of the MOF.

In August 1979, the MOF did submit one bill, the Small Financial Institution Law (*Chūshō Kigyō Kinyū Hō*), to replace the Mutual Bank Law of 1950. As long as desired by the mutual banks,

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93. T. HIRATA, DARE NO TAME NO GINKŌ 226 (1981); *Mutanpo sai Kyō Chōin*, NIKKEI, Mar. 20, 1979.

94. *Jūnen Mono wa Ōhaba Asshuku*, NIKKEI, Apr. 28, 1979, at 1, rows 1-6.

95. *Shakai Teki Sekinin o Kyōchō*, ASAHI, June 8, 1979, at 9, rows 1-8; *Bunkichino Horiga Ka Hogo Taishitsu wa Fuhēn*, ASAHI, June 21, 1979, at 9, rows 1-6; *Ginkōhō Kaisei o Tōshin*, NIKKEI, June 21, 1979, at 1, rows 1-5.

the law would allow mutual banks to drop the "mutual" from their title, thus giving them greater credibility with the depositing and investing public. Secondly, restrictions on lending to large firms would be relaxed, allowing this class of banks to compete more directly with the larger local banks or even city banks. The MOF's purposes would also be served, since equalizing the different categories of financial institutions would introduce a greater degree of competition and thereby generate a natural selection process. Mergers would be inevitable, the MOF reasoned. However, the local banks fought a successful campaign with the LDP against the law, and the Cabinet's Legislation Committee (*Naikaku Hōseikyoku*) quashed the bill before it even reached the floor of the Diet for deliberation. The bill the Diet eventually passed in April 1981 allowed the mutual banks and other small financial institutions to engage in foreign exchange operations, but it required the mutual banks to keep their title.<sup>96</sup>

In the elections of June 1980, the LDP won by a large margin, in part a result of the public's condolences for Prime Minister Ohira who died amidst the campaign. Although banking was not a campaign issue, the stage was now set for the MOF to resubmit a banking law to the Diet. As always, the MOF was striving for a workable mix of carrots and sticks, knowing further steps towards greater competition would be impossible without positive incentives. The sticks were that banks would be required to meet stricter disclosure rules, with the effect that shaky banks would be exposed and forced to merge with stronger banks and that banks would have to reduce their loans to any single borrower to twenty-five percent of their assets, with the goal of foisting some of the costs of maintaining a stable banking system onto the banks themselves. In exchange, the sweetener would be to allow banks entry into the government bond business.<sup>97</sup> It appeared to be a brilliant plan.

Banks reacted with less than gratitude. They wanted the carrot without the sticks. Disclosure, lending considerations, and bank management should be matters of each bank's judgment, the banks argued. Furthermore, as discussed earlier, banks complained that the sweetener was not sweet enough; they wanted to retail and deal in government bonds now, with no hitches.<sup>98</sup>

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96. *Kokusai Kai Miokuri de Zokuraku*, NIKKEI, Feb. 22, 1980, at 5, rows 4-5; *Yonesato Ginkō Gyōsei o Hihansuru*, KINYŪ TO GINKŌ, Apr. 18, 1980, at 30-31; *Ginkō no Neu Ikkai Kessan*, NIKKEI, Apr. 17, 1981, rows 6-9.

97. *Shin Ginkōhō ni Meiki*, NIKKEI, Dec. 18, 1980, at 1; *Ginkō Shōken Sōhō no Mitomeru*, NIKKEI, Dec. 25, 1980, at 1; *Kinkyū Kaisetsu*, KINYŪ ZAISEI JUŌ, Jan. 12, 1981, at 16-17.

98. *Ginkō Okura An o Kyohi*, NIKKEI, Dec. 31, 1980, at 1; *Zenginkyō Okura An o Hihan*, NIKKEI, Jan. 11, 1981, at 1; *Shōken wa Fuzui Gyōmu ni*, NIKKEI, Jan. 14, 1981, at 3; *Dare no Tame no Ginkōhō Kaisei ka*, ASAHI, Jan. 15, 1981, at 1; *Ginkōhō Kaisei*, KINYŪ ZAISEI JUŌ, Jan. 19, 1981, at 14-20; *Ginkōhō Kaisei no Okura Hōan*, NIKKEI,

Banks took their case to the LDP. The LDP would do nothing to invite a sharp backlash from the securities industry, but it could do something about the MOF's sound-banking provisions. On February 17, at the *Nikkō* Seminar, a meeting sponsored by the securities industry, the chairman of the LDP Policy Affairs Research Council (PARC), Shintarō Abe, stated, "The proposed disclosure requirement and loan restriction are remnants of the post-oil shock anger at banks and big business."<sup>99</sup>

It is true that, through much of the 1960s and 1970s, the banking industry was the object of public criticism. Bank profits were hardly affected by the recessions that wreaked havoc on other sectors of the economy, and in good times banks did better than anyone else. In the aftermath of the 1971 oil shock, when Japan was wracked with severe inflation, banks lent huge sums of money to trading companies that in turn purchased large swatches of real estate before land prices peaked, thereby contributing to the inflation. The MOF, responding to pressure from the Diet in the early 1970s to do something about banks' supposedly irresponsible loans, but acting also with system stability in mind, had restricted the amount lent to a single customer to twenty percent of total net worth. The targets were to be reached by 1979. For the MOF, this had been a welcome opportunity to reintroduce the provision that had fallen to political opposition back in 1950.<sup>100</sup>

Most banks complied easily by 1979 with the net worth-loan rule, less because of their sacrifice than because of their increasing diversification of their sources of funds. In one case, however, *Mitsui Bank* was still overlent to *Mitsui Bussan*, which was struggling with a beleaguered petrochemical complex in Iran. Lacking legal sanctions, the MOF could do little more about *Mitsui's* defiance of administrative guidance than slap the bank's wrist; licenses for three new branches to open in 1980 were revoked. This time, the MOF wanted the legal authority to impose more serious penalties in order to enforce compliance.<sup>101</sup>

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Jan. 22, 1981, at 3; *Shōtorihō no Ninka Nokosu*, NIKKEI, Jan. 30, 1981, at 3; *Shin Ginkōhō*, TŌYŌ KEIZAI, Jan. 31, 1981, at 102-06; *Ōkura Shūseian o Kyohi*, NIKKEI, Feb. 3, 1981, at 3; *Ikkatsu Kaiseian Tsukuru*, NIKKEI, Feb. 5, 1981, at 3; *Yamada Kaichō ga Sengen*, NIKKEI, Feb. 11, 1981, at 3; *Ginkōhō Kaisei, Part II*, KINYŪ ZAISEI JIJŌ, Feb. 16, 1981, at 14-17; KINYŪ ZAISEI JIJŌ, Feb. 23, 1981, at 22-34.

99. Abe may or may not have known that there are public interest reasons for disclosure and lending ratios, such as to enhance prudential behavior of financial institutions. See, e.g., Suzuki, *Comparative Studies of Financial Innovation, Deregulation, and Reform in Japan and the United States*, in JAPAN AND THE UNITED STATES TODAY: EXCHANGE RATES, MACROECONOMIC POLICIES AND FINANCIAL MARKET INNOVATIONS 156-67 (H. Patrick & R. Tachi eds. 1987). In the United States, the rule is that a bank cannot lend more than 10 percent of its net worth to a single customer.

100. TŌYŌ KEIZAI, Apr. 4, 1980, at 38-41.

101. GINKŌ: SHOAKU NO KONGEN 95-115 (T. Kaminogo & K. Kubota eds. 1978); *Mitsui Bank*, Ōguchi Shinyō Kisei 173 (*Mitsui Bank mimeo*).

The economic and political environments had changed. Now, with lower profit rates and problems of their own, banks were perceived more as victims of MOF ambition than as villains against the public. "I doubt," said PARC Chairman Abe, "that these kinds of provisions would get through the Diet in this day and time. Even if the MOF carts them out, the Party won't go for them." Abe passed over the MOF's goal to foster competition. "In a time when private sector vitality is essential, excess regulation is counter productive. We'll only consider the bill after the MOF and banks have worked out their problems."<sup>102</sup>

An MOF official, responding to the press's inquiry, declared, "We don't know why Abe said what he did, but we still intend to bring the bill to the floor. The LDP's Public Finance Committee [*Zaisei Bukai*] and Financial Issues Study Group [*Kinyū Mondai Chōsakai*] have approved the bill already, and party discipline should apply in this case as usual."<sup>103</sup>

In fact, it was Abe's view, not the MOF's, that prevailed. Banks had reached an understanding behind the MOF's back, and the two LDP committees examining the bill retracted their approval. Junichiro Koizumi, chairman of the LDP Public Finance Committee, and even Ichirō Satō, a former vice minister of the MOF and chairman of the Financial Issues Study Group, turned against the bill. A few Dietmen, such as former MOF bureaucrat Takujirō Hamada, remained sympathetic to the MOF's aims, but they were in the distinct minority.

In joint sessions stretching from February to April, the Public Finance Committee and the Financial Issues Study Group redrafted much of the law. First, the disclosure requirements were all but removed. Banks were obliged to specify, in broad categories, who their borrowers were, and in what percentages. Second, no sanctions attended the lending limit provision, while the limit itself was raised from 20% to 25% of bank net worth, discounted bills excluded. Third, the MOF was foiled once again in its quest for the legal authority to eliminate bad bank management (*kaizen kankoku*).<sup>104</sup> On May 25, 1981, the LDP's version of the banking

102. *Ginkōhō Kaisei ni Shinchō*, NIKKEI, Feb. 17, 1981, at 1.

103. *Id.*

104. *Jiminnai ni Shinchōron*, NIKKEI, Feb. 18, 1981, at 3; *Ginkōhō Ketchaku no Gōi*, NIKKEI, Feb. 21, 1981, at 1; *Kokkai Teishutsu Jiki Bimyōni*, NIKKEI, Feb. 24, 1981, at 3; *Kisei Yurume Kyōshō Sokushin Nerau*, NIKKEI, Feb. 27, 1981, at 3; *Ginkōhō no Konkokkai Teishutsu*, NIKKEI, Mar. 3, 1981, at 1; *Genjōde Na Hōku Dekinu*, NIKKEI, Mar. 3, 1981, at 1; *Minaoshi e Gutaiteki na Ugoki*, NIKKEI, Mar. 5, 1981, at 3; *Zaisei Saikenho o Seitei*, NIKKEI, Mar. 24, 1981, at 3; *Ginkōhō Kaiseide Jimin Shunō*, NIKKEI, Mar. 25, 1981, at 3; *Ginkōhō Jimin ga Shūseian*, NIKKEI, Apr. 8, 1981, at 3; *Gyōsei Kosuto ni Mondai ten*, NIKKEI, Apr. 14, 1981, at 3; *Shin Ginkō Hōan, Ohaba Shūsei*, KINYŪ ZAISEI JIJŌ, Apr. 27, 1981, at 14-16; *Ginkōhō Kaisei to wa Nandatta no ka*, KINYŪ ZAISEI JIJŌ, May 4, 1981, at 98-101.

law passed the Diet, to become effective April, 1982.<sup>105</sup>

What accounts for the LDP's volte-face? Obviously, the LDP does not grant banks special favors automatically; banks literally had to pay for this one. It is not that banks and the LDP were not already friendly. Each of the 13 city banks, for example, reports contributions to the LDP on an order of ¥65 million to ¥75 million annually.<sup>106</sup> However, as long as banks' relations with the MOF were stable, there was no incentive to spend larger sums on political campaigns. The banks wanted the politicians to be there when needed. For revisions in the MOF's banking bill, however, banks collectively paid a reported ¥500 million over the usual contribution.<sup>107</sup>

When asked about the LDP's revision of the law, Finance Minister Watanabe responded, "That's politics."<sup>108</sup> The career bureaucrats were less sanguine. Banks had taken the carrot—the government bond business—and escaped the sticks. Relations between banks and the Banking Bureau had never been worse. This situation was as bad for the MOF as for the banks since the MOF depended upon financial sector cooperation to a considerable degree for smooth administration of its regulations. The MOF set about mending the frayed relationship, replacing Banking Bureau Director General Yonesato with a new man, Miyamoto, in June 1981. Miyamoto's position was that efficiency in the financial system was a medium-range goal rather than an immediate one. Nonetheless, Miyamoto maintained that the "convoy system" would have to be curtailed eventually, and the sooner the better.<sup>109</sup>

Although the MOF had intended to exchange bank entry into government bond activities for market discipline, it was the politicians who interceded and relaxed market discipline in exchange for political contributions. Apparently, the banks felt that escaping the MOF's stick was worth at least ¥500 million.

## VI. CONCLUSION

The Banking Act of 1982 is a snapshot, as it were, of a dynamic banking sector in a changing economic environment. This piece of new legislation affords us insight into the financial policy-

105. *Ginkōhō Hanseiki buri Koromogei*, NIKKEI, May 25, 1981, at 1; YOMIURI, Apr. 1, 1982.

106. Every year in early September the Home Affairs Ministry reports sources of political contributions.

107. This is allegedly a conservative estimate, and is easily within the legally permissible sum for each participating bank. Ikeuchi, *Zoku Giin to Riken 157*, (unpublished manuscript); *Sankata Ichiryū Son*, KINYŪ ZAISEI JIJŌ, Apr. 20, 1981, at 10-11; Utsumi, *Atsuryoku Giin ni Jittai*, GENDAI, Aug. 1982, at 141-58.

108. *Ginkōhō Kaisei Teishutsu Ya Hō Medo*, NIKKEI, Apr. 11, 1981, at 1.

109. *Jiyūka Gyōsei o Sokushinsuru*, KINYŪ ZAISEI JIJŌ, July 6, 1981, at 16-19.

making process, the nature of the bureaucracy, and the structure of the political system in Japan. This information, in turn, allows us to assess the prospects for financial deregulation in Japan.

### A. Financial Policy Making

As this legislative history demonstrates, there is no single form of financial policy-making in Japan. In the first instance, when dealing with competing claims of the banking and securities industries, the MOF presided over a compromise that both groups ultimately accepted. In the second instance, banks circumvented the MOF to obtain a political solution more to their liking.

The MOF, unlike comparable financial authorities in the United States, is capable of maintaining basic equilibrium among various types of financial institutions because the MOF is the umbrella over all of them. Undeniably, tensions among the Bureaus over policy choices often surface and are cited by the media as evidence that the MOF is "all bureaus, no ministry" ("*kyoku atte, shō nashi*"). This, however, is patent exaggeration. Compromise is the name of the Ministry's game, and many of the compromises are internal, since different Bureaus often reflect the interests of those they regulate.

Not only does the MOF have the institutional capability to present a common front, but a strong incentive to do so is built into the structure. Each bureaucrat is assessed more on the basis of his ability to further the common interests of the Ministry than of his Bureau. Rotation occurs regularly, every year or two, and the chances are that a Banking man will find himself in the Securities Bureau the next time around. In 1981, for example, when a Tax Bureau official was regarded to have pushed too hard for taxation at the expense of banks he was sent off to what was considered to be a less desirable and out-of-the-way post on his next rotation. Moreover, MOF bureaucrats do not have to negotiate with the private sector for post-retirement jobs during their tenure as officials because the MOF personnel division manages all such placements. Also, a rule prohibits bureaucrats from parachuting into a private sector job for the first two years out of the ministry.

Politicians become involved in policy-making when they believe they can reap a net gain. They left the banking-securities compromise to the MOF because the MOF had already found an acceptable compromise. To swing the balance in either direction would invite serious opposition from the aggrieved group. Conversely, when the political support of the competing groups is uneven, political involvement is assured. Private sector demand is, therefore, a necessary but insufficient condition for politicians' direct involvement in formulating financial policy.

## B. The Power of the MOF

Conventional wisdom no longer holds that Japanese economic policy-making is bureaucrat-led. Even in the formulation of financial policy, the MOF's power, that is its ability to enforce autonomously made decisions, is minimal. The regulated parties have an appellate court, namely the politicians. While it is true that MOF's administrative guidance circumvents the legislative process, banks comply only if they feel they are fairly compensated.

The MOF's autonomy is greatest when dealing with competing interest groups of roughly equal political influence, but still the MOF must work with a narrow range of acceptable solutions. If either side were to deem the compromise too costly, it could pay the Liberal Democratic Party to enforce the equilibrium point. There is no reason for the MOF to slip up, however, because the MOF constantly avails itself of each group's reaction even while forging compromise solutions. In addition to meeting frequently, both formally and informally, with leaders of the financial community, MOF bureaucrats engineer leaks to test reactions before committing themselves to controversial policy positions.

The MOF has the least room to maneuver when working with a single, well organized group. The case in point is the success of banks in keeping to a minimum the costs they bear for the stability of the financial system. In a world of increasingly effective international yield arbitrage, banks still enjoy a considerable degree of domestic protection.

However, the MOF has some allies within the banking community, at least on some issues. As Japanese firms' increasing access to the virtually unregulated Euromarket provides large scale investors and borrowers with attractive alternatives to staying at home, domestic banks have either to lose business or to make their own deposits and loans more competitive. This has driven a wedge between the large, strong banks that can compete in an open market and the weak banks that cannot.<sup>110</sup>

Large banks, for example, began agitating some time ago for deregulation of certain interest rates, while small banks continued to resist. MOF's compromise solution was to deregulate large denomination instruments, while keeping small deposits regulated.<sup>111</sup>

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110. Though a large bank is not necessarily strong and a small bank not necessarily weak, there is a strong correlation due to economies of size and scope. Niche banks must be very good at what they do to survive in an open market.

111. In an example of big banks breaking the ranks, in the fall of 1984 the country's top five banks announced their decision to issue equity at the market price. Traditionally, banks had parceled out shares to existing shareholders whenever they wanted to raise capital, fearing loss of control. But now higher capital ratios were becoming key to competing with foreign banks abroad. *Togin Hatsuno Jika Hakkō Zōshi*, NIKKEI, Oct. 3, 1984, at 1.

Large banks have also been eager to begin new lines of business, such as trust banking and long-term banking, that have traditionally been off-limits to regular banks in the interests of minimizing competition. Their efforts have been only partially successful in these areas because of severe opposition from financial institutions enjoying the protection.

The obvious solution for the MOF, were it primarily concerned with developing a stronger, more durable financial system, would be simply to allow small banks to go bankrupt. Yet, there are still major obstacles. Japan lacks the safety net of a sturdy deposit insurance system, and there are strict bank disclosure requirements. While individual depositors in the United States are insured up to \$100,000 (¥15 million at ¥150 to the dollar), the Japanese depositor was only insured up to ¥3 million until recently and up to ¥10 million after 1986. To allow banks to fail in this environment would be to risk panic.

In 1984, when the MOF proposed upgrading the deposit insurance system, along with a rider allowing the MOF to force mergers, the banks opposed the motion and the bill got nowhere. By the time the bill finally passed the Diet in May 1986, the rider giving the MOF merger power had disappeared, and the cost increase to the banks was less than the increase in deposit protection.<sup>112</sup> Large, strong banks bore a disproportionate part of the cost, given that they were the least likely to make use of the pool of funds. Nonetheless, the increased payments were relatively small: from ¥8 per ¥100,000 of deposits to ¥12 per ¥100,000, for a three-fold increase in coverage to ¥10 million. This was half the coverage in the United States. Presumably, the Bank of Japan would still have to function as the lender of last resort on the occasion of a bankruptcy. Moreover, by way of compensation, the MOF further reduced the reserve requirements for bank deposits. On net, it was not clear whether or not the MOF was shifting any appreciable cost of stability onto the banks.<sup>113</sup>

In attempts to introduce stricter disclosure requirements in the new Banking Law, the MOF failed even more miserably. The MOF has been unsuccessful in forging a coalition even with big banks on issues where market forces have not already acted. While large banks could certainly withstand greater disclosure, they would rather not do so.

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112. *Yokin Hoken Kikō ni Kensa Ken*, NIKKEI, June 26, 1984, at 1; *Koguchi Yokin mo Kinri Jiyūka e*, NIKKEI, Oct. 12, 1984, at 1; *Jiyū Hōnin Shugi*, ZAIKAI, Sept. 18, 1984. Miyauchi, the Director of Research at the National Association of Mutual Banks, says the MOF is still not in a position to allow any bank to fail.

113. Nakamura (Assistant Director of the Research Division, Banking Bureau), *Yokin Hokenhō Oyobi Junbi Yokin Seido*, ZAIKEI SHŌHŌ, Mar. 31, 1986, at 2-6; Proceedings of the Finance Committee, House of Representatives (May 24, 1986).



### C. Financial Policy-making and the Theory of Regulation

The pattern of financial policy-making in Japan, at least in the wholesale end of the market,<sup>114</sup> corroborates the predictions of George Stigler's supply and demand theory of regulation.<sup>115</sup> The theory of regulation, in its simplest terms, posits that regulation transfers wealth from consumers to regulated groups in the economy. The presumption is that all producer groups benefit from protection from competition and, through their campaign contributions to politicians, see to it that regulation reflects their needs. Politicians are typically willing to confer the favored regulation in exchange for campaign support because the general public (which is hurt by the restriction on competition) is too dispersed to gain accurate information about their plight, has an inadequate per capita stake in policy outcomes to be aroused, and faces tremendous collective action barriers to organize with like-minded consumers to take action. In Japan, financial institutions have long been coddled with competition-inhibiting regulations at the expense of consumers of financial services.

James Q. Wilson and others have pointed out that, at least hypothetically, maverick politicians should emerge as entrepreneurs to expose the protective regulation in order to gain new votes among heretofore unwitting, unorganized consumers.<sup>116</sup> Given the LDP's close relations with the financial sector, why have the Opposition parties in Japan failed to seize the initiative, exercise political entrepreneurship, and incite the slumbering public to vote for their own interests? One answer might be that the public's interest is not clearly in the deregulation camp. After all, the MOF has not allowed a single bank to fail since World War II. On the other hand, banks' profits suggest that small depositors have been paying a very high, mandatory premium for security.

Another more plausible answer is that the Opposition parties are tied to their own special interests, labor for example in the cases of the Socialist Party and the Democratic Socialist Party. Labor is

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114. The theory of regulation would predict that no deregulation take place in the retail end of the market because small consumers are no match in the regulatory process for the organizational clout of financial institutions. This is not entirely borne out in Japan because, unlike in the wholesale market where the MOF oversees the entire landscape, the MOF and the banks compete against the postal savings system regulated by the Ministry of Posts and Telecommunications. In the absence of an effective interbureaucratic coordinating mechanism, the two ministries have waged a "100 Year's War" over the regulation of interest rates. The consumer has benefitted to some extent from this lack of coordination, which allows small deposit rates to be higher than they would otherwise be. See F. ROSENBLUTH, *FINANCIAL POLITICS IN CONTEMPORARY JAPAN* (1989).

115. Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3-21 (1971).

116. J. WILSON, *THE POLITICS OF REGULATION* (1980).

no more eager than is weak management for a consolidation of the banking industry if it would mean paring down the work force. Labor's concern has more to do with working conditions for bank employees than with deposit returns for the general public. Labor's strongest push in the Diet's Banking Law debates was to reduce bank employees' work week from six to five days.<sup>117</sup>

Financial deregulation occurs in Japan when regulations no longer suit the needs of the financial institutions that benefitted from them in the first place. Since this process usually entails adjustment among different types of financial institutions, as in the case of bank entry into the government bond secondary market, the MOF proceeds cautiously in an attempt to balance the interests of the various types of financial institutions to avert unwanted intrusions from the politicians, who have ultimate regulatory authority. This means keeping policy outcomes in line with the political resources of the competing groups.

Although beyond the scope of this article, Japanese corporate access to the competitive Euromarket is probably the single most important stimulus toward financial deregulation in Japan. Unable to stop corporate clients from taking advantage of attractive financial services in the Euromarket, Japanese banks have responded by making their domestic services more competitive and have softened their resistance to domestic bond market deregulation. However, the MOF will continue to play its role of balancer, ensuring that the interests of one group of financial institutions does not step far ahead of the others.

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117. *Shin Ginkō Hōan ni Taisuru Kakutō no Kenkai*, KINYŪ ZAISEI JIJŌ, May 4, 1981, at 90-96; *Ginkōhō Kaisei nado o meguru Shūgiin Ōkurai no Shitsugi*, KINYŪ ZAISEI JIJŌ, Nov. 3, 1980, at 38-41.