THE POLITICS OF FINANCIAL DEREGULATION IN JAPAN: THE CONCEPT OF APOLITICAL PACT*

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CONTENTS

INTRODUCTION

The Japanese financial system has undergone substantial changes since the mid-1970s. The changes in the financial system reflect its changing circumstances: a shift to stable economic growth and the accomplishment of rapid economic growth. The former has to do with an issue of huge governmental bonds and higher sensitivity to interest rate differentials, and the latter with an increase in financial assets and an increasing attractiveness of the Japanese market for foreigners. According to economists' explanations, the financial revolutions took place because these economic circumstances changed and financial institutions responded to them in order to survive. The changing needs of suppliers and users of funds were the major factors behind the introduction of new techniques and financial products.

The rate of introduction, however, was not necessarily synchronized to meet immediately the needs of the market. Demands were converted into policies through a political system. In this paper, we focus on political and administrative dimensions of the financial revolution. The problem is this:

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what roles have political and administrative actors played in these changes?

A few political scientists have examined financial development in Japan. James Horne focused on the role of the LDP in the development of the financial system[1]. He identifies the commitment and influence of the LDP in several policy areas such as the establishment of government financial institutions, the maintenance of low interest rates and the continuation of a separate postal savings system[2]. In his view, politics functions as a buffer to slow down the general process of deregulation. He says, "In the more political areas change was often delayed by the fear that adjustment to the status quo could have a negative effect on the LDP's electoral backing."[3]

This paper, in contrast to Horne's opinion, will assert that financial changes were delayed because finance as a policy area had been depoliticized according to an agreement between the MOF and banks: The banking sector could not rely on the LDP to circumvent the MOF, which resulted in delayed deregulation. Politics, in specific political leadership, promoted changes in the financial system.

Frances Rosenbluth examined three explanations of Japanese financial deregulation[4]. The first explanation is that Japan is a reactive state, and the United States and several European states have gradually forced open Japan's closed financial door. The second is that the Ministry of Finance has compelled Japanese financial institutes to conform to changing world conditions. A third explanation of Japan's deregulation holds that Liberal Democratic Party politicians are the key players. After looking into the deregulation process in detail, she concluded that "deregulation has been propelled by financial institutions, acting in cooperation with the Ministry of Finance and sometime politicians, to construct a new set of rules they need to compete in a changing economic environment"[5]. She uses financial deregulation as a vehicle for modeling the Japanese political system and her characterization resembles Richard Samuels's "reciprocal consent"[6] and Daniel Okimito's "network state" or "market conforming policy"[7].

1) James Horne, *Japan's Financial Market*, 1985.
2) James Horn, "Politics and the Japanese Financial System", in *Dynamics and Immobilist Politics in Japan*, ed. by J.A.A. Stockwin et. al., 1988 p. 172.
3) Horne, "Politics and the Japanese Financial System", p. 198.
4) Frances Rosenbluth, *Financial Politics in Contemporary Japan*, 1989, pp. 2–4. See also, Frances Rosenbluth, *Political Economy of Japan's Financial Deregulation*, Ph. D. dissertation for Columbia University, 1988.
5) Rosenbluth, *Financial Politics in Contemporary Japan*, p. 5.
6) Richard Samuels, *The Business of the Japanese State*, 1986.
7) Daniel Okimoto, *Between MITI and the Market*, 1989.

This paper will address different questions from Rosenbluth's works which aim to identify the propelling forces in policy changes. That is, why were policy changes processed more slowly than market forces would have expected and why did they accelerated at a certain time? I will present my working hypothesis for answering those questions.

The MOF and the banking sector had made a pact to minimize the intrusion of politicians into financial policy making. Finance was the last policy area to be politicized. The **apolitical pact** had benefited both the MOF and banks. It protected the MOF's autonomy, elite status and jurisdictional boundaries which the MOF gave the highest priority in its hierarchy of objectives[8]. Banks had no incentive to politicize financial policy making because the existing administration-dominant policy process secured suitable profits for them. Thus, this dominance by the MOF was actually the choice of the banking sector itself.

As the economic environment changed and banks began to call for changes in the system, however, the apolitical pact came to limit the activities of banks. It prohibited the banking sector from calling upon the power of political representatives. Given the negative stance of the MOF toward financial deregulation, there was left only the option for banks to resort to the LDP, but this meant breaking the apolitical pact with the MOF. It was risky conduct for them since they were strictly supervised by the MOF. Consequently, the banking sector was left with no choice but to follow the MOF's timetable for gradual deregulation, sometimes in conjunction with re-regulation.

In the end, the pact was broken by external forces in a way which was unexpected at least for the MOF: foreign pressures to open the Japanese financial system. Since then, the LDP and Prime Minister have entered the picture and helped realize the demands of the banking industry. At the present time, the MOF is in the process of reevaluating its strategy and restructuring its organization.

In this paper, I will examine the dynamics of the financial revolution in contemporary Japan in order to identify the limits of the MOF's dominance in financial policy making.

8) John Campbell, *Contemporary Japanese Budget Politics*, 1977, p. 111.

1. Regulated Financial System

Before examining changes in economic circumstances and their impact on the financial system, we have to note the features of the Japanese financial system before the changes, that is in the high growth period.

The first feature is functional specialization. The Japanese financial system is segmented into several specialized sectors. The first line of division is drawn between the banking business and the securities business, by Article 65 of the Securities Exchange Law of 1947, modeled after the Glass-Steagal Law of 1933 in the United States. The second is the division between short-term and long-term financing. While three long-term credit banks (the Japanese Long-Term Credit Bank, the Japanese Development Bank and the Export Import Bank of Japan) supply long-term funds to nonfinancial sectors by issuing bank debentures, other banks supply short-term funds by gathering saving deposits. The third is the division between financing for big businesses and financing for small and medium-sized businesses and agriculture. Along this line, city banks, regional banks, mutual banks, credit associations and credit co-operatives are recognized. Moreover government financial institutions for small business were founded in order to solve the dual structure problem of the Japanese industrial structure.[9] Among them, the People's Finance Corporation, the Small Business Finance Corporation and the Central Cooperative Bank for Commerce and Industry are important examples.

This specialization has been to some extent effective in preventing financial institutions in one sector from entering other sectors, thereby restraining intra- and intersectional competition.[10]

In this field of regulation, the tasks of the MOF are twofold. The first is to maintain the boundaries between sectors, which has been carried out not only by law, ordinances and other forms of guidance but also through management by separate organizations in the MOF[11]. The banking business is supervised by the Banking Bureau and the Security business by the Security Bureau. In the Banking Bureau, in addition, there are three institution-oriented divisions: the Division of Banking for city banks and regional banks,

9) See Kent E. Carder, *Crisis and Compensation,* 1988, pp. 318–322.

10) Hamada and Horiuchi, "The Political Economy of the Financial Market", in *The Political Economy of Japan, Vol. 1,* ed. by Kozo Yamamura and Yasukichi Yasuba, 1987, p. 235.

11) James Horne, "Politics and the Japanese Financial System", p. 173.

the Division of Special Finance for government financial institutions and the Division of Small and Medium Finance for mutual banks and credit associations and credit co-operatives. The second task is to keep order in respective financial subsectors. In the banking sector, the Banking Bureau controlled the rate of expansion of branches and the types of financial products. The regulation of interest rates prevented banks from competing with each other in the market. In the securities sector, the Securities Bureau also controlled the rate of expansion of branch networks, the rules of governing corporations' entry into the bond issue market, the character of the secondary bond market in some areas and the interest rate on bonds in the primary market.

The second feature of the Japanese financial system is regulation of interest rates. Interests rates have been regulated very comprehensively during the past three decades. Interest rates for bank deposits and short-term bank loans are regulated by the Temporary Interest Rate Adjustment Law enacted in 1947. Private banks fix the short-term prime rate at a constant margin above the official discount rate based on this law. Long-term loan rates and bond-issue interest rate are, though not directly regulated by law, determined by an implicit cartel arrangement among large financial companies. In this field of regulation, the task of financial authorities is to fix several interest rates in narrow range.

Because of an artificially low interest rate policy, demand for funds always surpasses supply. The commercial banks could not satisfy all demands for industrial funds. The shortage of funds was alleviated by direct loan from the Bank of Japan(BOJ). This phenomenon is called "over-loan", which allowed the BOJ to use "window guidance" as major tool in the implementation of monetary policy.

As a result of the regulation of interest rates, banking sectors undertook no-price competition and used "compensating balance" (kosoku yokin). The expansion of branch offices was especially crucial to bank management. The more branches a bank develops, the more funds one gathers. Because the MOF officials were responsible for branch administration and determined number and geographic distribution of branch offices of each bank, they exerted powerful and important influence over the banking sector[12].

The third and last feature is international isolation. The Japanese financial system was relatively isolated from the international market.

12) Hamada and Horiuchi, *op. cit.*, p. 237.

During the high growth period, the Japanese monetary authorities closely regulated capital inflows and outflows in order to maintain sufficient levels of foreign reserves under the fixed exchange rate system. This control is a sufficient condition for the domestic regulations to work as expected. If the Japanese financial market was open to the foreign investors and the Japanese investors had easy access to the foreign markets, the regulated system could not endure. As T.J. Pempel has noted, in an era of high economic growth, the Japanese government served as a doorman between domestic society and the international arena, determining what could enter and leave Japan and on what conditions[13)]. While such control assuredly did not insulate Japan fully from international developments, it moderated its impact on the society. In financial sectors, however, isolation policy was more complete than in nonfinancial sectors.

Isolation policy in the financial sector along with other sectors was possible because Japan is a medium-size country. As Peter Katzenstein has mentioned, the European small countries, "because of their small size, are very dependent on world markets, and protectionism is therefore not a viable option for them."[14)] In contrast, Japan could choose financial isolation policy because it had a relatively large domestic market filled with more than one hundred million people with a high propensity toward deposit. At the same time it was neither so large nor attractive enough for foreign capital to be induced as it is now.

2. Changing Circumstances

As for changes in economic circumstances, two points are important. The first is a shift to stable economic growth and the second is the accomplishment of rapid economic growth.

For many years after 1949, the general account of the national budget was based on a balanced-budget policy and not on long-term borrowing. In FY1965 the balanced-budget policy was abandoned, and long-term bonds were issued as a means to supplement tax revenues, which declined because of post-Tokyo Olympic recession. Until FY1974, however, borrowing was only marginal source of revenue. The average bond dependency ratio was

13) T.J. Pempel, "Japanese Foreign Economic Policy", in *Between Power and Plenty,* ed. by Peter Katzenstein, 1978, p. 159.

14) Peter Katzenstein, *Small Sates and World Markets: Industrial Policy in Europe,* 1985, p. 24.

about 10% from FY 1965 to FY 1974.

A significant change, however, occurred in the supplementary budget of FY 1975. Tax revenues dropped sharply because of the recession caused by the oil shock. Consequently, it became necessary to increase the bond dependency ratio from initial budget level of 9.4% to 25.3%[15].

The scarcity of public bonds was crucial to the financial mechanism before 1975. Secondary markets for bonds were not developed and suitable substitutes for bank deposits were not introduced. The MOF prohibited the underwriters from selling national bonds on a secondary market because the MOF believed that the development of such a market would make it difficult to enforce the artificially high issue prices of national bonds on the syndicate of national bond underwriters. But the development of a secondary market became indispensable to the smooth absorption of a large volume of national bonds by the financial markets. The MOF unwillingly permitted members of a syndicate (banks and other financial institutions) to sell national bonds they had underwritten in 1977.

Because the government has issued 10-year-maturity bonds since 1975, large-scale government bond maturities arrive in and after 1985. City banks became aware of the impact of maturing bonds on their business around 1980[16]. That is, non-financial sectors can buy the bonds which will mature in a couple of years in the secondary market instead of savings media such as time deposits, if free interest rates on such bonds are higher than regulated interest rates on financial products supplied by banks. This concern led banks to re-examine the regulated interest rates system.

The second factor was increasing financial assets brought about by the accomplishment of high economic growth. The level of financial assets held by households and firms at the end of the Second World War was quite low. Because economies of scale are also applicable to financial transactions, they faced substantial transaction costs, which prevented them from diversifying their assets and greatly biased their portfolios toward both safe and divisible assets such as bank and postal savings deposits. Thus, the low level of accumulated financial assets and the associated transaction costs allowed the banking sector to become a predominant influence in postwar financial markets[17].

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15) Yukio Noguchi, "Public Finance" in *The Political Economy of Japan, vol. 1,* p. 192.
16) Saitho Seiichi, *Gendai Kin-yu Nyumon (An Introduction to Japan's Finance),* 1985, p. 137.
17) Hamada and Horiuchi, *op. cit.,* pp. 229–230.

As financial assets were accumulated, both corporations and households became more sensitive to the profitability of the assets that they held. These changes expressed themselves in altered behaviour of corporations, households and the government with respect to financial transactions. In order to improve the efficiency of financial transactions, there was a greater need for methods of transaction that did not limit interest rates or participation. There rose the latent demand for financial innovations that sought to circumvent the regulations.

3. Responses of Financial Sectors and Strategy of the MOF

Because corporations now held surplus funds, they sought to invest those funds efficiently through circumvention of deposit interest rate regulations. One method of doing this was to shift funds from three- to six-month time deposits into *gensaki market* (repurchasing agreement). This is the only short-term, negotiable instrument available to corporations with surplus funds. Although gensaki market had existed since late 1940s, it took a great leap around 1975. Maturing bonds were also becoming a substitute for time deposits in nonfinancial sectors. An innovation for smaller transactions, a medium-term government bond funds (Chukoku Funds) was also made. Chukoku Funds are liquid assets but also pay yields higher than those on short-term deposits. They were also an effective means by which households and small- and medium-sized corporations could circumvent interest rate regulations.

These new products reduced the ability of banks to gather deposits and caused a rapid decline in the role of banks in total financial intermediation, which drove them to introduce liberalized interest-bearing financial products. The larger city banks in particular, because they supplied funds to big companies with surplus funds to be absorbed in gensaki market and the secondary market of the national bonds, were eager to introduce counter-products, certificates of deposite(CDs), which are negotiable deposits of up to six months' maturity with free interest rates, But the MOF at first (in the late 1960s) expressed no interest in their demand because deregulated interest rates might pose a threat to its control.

The position of the MOF had changed when the CDs debate was reactivated in the late 1970s when the problem of maturing bonds became a reality. The shift in deposit shares and the significant expansion in government demand for funds in the bond market after 1975 led the MOF to support the introduction of CDs. In 1979, the banks introduced CDs. Although the Banking Bureau still supports the idea of regulated interest rates, the Budget Bureau, which was responsible for making the national budget and interested in enough revenue to finance the budget, became a more vocal supporter of interest rate deregulation.[18] An introduction of CDs reduced the meaning of interest rate regulations[19] and strengthened competition between banks and securities companies. As a result there has been a partial relaxation of the segmentation of business between the two types of institutions.

Along with reducing segmentation between banking and securities, the MOF began to reconsider the separation between long- and short-term business. Under the Long-Term Credit Law, as mentioned before, only six financial institutions can issue five-year bank debentures whenever they need to raise long-term lending funds. Commercial banks are not allowed to float such debentures. The maximum term under which commercial banks can raise funds is three years. While commercial banks have become more dependent on long-term lending activity, banks are increasingly facing "mismatching" of maturities on deposits and loans, which makes them more vulnerable to risks stemming from interest rate fluctuations. Commercial banks, in particular, city banks thus call for government measures them to enable them to freely issue fund-raising debentures. In opposition to ordinary banks' demands, the long-term credit banks point to the merits of specialization and division of labor and seek to the continuation of the regulations while stepping up their short-term loan business. The MOF at first responded negatively to the demands of the ordinary banks, and changed its position after the Yen-Dollar Committee met, as mentioned later in this paper.

The last issue was relaxation and abolition of foreign exchange regulations. Pressure for the relaxation or abolition of exchange regulations gained strength with the increased incentives for international capital transactions that accompanied the shift to floating exchange rates in 1973. The MOF, however, did not take a positive stance on the internationalization of financial markets. They have retained many regulations that they felt were necessary to preserve the system of functional specialization in domestic

18) Horne, "Politics and the Japanese Financial Politics", p. 186.
19) Yoshio Suzuki, *The Japanese Financial System*, 1987, pp. 46–47.

financial markets. The Three-Bureau-Agreement is an example. In 1974, three bureaus in the MOF, Banking, Securities and International Finance, agreed to impose regulations on the underwriting activities of Japanese banks in foreign markets. These regulations corresponded to those in the domestic market separating securities activities from banking activities. Moreover, Japanese ordinary banks are prohibited from using, in Japan, funds acquired by issuing long-term liabilities in foreign markets. The purpose of this regulation is to support the position of long-term credit banks in domestic funancial markets.[20)]

Regulations were eased in stages after 1977, and the revised Foreign Exchange and Foreign Trade Control Law of 1980 liberalized all capital transactions in principle. In this issue also, more types of liberalization started after the Yen-Dollar Committee.

Some observers viewed the MOF as a promoter of financial deregulation and said that the MOF was deregulating Japan's financial markets because it deemed Japanese financial institutions now competitive enough both in the domestic and world economy to take advantage of freer financial markets.

The MOF, however, did not take a positive role in financial deregulation. First, the MOF had a negative stance toward the development of a secondary market for national bonds because as a budgeting authority it had to maintain the artificially high issue prices of national bonds[21)]. Secondly, the MOF was at first disinterested in the demands of city banks to introduce CDs. It took almost ten years for the MOF to change their attitude toward the liberalization of interest rates. Thirdly, by the Three-Bureau-Agreement, the MOF decided to preserve the system of financial specialization. The MOF made only step-by-step concessions to the demands of financial institutions rather than initiating the change. In the view of the MOF, financial deregulation should be done at a slow pace so that it does not disturb domestic financial order. At the same time, deregulation should be compensated for with re-regulation.

Revision of the Banking Act in 1981 was an attempt by the MOF to change its de fact authorities in banking administration into de jure

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20) Hamada and Horiuchi, *op. cit.*, p. 254.

21) Masataka Nakajima, *Nihon no Kokusai Kanri Seisaku (The Japan's Policy for National Bonds Management)*, 1977, chapter 7.

authorities[22]. The old Banking Act was enacted in 1927 and was not revised even under the occupation. It was long-lived because MOF's regulatory policy came from its use of administrative guidance and the Banking Act served as only a guideline[23]. In facing demands for domestic deregulation from the banking sector and making a partial concession to them, the MOF was driven to define in legal terms what it could do hereafter.

In short, the MOF was planning to deregulate the financial system at a moderate pace against banks' demands for rapid deregulation. The MOF's dominance over the financial administration made this possible. Financial policy process was apolitical by nature. It is highly technical, continuing from year to year unlike budgeting, and administered not by law but by administrative fiat. Keeping the financial policy process apolitical was, however, based on an agreement between the MOF and the banking sector. Certainly banks have been consistent contributors to the LDP, but they generally have avoided becoming too close to individual LDP politicians. In the views of banks, the LDP is important because it has maintained stable economic circumstances for the banking sector not because it supplies benefits to individual financial institutions. To commit an individual politician is rather risky and costly for banks. Consequently, the banking industry has been a less politicized arena than other industries. This prohibited banks from using the LDP to realize their requests. This negative attitude of banks toward political maneuvering also explains why when the MOF defined banks' rights to deal government bonds in the new Banking Law, banks received a disadvantageous treatment in comparison with securities.

4. Economic Friction Problem: From Micro To Macro

Japan has a long history of trade friction problems with the U.S. It started with textile and footwear in the late 1960s, and moved to steel, color TVs and auto mobiles, before changing to semiconductor and super computer in 1980s. Issues of trade friction developed from labor intensive through capital intensive to knowledge intensive industries, as the "product cycle" theory suggests. Because high technology industry has a more

22) The other purpose was to settle debate about legal interpretation of banks rights to engage in the security business: types of securities operation in which banks may participate.

23) Tsuchida Masaaki, "Ginkouhou no Kaisei ni tuite", in *Kin-yu (Finance)* No. 411.

strategic importance for the U.S. than for Japan, and because Japan has a comparative advantage in some items in this field, the trade friction will become more intensified.

Since 1981 when the balance of payment of the U.S. has deteriorated, the U.S. government has demanded the Japanese government open either the rice market or the financial market. These two sectors had been supposed to be "sacred cows" by respective reasons and therefore were left untouched as trading issue for a long time.

Agriculture is the cornerstone of the conservative ruling party in Japan as well as in other countries. With the process of economic modernization after the Second World War, the number of farmers has decreased drastically, but their importance for the LDP in elections has not decreased at the same pace as their number "because of the gerrymandered system of electoral districting"[24]. The population in metropolitan districts exceeded 40% of the national total in 1984, but they elected only 100 out of the 511 seats in the Diet (less than 20%). By contrast, although eligible voters in the sector represented only about 20% of the national electorate, the districts in which they were located elected about 30% of the Diet. In spite of its relative small size agriculture is crucial to the LDP's majority. This simple fact will explain why trade frictions over agricultural products such as beef and oranges are politically hard to resolve[25].

If the aim of the U.S. government is to recover its trade imbalance, however, "beef and oranges" is not important by itself. Even with complete liberalization of the Japanese markets, exports from the U.S. to Japan would amount to only $500 million, which is marginal compared with the total amount of trade between the two countries, $40 billion in the late 1970s. Beef and oranges are not more than a symbol of closed Japanese markets. The true target of the U.S. in pressing Japan to open the markets for agricultural products was rice.

Although in any country financial industries are more heavily regulated than other industries, the Japanese financial system is one of the most strictly regulated one among all modern industrialized countries. Some observers state that the Japanese financial system has promoted economic development and her miracle may be explained at least partially by the

24) Daniel Okimoto, "Political Inclusivity", in *The Political Economy of Japan: Vol. 2,* ed. by Takashi Inoguchi and Daniel Okimoto, 1988, p. 327.

25) I.M. Destler and Hideo Sato, ed. *Coping with U.S.-Japan Economic Conflicts,* 1982, chapter 4.

administrative manipulation such as window guidance possible under the regulated financial system[26]. Others argue that the financial system is the very driving force of high economic growth in postwar era Japan[27]. In spite of obvious intervention by government into the financial system, however, finance has not become an agendum between the two countries for a long time. The MOF also thought that trade friction problems relating to finance were none of its business.

In the 1980s some industrialists in the U.S., however, combined an undervaluated yen with the strictly regulated Japanese financial system and complained that Japan government manipulated the exchange market to decrease the value of the Japanese currency, which led to expansion of the U.S. trade imbalance. Lee Morgan, chairman of Caterpillar Tractor, presented the Solomon Paper to President Reagan in September 1983. Morgan told the President that his company and hundreds of others were losing billions of dollars worth of orders at home and abroad simply because a severely cheapened yen let Japanese competitors underprice them. The cheap yen, he asserted, was like giving Japanese exports as a 20% subsidy while putting a 20% tariff on American goods[28]. The paper entitled "Misalignment between Dollar and Yen" argued that the single most important cause of the U.S. trade imbalance was a prolonged misalignment of the currency exchange rate between the Japanese yen and the U.S. dollar, and the reason for the chronic undervaluation of the yen is a highly-regulated financial system in Japan which controls capital flows in order to maintain low interest rates domestically. One of the most important Japanese policies that affects exchange rate, the paper says, was regulated interest rates, which discouraged investment in Japanese securities by non-residents and encouraged residents of Japan to invest in foreign securities. A dispute on economic problems between two countries entered a new dimension: finance friction[29].

Which market, agriculture or finance, would become an agendum depended on the Japanese government's decision, and the Nakasone government chose opening the financial market and deregulating the financial system. It was reported that Prime Minister Nakasone made a commitment

26) Ira Magazine and Thomas Hout, *Japanese Industrial Policy*, 1980.
27) John Zysman, *Governments, Markets, and Growth*, 1983.
28) *The Japan Economic Journal*, May 8, 1984.
29) Heizo Takenaka and Naoko Ishii, *Nichibei Keizai Ronso* (Japan-U.S. Economic Controversy), 1988, p, 44.

to President Reagan to undertake liberalization measures in the financial markets by May[30]. Nakasone's choice was easy to understand. While farmers were opposed to opening the rice market, financial sector as a whole welcomed the internationalization of the Japanese financial markets.

Thus, the yen-dollar problem was treated as the most important economic issue between two countries when Reagan visited Japan in November 1983. A joint announcement by Finance Minister Noboru Takeshita and Treasury Secretary Donald Regan contained a number of concrete measures that would begin to deregulate the Japanese capital markets, increase the yen's use internationally, and help raise the value of the yen. Moreover two countries decided to establish the U.S.-Japan Ad Hoc Committee on the Yen-Dollar, to survey the progress of Japanese actions and to examine the additional possible actions by the Japan government. Mr. Nakasone urged Vice Finance Minister Tomomitsu Oba, co-chairman of the Yen-Dollar Committee to solve the finance friction problems immediately[31].

In 1984, the Report of the Yen-Dollar Committee was issued, and broad measures for financial internationalization were adopted. The major points of the report were: 1) liberalization of interest rates on large denomination deposits within a course of two or three years; 2) abolition of the restrictions on the conversion of foreign currencies into the yen; 3) granting approval to foreign banking institutions to enter the Japanese trust market on their own.

The single most significant thing in the announced measures was that the Japanese Government showed its schedule for liberalization of interest rates on large denomination deposits; in specific, to lower the minimum denomination of CDs from ¥300 million to ¥100 million by May of 1985. Another step was authorization of sale of MMCs. While the report cites liberalization of interest rates on small denomination deposits as an ultimate goal to be studied, it stresses the need to reconsider the present method to determine interest rates on postal savings if full liberalization of interest rates is to be achieved[32].

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30) *The Japan Economic Journal,* April 3, 1984.
31) *Nihon Keizai Shimbun*, November 11, 1984.
32) *The Japan Economic Journal,* June 5, 1984.

5. Acceleration of Liberalization

The Yen-Dollar Committee accelerated a pitch of liberalization of the Japanese financial system which had already launched by the domestic market forces. In interest regulations, the lot of free interest rate products was decreased. The minimum deposit for CDs was lowered to ¥300 million in January 1984, to ¥100 million in April 1985 and to ¥50 million in April 1988. In 1985, money market certificates (MMCs) were introduced. MMCs had interest rates which were linked to those of CDs but were made available in units as little as ¥50 million and thus had merit an asset for smaller investors. The minimum denomination was reduced to ¥30 million in September 1986, to ¥20 million in April 1987, to ¥10 million in October 1987 and to ¥3 million in May 1989. Moreover, the maturities of CDs and MMCs were extended up to one years.

Barriers between banking and securities were removed in parallel with internationalization. Although banking and securities fields are strictly separated in Japan, Japanese banks are engaged in the securities business and securities companies in the banking business abroad. The countries having the system of universal banking, such as West Germany and Switzerland, take the Japanese regulations as "unfair" in terms of the principle of reciprocity. Consequently, Article 65 of Securities and Exchange Law has come to draw considerable attention in Japan and abroad. An increasing number of European banks engaged in both banking and securities activities began to seek securities licenses in Japan.

In response to those complaints, December 1985, the MOF decided to give the go-ahead to the German bank on the condition that the bank's equity holding in the subsidiary in Japan did not exceed 50%[33]. This decision inevitably stipulated both other foreign banks interested in the Japanese market and the Japanese banks interested in the securities business. In these circumstances, in April 1986 for the first time city banks officially requested that the MOF conduct a review of Article 65 of the Securities and Exchange Law which prohibit banks from engaging in securities business[34]. They stated that Article 65 has more fulfilled its initial purpose of fostering the sound growth of Japan's securities industry and strongly suggested that the MOF remove the barriers separating banking and securities businesses.

33) *The Japan Economic Journal,* December 7, 1985.
34) *The Japan Economic Journal,* April 5, 1986.

They added that removing barriers was necessary from the international viewpoint.

Accelerating liberalization had a substantial impace on the MOF. As mentioned before, the MOF has its own strategy for deregulating the financial system. First, deregulation should be done at a slow pace so that it not disturb domestic financial order. Second, deregulation should be compensated for by re-regulation. Reorganization of financial system was done at MOF's pace to maintain its authorities over financial markets. The Yen-Dollar Committee was a shock, upsetting its timetable for deregulation. Still more, it had substantial meanings as far as the "institutional interest" of the MOF. Deregulation, not followed by re-regulation, is a loss of powers.

In mid 1960's, MITI faced the same problem in capital liberalization issue. When Japan joined the OECD in 1964, it had more reservations to the OECD's capital liberalization code than any of the sixteen other members except Spain and Portugal. There were many non-Japanese who criticized the Japanese for not having agreed to end restrictions on direct foreign investment in the Japanese economy. Demands that Japan liberalize were made in May 1965 at the Japanese-American Financial Leaders Conference and again in July at the Japanese-American Joint Committee on Trade and the Economy, and repeated again in February 1966 at the OECD itself. But "the very thought of capital liberalization struck terror in the hearts of MITI officials and Japanese industrial leaders....... [C] apital liberalization meant competition at every level of an enterprise-in technology, capital resources, managerial skills, and all the rest. The low level of capitalization of Japanese firms, a consequence of the Korean War period, made them easy targets for foreign acquisition. The issue, of course, was nationalistic rather than economic..."[35] The issue was at the same time an administrative one. In the process of trade liberalization, MITI had lost powers it had exerted over the industries. Capital liberalization inevitably accelerated the trend toward degrading the authority of MITI in the Japanese economy. It was the Special Measures Law for the Promotion of Designated Industries that the MITI tried to introduce in order to regain the powers over the nonfinancial industries.

There is, however, an important difference between MITI and the MOF facing the liberalization problem. In the case of trade and capital liberaliza-

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35) Chalmers Johnson, *MITI and The Japanese Miracle*, 1982, p. 276.

tion, the industries shared the terror with MITI while the financial institutions rather welcomed financial liberalization. Some American officials and bankers, it is alleged, believed their biggest ally against the MOF in the liberalization effort was the private financial community of Japan. Former Reagan National Security Council economic official Norman Baily commented, "With the very strong exception of the pension fund issue, our position on deregulation has the support of the major Japanese private financial institutions; they also want to make Tokyo an international financial center. Only the MOF opposes this trend, because they fear it would lessen their control over the economic life of the country."[36)]

Conclusion

The U.S. government pressed the Japanese government to deregulate the Japanese financial system and the Nakasone Administration decided to follow the American demand. This meant that the apolitical pact was dissolved by external forces. As a result, the banking sector could call upon the LDP with less reserve toward the MOF whenever they needed to do so. Because the banking sector has demanded more rapid deregulation, the MOF was forced to re-examine its original strategy.

Although we don't have clear insights into the future development of the MOF's strategy, several points can be identified.

(1) The MOF seems to use any chance to enlarge the number of available posts in private banks which will decrease if left as it is[37)]. Of the 13 major ministries, the MOF has maintained by far the most prominent positions in influential governmental organizations, affiliates and big businesses. As of December 1983, 38% of the total 754 known MOF officials who left the ministry and sought a second career, assumed posts in prestigious financial institutions. They include the head of the BOJ, the Export-Import Bank of Japan, the Japan Development Bank, Smaller Business Finance Corp., and some city banks, regional banks, mutual banks, securities and insurance firms. As for government affiliates, because the government has moved to steamline government-affiliated institutions as part of administrative reform,

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36) *The Japan Economic Journal,* May 8, 1984.

37) On the function of amakudari in the Japanese political economy, see Kent Calder "Elites in an Equalizing Role: Ex-Bureaucrats as Coordinators and Intermediaries in the Japanese Government-Business Relationship", in *Comparative Politics,* July 1989.

the MOF has been facing increasing difficulties in securing posts for its high-ranking officials coming up for retirement[38]. Financial deregulation inevitably accelerates this trend.

A good example is an issue of the status conversion of mutual banks. Although the National Association of Mutual Banks sought a simultaneous switch of status for all its 68 member institution, the MOF didn't approve this demand. A simultaneous switch would be done on the objective rules and therefore would have deprived the MOF of discretions, which could be utilized for obtaining *amakudari* posts in converting banks. After a series of tough negotiations with the MOF, the National Association changed its policy and decided on a group-based conversion policy: a simultaneous conversion only for banks which were ready to change at the time.

(2) Deregulation is bringing forth new markets such as finance futures, offshore markets, commercial paper markets and option trading. With the barriers separating sectors being removed and several kinds of institutions including non-financial sectors entering the new markets, the MOF if busy arranging the conditions and circumstances of these new markets. They are looking for areas to re-regulate.

(3) Along with the birth of new markets, institution-oriented divisions in the MOF, such as the Banking Bureau, the Securities Bureau and so on, will go out of date. In the case of MITI, it abandoned the vertical industrial bureau oriented micro polices in favor of horizontal functional bureau oriented to macro policies in 1973 in response to internationalization[39]. The MOF also will have to reorganize its institution-oriented bureaus and divisions into market-oriented bureaus and divisions sooner or later.

38) *The Japan Economic Journal,* May 31, 1988.
39) Johnson, *op. cit.,* p. 290.