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A GLIMPSE OF THE FINANCIAL REVOLUTION IN JAPAN

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1. The so-called Japanese Financial Revolution is now in progress. It came to Japan in a wave from over the Pacific Ocean.
2. After the visit of President Reagan in 1983, deregulation, or the process of stimulating competition and removing competition-suppressing factors, arose in Japanese financial structures.
3. The symbols of deregulation were a) a liberalization of financial markets, b) the internationalization of the Yen, c) a change in corporate financing, and d) increasing international financial frictions.
4. In the progressive course of deregulation, gradually the wave of deregulation faced the hard wall of the financial institutions and as a result, this wave is becoming half-frozen. The new reaction is "reregulation".
5. Reregulation copes with some of the following questions;
   a) how to revise the traditional financial systems?
   b) how to cope with the enormously growing financial risks?
   c) how to *accustom* ourselves to daily-intensifying globalization of financial innovations?
   d) how to suppress the threat of the accumulated debt of the developing states?
6. Japanese financial society now faces several new challenges:
   a) to overcome the traditional financial systems;
   b) to refine the Money-Market;
   c) to intensify the internationalization of the Japanese Yen;
   d) to reconstruct the old capital markets;
   e) to develop new prospects for the Tokyo money and capital markets;

I. A HISTORIC REVIEW

Japan opened her gate to the outer world in 1868, in the Meiji Restoration. Since that time, everything has changed. The so called modern banking system was introduced, using models, the American national banking system, the British central bank, German universal banking and the European "Governmental Banking" methods[1]. From her beginning, the Japanese banking system was powerfully influenced by Western banking. After 1945, military defeat also meant big change. But fortunately, the Allied Forces did not dissolve the Japanese banking system unlike in Hitler's Germany, the Allies just modified the existing method of corporate financing, introducing a separation between the banking and securities business, a Japanese modification of the Glass-Steagall acts. Since then time elapsed very quickly. In 1983, the U.S. President and Mrs. Reagan, and Cabinet Secretaries Mr. Regan and Mr. Shultz visited Tokyo, since then, a Financial Revolution[2] has attacked this Far East country. In each of the above three occasions, the Japanese banking system has been changed, not voluntarily but involuntarily by outside forces. These "Outer Influences" are the most significant features of the Japanese banking system. In particular, the "Wind" from the Pacific Ocean or I dare say,

Washington D.C. was the strongest[3]. The banking system in Japan, especially after 1945, has had the following features[4].

(1) The three pillars of Banking Administration;
Separation and adjustment of the sphere of the banking business – the Repletion of the banks' capital and Limitations on the use of the banks' assets – Enlargement of the Finance Minister's authority and scope of jurisdiction
(these are the principles of banking administration and control)

(2) The three pillars of controlling financial methods;
Controlling interest level and its structure[5] – controlling banking business activities and sphere – separating domestic financial markets from international financial markets
(These are the principles of Strengthening the Indirect Financing Method[6])

(3) The three Pillars of the Banking System[7];
Separating long term financing from short term financing – separating the trust business from ordinary banking business – separating the securities business from the banking business
(These are the principles of banking-business scope separation)

Furthermore, a discussion of some historical and political dramas should not be omitted[8]; The reelection of both of the leaders of the two countries, Mr. Reagan and Mr. Nakasone (Japanese Prime Minister at that time) was coming up in 1984. The President of the United States needed an impressive diplomatic performance besides the domestic economical victories; controlling double-digit inflation and a soaring interest rate. The Japanese Prime Minister, on his sided, needed the President's support and friendly tie between the two nations. So, Mr. Reagan's tour to the ASEAN countries was designed and promoted to accomplish these needs.

Meanwhile, in the House of Representatives, a kind of theory, "Misalignment Theory", was loudly testified to by corporate leaders[9], saying that the trade inbalance between the United States and Japan has been caused by undervalued Japanese Yen and this undervaluation came from Japan's stance of complete closure of financial markets to foreign financial trends. Finally a resolution requesting the opening of the Japanese financial market to international financial business was passed by the U.S. Congress.

Moreover, suddenly a mysterious assassination at Manila Airport caused a cancellation of President Reagan's visit to East Asian countries and the talk in Tokyo became a politically hot issue. But, "what subject should be talked?" On September 28, 1983, at Shultz-Abe (Japanese Foreign Minister at that time) meeting, it was decided that the topic should be the Yen-Dollar issue. An economic issue was suddenly changed into the hottest political matter. After that, the two nations' joint press releases of the 10th of November 1983 and the 30th (Tokyo time) of May 1984 were telling the bell for the closed nature of the Japanese Financial Market.

Again, suddenly, on September 22, 1985, two years after the Reagan-Nakasone meeting, the Plaza G-5 meeting was secretly held and the Yen-Dollar quotation in the Tokyo Foreign Exchange Market changed tremendously (from a peak 263 Yen per Dollar on Feb. 25, 1985, the Yen slid to 242 on Sep. 20, 1985, finally bottoming at 121.65 on Jan. 4, 1988). In spite of this change, during 1987, Japan's trade

surplus still totaled $94 billion and the U.S. deficit rose to $170 billion (the bilateral deficit with Japan was $60 billion) at the end of 1987, the net external asset surplus of Japan soared to $240 billion, but the U.S. net external liability grew to $368 billion.

II. THE DEVELOPMENT OF FINANCIAL DEREGULATION
(The tumultuous rapids of the American revolutionary stream)

The press-release of the U.S.-Japan Joint Ad Hoc Committee, on May 30, 1984[10], opened the door of the Japanese Financial Market to international financial trends. The principal features of this are as follows:

(1) The Liberalization of Money and Capital Markets;

(A) Liberalization of the interest rate on time deposits;
Large-amount time deposits and Money Market Certificates (MMC's)[11] were introduced and restrictions on Certificate of time deposit (CDs) were gradually lifted. But the interest rate structure for small-amount time deposit[12] is still controlled, due to the fierce struggle between the Bankers Association and the ministry of Postal Services.

(B) New Financial Tools[13];
Yen-denominated Banker's Acceptance bills were introduced; sales of and dealing in national bonds by banks were liberalized; commercial paper, short-term and medium-term bonds markets were expanded; a Japanese off-shore market, and financial futures and option markets were started.

(C) New Banking Facilities;
Restrictions on Yen-Dollar swaps and forward exchange contracts were withdrawn. Overseas Yen-denominated loans were freed[14].

(D) New Capital Market Features;
The issuance of Samurai bonds and also Daimyo bonds (both are floated by non-residents in Tokyo) have been stimulated by deregulation. 1983 was a remarkable watershed for Japanese corporate financing[15]. In that year, a number of major Japanese corporations raised funds in both the traditional domestic bond market ($6.4 billion) and in the international bond markets ($7.8 billion). Before 1983, the domestic bond market had been the predominant market. The reversal that occured was based on the deregulation of the former restrictive governmental stance concerning Japanese corporate financing in the international fund markets[16].

(E) Advances into Japanese markets by foreign financial institutions;
A restrictive attitude on the opening of branch offices by foreign financial institution (both in banking and in the securities business) in Japan no longer exist, except for some special cases[17].
In August, 1983, Nomura Securities and Morgan Guaranty Trust jointly sounded out the opinion of the financial authorities concerning the establishment of a new trust bank in Tokyo, but in accordance with the then existing separation principle, this attempt was withdrawn. However, finally nine[18] new foreign trust banks were established in April 1986 and became legally eligible for appointment as designated trust banks for Japanese cor-

porate pension funds, which at the end of 1985, reached $150 billion. (Still, at the present, such pension funds are legally entrusted exclusively to life-insurance companies and trust banks.)

As pointed in the Ad Hoc Joint Committee Report of May 30, 1984, to get full membership in the Tokyo Stock Exchange (TSE)[19] had been a long standing target of the foreign securities houses for long period of time. Membership had been denied as a result of the negative attitude of the TSE. As in the case of foreign trust banks, the jet stream from Washington prevailed and 22 foreign securities houses (10 American, 6 British, 2 each that were German, French and Swiss) are now in the TSE member list.

As mentioned already, in Japan, banks and securities houses are kept separated, but in consequence of the British Big Bang, Citicorp purchased Vickers da Costa[20], Security Pacific gained control of Hoare Govett, and Chase Manhattan bought Laurie, Milbank[21]. All three of these subsidiary companies were British (originated) securities houses whose Tokyo branches were already licenced securities dealers. Utilizing these vested interests and according to the stipulations of the Law Concerning Foreign Securities Houses, almost all foreign commercial banks are now eligible to open and maintain securities firms under 50% majority clause in Tokyo[22]. As of June 1987, 22 foreign commercial bank-controlling securities houses' Tokyo branches are in full operation.

(2) The Internationalization of the Japanese Yen;

Our Government has been for many years reluctant to admit that the Yen is an international currency, just as in Bonn and Bern. The Euro-Yen, for instance, has long been regarded as a hybrid. The Ad Hoc Committee Papers created and effected its legitimacy. Euro-Yen currency transactions, Euro-Yen CD issuance, certain Euro-Yen loans and also Euro-Yen bond floating were liberalized. But Euro-Yen denominated loans of long and medium term for Japanese residents and Euro-Yen bonds issued by residents are still under severe government restriction. Why? The government still prefers to reserve and maintain harmonious and desirable interest structure as it is and corporate financing methods in Tokyo Money and Capital Market, apart from the ill effects of Euro markets. The phrase, "Internationalization of the Yen" includes four mensions;
(1) the liberalization of the Tokyo money and capital markets, (2) the liberalization of the Euro-Yen Market, (3) the internationalization of the Tokyo money and capital market, and (4) the promotion of confidence in Yen. In particular, the creation of Tokyo Offshore Market (JOM), which has expanded to $400 billion at the end of Sept. 1988 after its opening in Dec. 1986, is quite significant. Although, generally speaking, the internationalization of the Yen is to be translated as the "enlargement of the Yen's usage and reserve in the fields of international transactions"[23], the present situation is not to be overestimated. In current trading, the Yen is used only in 33.4% of total exports, and in 10.6% of imports. In international capital transactions, Yen-denominated bonds comprise 15% of the total international bond market, while Euro-Yen loans increased to 5 trillion Yen (nearly 5% of total international loans). As a reserve currency, the Yen is used in 6.9% of the total currency reserves by

world governments. In this context, Mr. Sumita, Governor of The Bank of Japan, made his idea clear that the Yen is to be a supporting currency to the U.S. dollar. To my astonishment, this statement was made on the occasion of the meeting of the Group of Seven in September, 1988 in West Berlin.

(3) The Metamorphosis of Corporate-Financing in Japanese Industries;

The wave of deregulation opened new methods of corporate-finance in Japan. As mentioned above (1, D), Japanese companies' international bond-floating rose from $21.7 billion in 1986 to $32.3 billion in 1987 and in the first nine months of 1988 to $39.6 billion. In 1987, Japanese companies raised the historically biggest amount of fund from world capital markets, comparing to U.S., British and West German companies. The main fund raising-vehicles (tools), over 70% of the total are equity bonds (convertible bonds and bonds with warrants attached). This trend brought some conspicuous changes in the forms of fund raising, changing from traditional bank-loans to a dependence on capital markets, domestic as well as overseas. This was especially true for the big and prestigious industrial firms. This new wave accelerated and hardened the conflict between the big City-Banks and the big Four Securities Houses in Japan as well as in overseas funds markets[24].

In the mid-1980's, a number of factors contributed to encouraging capital flows form Japan to the U.S., they included; (1) a low level of domestic interest rates and easy money policy, (2) annual export surpluses in excess of 100 billion dollars, (3) relatively low Japanese growth-rates, (4) a spreading interest-rate gap between Tokyo and New York, (5) sharpened swap-techniques, and (6) the Tokyo authorities' increasingly positive stance towards foreign indirect investment by Japanese institutional investors (recently these last are well known as SEIHO-Life Insurance Corporations and "Mrs. Suzuki's", small but well-organized and quick-responding private personal investors as compared to the traditional picture of Belgian dentists in Europe.) These are the main factors in analyzing why $144.7 billion in 1986 and $119.5 billion in 1987, flowed into mainly New York from Tokyo in the form of long-term capital investment. This flow mostly in the shape of purchases of 30-year U.S. Government bonds and U.S. stocks. The world knows this is helping the tremendous funds-shortage, created by the twin deficits in public finance and in the international balance of payments in the United States. ZAITEKU, making money with money, has been fashionable in Japanese corporate accounting[25], especially after the Plaza G-5 meeting (Sept. 1985). The soaring-Yen suffering Japanese companies utilised these techniques fully, covering "squeezing" operation profits due to the soaring Yen-Dollar exchange rate. Such easy money situations made land prices in major cities and the Tokyo Stock Exchange Price Average Level extremely high. The price increase on the TSE also allowed major Japanese listed-corporations to successfully utilise equity-financing through the issuance of convertible bonds and bonds with warrants in both domestic and overseas capital markets[26].

(4) Enlargement of International Financial Conflicts;

As stated above (1, E) after the 1970's, year by year, with the progress and enlargement of Japanese banks and securities houses networks in the world money and capital markets, international friction or discord became apparent.

Supported by the growing Japanese economy and international trade and by monetary expansion, at the end of 1987, 837 banking offices and 166 securities houses business-bases could be found spread all over the world. For example, in the middle of 1986, 27 Japanese commercial banks maintained offices in the United States and in the U.S. commercial loan market. Their total loaned money balance occupied 8.4% of total U.S. domestic loans. (American banks covered 77.7%, British 2.5% and Canadian 2.4%[27].) During the period Jan.–Sept. 1988, in the Eurobonds and International bonds issues markets, four Japanese securities houses as the "book-runners", took second, third, sixth and seventh positions (the companies names are well known; Nomura, Daiwa, Nikko, and Yamaichi[28]). The Big Four Japanese securities houses and the Big City banks have licenced Primary Dealer subsidiaries in New York. It is said that these Japanese financial institutions have a problem of "OVERPRESENCE" (too much conspicuous) in the international financial markets. In response to this "Overpresence", international financial conflicts or frictions rose higher[29].

International financial friction has two meanings; one is "inter-State", or one country against one or several other countries, and another is "inter-financial markets" conflict. But in both cases the State or States concerned is(are) the Negotiators. The followings are some examples which appeared as Japanese problems.

(a) Antagonism against giving licenses to Japanese securities dealers as Primary Dealers of U.S. treasury bonds. (A new legislation now in effect in U.S.)
(b) The new international banking accord for maintaining proper primary equity capital ratio for international commercial banks by the BIS.
(c) Hesitation in giving banking licenses to Japanese securities houses' London financial subsidiaries in the U.K.
(d) Heretofore restrictive attitudes in acknowledging Japanese underwriters as bookrunners in the Frankfurt and Zürich bond markets.
(e) Since the U.S.-Japan Ad Hoc Committee commenced in 1984, bilateral government consultations on finance have been held periodically to negotiate, to exchange opinions, and to reach mutual understandings on solving mutual financial problems. Within the group of nation's, including the United States, the United Kingdom, the Federal Republic of Germany, France, Italy, Canada and the EC Committee, these consultations have already been held 27 times[30].

What are the most important sources of international financial frictions? Some came from old fashioned "Bilateralism" of eighteenth century; some are from the desire for a "Most Favored Nation Clause"; "Equal Footing" is to be required; sometimes "to defend domestic financial institutions from foreign aggressive Money Monsters". Such frictions become apparent in many forms: in government consultations, or private talks between financial leaders or through central bank discussions, or in international monetary institutions (i.e. BIS, OECD, IMF etc.). But recently financial trends such as Securitization and Globalization are intensifying these discords. Securitization means accelerated liquidization of bank assets and the creation of new financial merchan-

dise. Globalization combines separate world money and capital markets and threatens closed markets with fears of hollowing or dwarfing domestic markets. Daily developing new financial techniques like swaps, financial futures, options and arbitrage technique also accelerate these trends. These new waves always ignore artificial national borders and currency sovereignty as well as traditional financial systems, monetary policy, the equilibrium of money and prices and stable foreign exchange quotations in world money markets and sometimes even impair national prestige.

III. A NEW DEVELOPMENT, "REREGULATION":

(1) REVISION OF THE FINANCIAL SYSTEM:

If Deregulation might be defined as the removal of anti-competitive factors, Reregulation may mean a reorganization or defence of a desirable financial order, which in the midst of deregulation might have been impaired or lost. This is to say, deregulation secures free competition, but after some degree of deregulation, re-regulation becomes desirable, as in every game, some rules are indispensable.

In many OECD countries, a reregulative wave has become apparent. Deregulative trends finally collided, in every country with the traditional financial system. In the United States, deregulation of the three pillars of the financial system (Regulation Q as the ceiling for deposit interest rates; the McFadden Act and additional stipulations of bank-holding regulations prohibiting inter-State branch extensions; and the Glass-Steagall Act severely separating bank and securities businesses,) met strong resistance. But Regulation Q was finally abolished in Oct. 1983; Cross-State-border prohibitions have become substantially ineffective after many bank failures and their inter-State rescue; Cross border loan production offices were founded rather freely and state-border skipping, electronic automatic transfer machines were installed everywhere. Finally the Glass-Steagall prohibition is now in Congress and hopefully will shortly be revised. In the U.K., the Big Bang and the Financial Service Act were brought into effect. In Paris, a powerful deregulation of money and capital markets is going on. The situation in Italy is the same. In Frankfurt am Rhein and in Zürich, capital markets face gradual liberalization. Canada, formerly a Glass-Steagall state, now has changed in favor of a Universal banking system. The revision of a respective country's financial system[31)] is the final stage of deregulation and also actually a de-facto recognition of the present situation and the beginning of reregulation. Change or amendment of one country's financial system means to fix the rules of the game to some extent.

(2) INTERNATIONAL RESTRICTIONS ON DESIRABLE CAPITAL EQUITY RATIO FOR INTERNATIONAL COMMERCIAL BANKS BY THE BANK FOR INTERNATIONAL SETTLEMENTS:

In the summer of 1988, in Basel, a final accord on international regulations mandating on 8% capital ratio by 1992 for international commercial banks, was successfully made. But really, who actually considered it a success? Please remember the reference in the foregoing chapter about the "Overpresence" of Japanese financial institutions. In the preliminary stage of a joint request by the U.S. and U.K.

Central Banks in Jan. 1987, the reason given was that, due to the growing integration of world money and capital markets, and also because of a deepening fear of the possible repercussion of any one country's financial disorder on the international financial system, "Banks undertaking significant cross-border business" should be subject to international rules requiring a sound capital ratio. This was by itself quite self-explanatory, but Tokyo felt something inexplicable in this matter. A new wave of "Japan Bashing"?[32)]

Almost 35 leading Japanese financial institutions are to be affected by this new regulation (13 City banks, 10 regional banks, 6 trust banks, 3 long term credit banks and 3 other institutions). Presumably, at the end of March 1988 (Fiscal year-end of 1987), the City banks' primary capital ratio (Tier I) was about 2.75%[33)]. To be able to meet the required ratio of 8% by 1992 or not is now hotly debated. Equity-financing by banks (capital increases, the floating of convertible bonds and bonds with warrants in Japan and overseas, etc.) are quite fashionable and inevitably bank-stocks prices shows low level in TSE. Each bank is seriously seeking a proper solution to meet the target standard ratio, i.e. to raise the return on assets ratio (ROA), to cut unprofitable loan balances, to recommend that prime customers issue private-placement bonds or CPs, to securitize their assets, and so on. One hidden point is the Tier II ratio, 75% of the latent profit arising from securities-portfolios is to be counted; but are the general stock price-level and capitalization-price on the TSE to be expected optimistic forever? As almost all Japanese banks expect to meet the required standard target ratio in 1992 and thereafter, bank management strategy will be drastically changed:

(1) to promote a higher ROA ratio and to perform better Risk-Management at the same time will create antinomy or trading-off.
(2) Securitization will be developed and risk which has been confined to the banking circle will flow out to general investors.
(3) Considering the risk-asset-ratio and the ROA, banks asset-portfolio strategy will be frequently and drastically changed.
(4) Listed stock price competition between banks will become keen.
(5) Responding to the banks' changing policies, Japanese corporate financial tactics and strategy will become diversified and financial behavior will be dramatically modified.
(6) Now that the risk-asset-ratio has been defined, some change will be seen in the industry-bond and regional bond markets; seemingly their transparency[34)] will increase.
(7) Off-balance transactions which require no coverage will increase and some favorable effect will be felt in the newly opening financial-futures and option markets in Tokyo and Osaka.
(8) Since these BIS regulations were stipulated, rescue of failed banks by merger has become more difficult and further international expansion by banks will also be harder.

A conspicuous bank failure has never happened since the 1940s in Japan (but also please note there has been no new[35)] commercial banks founded since 1954), but a realistic consequence of this BIS rules will be the establishment of the principle of "the survival of the fittest", and this is the hidden meaning of this new type

of reregulation.

One more point regarding the BIS, in spring of 1986 this bank issued two notable reports. One was a kind of circular to central banks, entitled "Concerning Recent Off-balance Transactions Management" ("Cook Committee Report") and another was "Recent Innovations in International Banking", ("The Green Book"). These are two of the official warnings concerning deregulation by The Central Bank of central banks.

(3) RISK MANAGEMENT:

As clearly and minutely stated in the above two BIS Reports, risk and innovation mutually interact with each other. In general, risks appearing in the banking sphere may be classified into five types[36); electronic banking settlement system risk, credit risk, foreign exchange risk, liquidity risk and interest risk. Alternatively we may classify risk in three ways[37); liquidity-market change and position risk (including liquidity risk, funding risk, interest fluctuation risk, foreign exchange fluctuation risk and option-related risk), credit risk (large amount credit risk, finality of settlement risk and country exposure risk) and operational management risk. For example, the following are new kinds of bank commitments which involve different types of risks; asset sales and repurchase agreements, outright forward purchases, forward-forward deposits, partly-paid shares and securities, short-term credit facilities (Note issuance facility (NIF), revolving underwriting facility (RUF), transferable RUFs, multiple component credit facility, roly-poly CD facility), currency and interest rate swaps, currency futures, currency options, interest rate futures, interest rate options, interest rate capping agreements, stock-index futures, stock-index options, security-underwritings and fiduciary services.

Such swaps, futures, options and short-term facilities are based upon recent financial innovations, supported by developments and new applications in electronics, mathematics and provability-theory. For these growing risks, banks should become more prepared. Because of this, central banks are sounding a warning, especially in the Euro Markets where no central bank, and so no "Lender of Last Resort" exist; and therefore, no actual regulatory control or regulatory oversight exists. The Cook Committee of the BIS, faced several credit and market crises such as those involving I.D. Herstatt, Banco Ambrociano etc. It finally established the so-called "Basel Concordat", making some rules for oversight-responsibility by central banks and put out a yellow warning light about the varying risks of expansion for banks.

(4) GLOBALIZATION:

The notion, "Globalization" has a wide meaning, or rather it is difficult to precisely define. But it is sure that this term cannot be confined to only refer to 24-hours foreign exchange transactions or stock and securities buying and selling regardless of the time-gap or state borders at the requests of clients who are spread all over the world. Normal usage of the term "global" might be seen in the "Global Account" of the U.S. ERISA Pension funds. Compared to the "International Account", in which funds are to be invested in all countries except the United States, the Global Account's funds may be utilized in every country including the U.S.

By the word of "global", one's specific country is neglected and is regarded as one non-specific area in a cosmopolitan world. In this sense, globalization means that; (1) all the major markets become homogeneous in market practice, in financial systems, in financial merchandise, in trading time, in tax treatment, in interest rate structures, in monetary policies. (2) such unitary and solid global market becomes more and more oppressive to each isolated market, ignoring, making isolated market "hollow" and shrinking in importance. (3) finally the "Unitary" threatens the "isolated" as aggressive and powerful financial institutions trespass into the latter markets, seeking so-called "Equal Footing" or "Bilateral Treatment" or Liberalization. The British Big Bang and the European monetary liberalization in recent years, and also the Japanese Financial Revolution might be understood in these terms. There are many trends which accompany the current wave of change called Globalization; spreading securitization in the United States and in Euro-Markets; varying quality and enomous quantity of financial risks; deeply connected international settlements network and a global electronic system; a conspicuous presence of gigantic international institutional investors; and daily sharpened and more highly developed financial devices and practices. The Plaza Group of Five International Conference in 1985 developed and harmonized a number of concerted actions by the major countries. Through monetary policy and by intervening in foreign exchange markets the Globalization trend was smoothly developed. It should be pointed out that after September 22, 1985, individual monetary policy of the major countries was frozen and a free hand in monetary policy-making was checked internationally for the purpose of establishing a desirable equilibrium in foreign exchange markets, including revisions of the overvalued U.S. Dollar and other currencies thought to be undervalued. This spellbound status quo was, however, broken after the Summit Meeting in Toronto of 1988.

(5) THE ACCUMULATED DEVELOPING COUNTRIES' INDEBTEDNESS

At the end of 1988, the accumulated debts (estimate) of the developing countries expandingly rose to U.S.$1,177.3 billion[38], comparing to that figures of Mexican Holiday of August 1982 for $803 billion. The Substantial problems became progressively more serious in the period 1983–1986, that is to say, during the time in which most people in the OECD creditor countries believed that the IMF's "conditional policy" and a sufficient supply of new money would give the debtors a better position, in other words, the heart and soul of this question was lack of liquidity itself. But after the Louvre G-5 meeting in February 1987, the real problem was shown to be not liquidity but possible insolvency. If this is really so, all the efforts after the Mexican collapse of all the creditor countries and the many international financial organizations were in vain and the ghost of international financial uncertainty would walk forever. This is the reason why in recent years many solutions have been proposed in which considerable debt-exemption or write-offs and debt-equity-swaps[39] were pressed; all in the name of a debt-relief-approach. To cope with this problem, American commercial banks increased their bad-debt reserves. (Their earned-profit and loss statement showed a $10 billion loss in the second quarter of 1987, historically the largest loss seen, and the bad-debt reserve coverage ratio reached the 25– 49% level.) European banks also did the same or have written-

off partially or totally their loans. In this, they learned from the experience of Turkey and Poland in 1980 and 1981. Nevertheless, Japanese banks whose bad-debts rose to 65–70 billion dollars, have choosen a milder path, to pile-up reserves or to write-off only to the extent of normal time and to make a relatively small possible loss allowance. Instead of piling bad-debts reserves, they just founded a "Ware House" joint company, transferring their bad-debts from their books to this factoring company in a taxhaven island. (In coping with the debt problem, the Japanese government made several proposals and took some actual measures, such as the "Contribution to International Society Program" for $30.5 billion of non-project economic grants in Sept. 1987 and also in Sept. 27, 1988 at West Berlin, Japan revealed the so-called MIYAZAWA PLAN.)

If, in the near future, some concerted action is undertaken by the creditor countries to mitigate the heavy burden of the debtor states, the reaction or behavior of the Japanese commercial banks might be different from that of their American and European colleagues. As I suggested above, the international debt problem remains the most important banking managerial question for the Tokyo side (in addition to the new BIS capital ratio rule.). As a result, movement to deregulate Japanese commercial banks will be subject to or will be limited by the World debt problem.

(6) EUROPEAN INTEGRATED COMMUNITY MARKET PROSPECT FOR 1992:

The news and information concerning the prospect for an integrated financial market in the EC in 1992 are frequently irritating Japanese financial circles. In the United Kingdom, while the final decision to be a member of an integrated financial society in the EC remains unsettled, no one is likely to welcome more Japanese banking establishments or to admit Japanese underwriters as bookrunners for sterling pound-denominated bonds. In gaining admittance to banking circles in Madrid, the minimum amount for brought-in capital was set unexpectedly high[40] and constituted a barrier to entry. In West Berlin, possible general manager candidates of Japanese commercial banks[41] are liable to receive interviews by officers of the Bundesaufsichtsamt für das Kreditwesen "auf deutsch" (in German). In Paris, in Zürich and also in Milan, Japanese underwriters have failed in being becoming bond-bookrunners. These treatments are generally not very important, but banking licences in the proposed integrated market could very well be given out in a discriminatory fashion, if the applicants are banks of non-member states, regardless of whether the applicants have for many years maintained permanent establishments in EC territory. The EC will judge eligibility from the stand-point of Bilateralism only. Regionalism, to conclude, might hamper the access by non-member countries' banks to the EC and, if so, will create serious problems in future.

IV. A GLIMPSE ON MONETARY AND CAPITAL MARKETS IN JAPAN

Five years have passed since that brilliant Ad Hoc US-Japan Joint Committee Report was released. The flaming heat of the financial "Revolution" in the first stage has cooled down and now it is time to construct sound and durable financial

structure. The title-role singer is still the Ministry of Finance, especially its two powerful bureaux; Banking and Securities. They have one consultative committee each; under the Bnking Bureau there is "The Financial System Research Council" and several sub-committees, while the Securities Bureau holds sessions for its "Securities Transaction Council". Both chairmen are former MOF executives, and each council consists of members from the MOF, financial sector leaders, and university professors. Two current sub-committees include the Financial System Sub-Committee, Second Assembly, headed by Professor Tachi, and the Fundamental Problem Study Sub-Committee On Securities Transactions, led by Professor Royama.

(1) Proposed FINANCIAL SYSTEM REVISION:

As described briefly in Chapter One, after 1945 the financial system has been changed considerably. Government financial institutions were dissolved and changed into private ones; banking and securities businesses were separated and The Bank of Japan gained a new Policy-Board. But the banks themselves were not dissolved. A tremendous demand for funds for reconstruction was seen by the big City-Banks. Despite a full supply of high-powered money flowing from the central bank, the "overloan" position of the City-Banks remained a problem. Trust companies were transformed into trust banks[42] and Long-Term Credit Banks[43] were established. These two types of financial institutions began to supply long-term funds to industries with the governmental Reconstruction Bank and Trust Funds Bureau pushing forth the best effort. The Long-term credit banks were privileged to float bank debentures and Trust Banks were permitted to operate trust accounts. In addition, the Ministry of Postal Services accumulated large sums of money through the Postal Saving Accounts. Thus, at present in Japan, we have 13 City banks, 64 regional banks, 7 trust banks, 3 long-term credit banks. For small business finance, there are 69 Sogo Banks, 456 Sinkin Banks, 448 credit cooperatives, 6,048 agricultural and fishery cooperatives, 212 seculities houses, 23 life insurance companies, 23 non-life insurance firms, 11 governmental financial institutions and a huge mammoth-like Postal Saving, Life Insurance and Annuity Accounts. Finally there are now 81 foreign banks and 125 foreign securities houses in operation.

Last December; 1987, the Financial System Research Council revealed a report, recommending the following Revision Plan; Sogo banks[44] are to be transformed into regional banks, the privileges held by the trust banks and the long-term credit banks (including The Bank of Tokyo[45], as a special foreign exchange bank) are to be reconsidered and the separation principle between banks and securities houses is to be reexamined. This report created a big sensation. Within the above recommendations, almost all sogo banks will be changed into regional banks by 1989, but other questions are now undergoing more thorough investigation and discussion in above-mentioned sub-committees under Prof. Tachi and Prof. Royama. The separation principles of ordinary banks vs. trust banks and long-term credit banks were critically attacked by the city banks, but the forces for change are very strong. The Glass-Steagall separation is powerfully supported by the four gigantic securities houses: antagonism on both sides of the issue is severe and hostility is growing. The rumors are widely spread in Tokyo that the authorities concerned might introduce the idea of an Investment Banking Facility into those businesses. This possibility is

suggested by the recent Canadian solution, where each business can establish a whole-sale financial subsidiary through which the mother company can pursue the other line(s) of businesses: i.e. banks can do trust business, securities-underwriting, bank-debenture-floating and, vice versa, securities-houses may operate banking businesses, in the wholesale field, engage in foreign exchange business and so on. To cope with changing financial worlds, Japanese financial institutions can select one in four ways; (1) to stay as it is with the present financial system; (2) to change into a universal banking system like that found in continental Europe; (3) to establish bank-holding companies like in the United States; or (4) to establish whole-sale type investment banks. Under the international influence of securitization and globalization, temporary remedies or patchwork solutions cannot resolve the current dissatisfaction and trouble that are growing in contemporary financial circles in Tokyo.

The two separation principles on involving ordinary banks, trust banks and long-term credit banks pose questions within banking circles of how the whole territory should be divided, without any dissatisfaction. But the Japanese Glass-Steagall division between banks and securities houses is a fundamental problem in the Japanese financial system. Article 65 of the Security Transactions Law (Law No. 25 of April 13, 1948) was abruptly inserted in this Law at the order of Mr. Adams of the General Head Quarters of the Allied Occupation Army just 20 days[46)] before the Japanese Cabinet Meeting. It was clearly modeled after the American Glass-Steagall Legislation. The opposing points of both parties cover 13 issues[47)]; (1) Separation principle will hinder or promote total benefit of national economy? (2) Article 65 should be or should not be revised (without revising the Law, actual administrative order or measure can suspend the Separation Principle?) (3) Banks do more powerful control over industries if Separation is cancelled? (4) Risks of securities business are too much volatile and sound banking principle could be impaired? (5) Banks should be free from volatile fluctuations of daily dangerous speculations? (6) Banks should be free from the conflict of interest between loan and securities-underwriting? (7) Article 65 was stipulated to promote securities firms more prosperous growth. (8) Economies of Scope (much variety of business should be introduced to cope with changing business chances). (9) Markets and Investors will or will not prefer various business chance by making business with universal bank? (10) Price-making mechanism in securities markets can or cannot be secured? (11) Recent trend in world-wide financial business, such as Securitization, Globalization and Internationalization will or will not support Separation Principle? (12) Recent trend in Banking-Securities business integration; such as Glass-Steagall Act is to be revised in the U.S., British movement of integration by doing Big Bang, favorable conclusion of integration by West German Gessler Report and recent revision of Canadian government for integration, should be observed or not. (13) Old fashioned guide-lines, made by Ministry of Finance, for acknowledgement of the superiority of securities firms over banks in underwriting business abroad, must be cancelled?

Point No. 13 should be more precisely explained[48)]. Corresponding to the increase in bonds floated by Japanese corporations on the international bond markets, Japanese commercial banks' underwriting subsidiaries in Europe must decide whether or not to participate in the competition for bookrunning. This question led to a big war between the banks and the securities houses. Pressed by the securities

firms, the MOF banking Bureau issued a memorandum in April 1974 to the Banks, saying that their subsidiaries can not become managers. This was in consideration of their prematured capability for underwriting. In August 1975, a second memorandum was circulated stating that as far as their prematuredness becomes fulfilled, the banks' subsidiaries are eligible for becoming managers in bond-syndications, but IN ANY CASE, their positions in the management of the syndication (Tombstone-order) should never be superior to those of the securities houses. Of course, this regulation is only applied when it is Japanese companies that are floating bonds. Basically this is a question of both profit and prestige, but also raises a fundamental issue of the bank-securities separation principle. These Memoranda were issued by the Banking Bureau, but other 2 bureaux (Securities and International Finance) of the MOF had countersigned them. This Three Bureaux Guide-Line (in Japanese: Sankyoku-Shido) is still in effect and continues to defend the securities industry's interest in underwriting business not only in Japan but also in international capital markets.

Another institutional issue is the very existence of Postal Saving. As of the end of 1987, the balance of deposits in Postal Savings accounts rose to ¥116 trillion ($859 billion). Moreover, Postal Savings not only competes with private saving institutions, but by also selling high-yielding saving certificates (Teigaku Teiki Chokin), Postal Saving has been hindering market interest rates from fluctuating. Indeed, the reason why the interest rates for small-sum savings account are not yet liberalized is mainly due to this fact. For more than 100 years, since May 1875, Postal Savings has been working as the biggest channel for supplying funds from Japanese individuals and institutions for public finance purposes and also for industries (through Fiscal Loans and Investment Special Accounts and government financial institutions). No one has doubted that this function has been quite useful for accumulating small savings effectively and for efficient capital formation since 1875 and also since 1945. One more fact is worth pointing out; the Dutch Royal Postal Saving Bureau was privatized in Jan, 1986. In Tokyo, the same idea has been discussed for years.

(2) Questions About Money Markets in Japan:

Short term money markets include the following financial markets;

A. The Interbank Markets (bills discount, call, Tokyo Dollar call and JOM markets)
B. The Open Markets (CD, CP, BA, RP, TB, FB, Overseas CP+CD, Large-Sum Deposit, non-resident Yen Deposit, MMC, Foreign Currency Deposit)

In June, 1988, the grand total of all transaction in all of these markets rose to ¥178 trillion ($1,319 billion) up from ¥150 trillion in March of 1987 ($943 billion). These levels are quite comparable to the levels seen in the New York money markets.

But while of considerable size, are the markets in Japan supported by fully liberalized money market vehicles? New money market tools were rather late in being introduced into the Tokyo Market. For example, commercial paper, banker's acceptances, overseas CP+CD, large-sum deposit (Time deposits with liberalized interest rate), money-market-certificates, and the Japan Offshore Market are all

products of the US-Japan Ad Hoc Joint Committee, directly or indirectly. As a result, the functions and facilities of these money tools are rather different from the ones described in text-books about the US Money Market, such as Ms. Marcia Stigum's MONEY MARKET. Perhaps the best example is the Banker's Acceptance Market. This tool was introduced in June 1, 1985 to facilitate the use of the Japanese Yen, as similar markets in London and in New York do for the pound and the dollar for international trade financing. But, from the beginning, there were problems, the heavily criticized stamp-duty is too heavy, financing procedures are too much complicated and the level of interest rate applied is rather high (compared to the ordinary market rates which ordinary traders can utilize). Gradually this Yen-denominated BA market is shrinking. On the other hand, the commercial paper market, which was born in Nov. 1987 after a hard struggle between the banks who had opposed its establishment, and the securities houses who had supported the market, the market shortly grew, in just two months, to ¥1.7 trillion, and is now ¥6.3 trillion[49)] ($47 billion) as of Sept, 1988. The size and growth rate are quite satisfactory, but precise observations can reveal something strange as regards a standard money market tool; the interest rate applied is now nearing the level of that for a Bank CD, but it is still lower than that used for large-sum deposits. That means almost all the issuers are getting a substantial interest rate margin spread by issuing CPs and by placing those proceeds in large-sum time deposit where the rates are liberalized. In New York, at the end of October, 1988, the CD rate was 8.20% and the CP yield was 8.4%. The Japanese CP Market has the following regulatory inabilities: (in parentheses are the characteristics of the U.S. CP market)

Duration; 2weeks – 9 months, usually 3 months (within 270 days, mostly short-term)

Stamp Duty; Sliding-scale, i.e. ¥500 mil. Paper costs 0.24% pa for 1 month. (actually negligible)

Issuer; About 410 prime companies, designated as eligible for issuing non-security (real collateral) bonds in Tokyo. (No Limit)

Rating; Now studying (MOODY or STANDARD & POOR's A or P rating indication)

Legal Entity; Promissory Note (now hotly debated)

Back-up Lines (Earmarking); mostly required (up to the market)

Direct Paper; only indirect issuance (free for both Papers)

As the terms and conditions are listed above, the CP is still regarded as a money-game tool only for the largest, prime industries and as such the size of this market (By comparison, the U.S. CP Market; $420.8 billion, as of Sept. 1988) is somewhat fictitious. More importantly, CDs are not really NEGOTIABLE; when transferred, the issuing bank's consent is required. When we examine aother financial instruments in Japan, we find similar problems. For example, treasury bills do *not* work as fundamental short term money market vehicles, due to the artificial interest structures. MMCs were invented by Saving and Loan Associations to cope with disintermediation in the United States; in Japan Sogo Bank opened this gate, but the interest level is to be determined by following rule, (The average CD interest rate minus 0.75 percent (per annum basis), and not determined by market specific forces. Concerning other markets, the interbank call-loan and call-money market,

and the bill discount market are under strict control of the Bank of Japan. The Japan Offshore Market[50], just like the CP Market, grew very quickly (over $400 billion, as of the end of August, 1988, after its opening in Dec. 1986). But almost no funds are utilized by non-residents. The market is used mainly as an operating funds turnstile by big international banking corporations because of the restrictive regulations upon the JOM Special International Financial Transaction Accounts. The Tokyo Dollar Call Market was opened on April 17, 1972 to enable residential banks to conduct foreign currency funds transactions freely without security and it has been working quite efficiently. But how to open the door to non-resident-banks is the next question.

(3) ENLARGING THE EURO-YEN MARKETS:

The process of the internationalization of the Japanese Yen involves gradual course of abandonment of currency-sovereignty. The Euro-Yen is a typical example of this and as government restrictions are lifted, the utilization of Euro-Yen in international money and capital markets has been growing, especially in the sphere of capital transactions. Euro-Yen are used as follows. With respect to the total Eurocurrency market, the Euro-Yen portion rose to a 5.8% share at the end of 1987 (source: BIS). The Yen was the fourth most widely used currency next to the US Dollar, the Deutsche Mark and the Swiss Francs. In total international bond floatation, Euro-Yen bonds increased to $26.2 billion and held the second position after the US Dollars. In addition, Euro-Yen loans to residents and non-residents sharply expanded from ¥551 billion (1983) to ¥8,433 billion ($62.5 billion, as of end 1987) in 4 years and Euro-Yen CDs have been a very popular part of the Euro-CD Market.

But Euro-Yen, as a currency denominated in Yen to be settled in Tokyo, closely connected to the interest rate level of domestic CDs in Tokyo and directly or indirectly controlled by the authorities in Tokyo. And for Euro-Yen utilizers, Euro-Yen creates no risky foreign exchange exposures. But when it comes back to Tokyo, it turns into ordinary domestic Yen and exactly from that simple reason, the authorities concerned have been for a long time nervous about the Euro-Yen's potentially destructive influences on the restricted and neatly organized Yen market and Japanese financial system. The authorities are concerned with many aspects of the Japanese capital markets; the domestic interest rate structure, the prime rate system[51], the market supply and demand for Yen, the central bank's monetary policies, well-maintained capital fund-raising systems, YUTAN GENSOKU (the strict principle in corporate financing for bond floatation and long-term bank loans which states that real collateral or security is absolutely necessary), and the taxation at the souce system. The fear is that volatile flows of foreign short-term speculative funds would be quite turbulent to the well-harmonized Japanese financial world; if such funds are disguised in Yen from Euro-Yen, the result could be catastrophic. For these reasons, Euro-Yen medium and long-term loans to residents and Euro-Yen bonds floated by Japanese issuers are still heavily restricted. Further Euro-Yen CD's proceed must stay for a period of time in Euro markets before repatriation to Tokyo is allowed and sales to residents are forbidden. In addition, the duration of a Euro-CD is limited to less than one year. All of these restrictions reflect the domestic

situation and concerns in Tokyo. In contrast, Euro-Yen CPs issues by non-residents were finally allowed is November 1987, and somewhat deregulation is being applied.

(4) THE RECENT TENDENCY OF THE JAPANESE CAPITAL MARKET:

The capital market is divided into two parts; one comprises the primary market (issuing market) and the secondary market (circulation or trading market), and the other is the stock (share capital) market and bond (debenture) market. Each division has a domestic part and an overseas sphere. The proportional sizes of each division, after 1980, are currently very close to those of the New York markets.

By some measures, such as the capitalization value (the present total value = the number of shares X the current market price), the Tokyo Stock Exchange already exceeds that of the New York Stock Exchange. In this section (4), primary bond markets, both domestic and overseas, are dealt with. (See Table a). The features of Japanese capital inflows and outflows are summarized in the following table.

A. Indirect overseas investments ($ million) (See Table b)

Japan's balance of payments, especially long-term capital outflow shows large deficits (in billion dollars in 1985, 74; in 1986, 144: and 1987, 119:), principally due to "paper-money" investments, especially in US Treasury bonds and US stocks, not due to the direct overseas investment.

Table (a)

Year/Month	TSE Price	Tokyo $/Yen
1983	8,806	232.00
1984	10,567	251.58
1985	12,556	200.60
1986	16,386	160.10
1987	23,176	122.00
'86 Apr.	15,481	168.10
Jun.	17,180	163.95
Sept.	18,180	153.63
Dec.	18,705	160.10
'87 Mar.	21,433	145.65
Jun.	25,243	146.75
Sept.	25,290	146.35
Dec.	22,683	122.00
'88 Mar.	25,703	124.50
Jun.	27,876	132.53
Sept.	27,568	134.30
Oct.	27,461	125.00
Nov.	28,729	121.85

TSE 225 Selected Stocks NIKKEI Stock Average: Tokyo Foreign Exchange Interbank rate US Dollar Spot closing, end of month; Source: The Bank of Japan Economic Statistics Monthly.

Table (b) Japan's Indirect Overseas Investments ($ mil.)

Year	Bought	Sold	Net	Stock & bond	
(Stocks)	5,483	4,490	993	(Total, Net)	
1985	20,917	13,869	7,048		
1987	70,935	54,060	16,874		
1988 (*)	53,821	50,990	2,832		
(Bonds)					
1985	291,339	237,860	53,479	1985	54,472
1986	1,346,898	1,253,965	93,024	1986	100,072
1987	1,273,829	1,200,944	72,885	1987	89,759
1988 (*)	943,335	876,717	66,618	1988 (*)	69,450

Source: MOF, Annual Report, 1988, Jan. – Dec.
* April – November, 1988.

B. Japan's international bonds floatation ($ billion) (See Table c & d)

As described above, Japanese corporate finance deeply depend upon bond issues in overseas markets. Judging from the above tables, Japan absorbs from trade and by floating bonds, and utilizes that money in indirect investment overseas.

The secret of this lies in domestic capital market structures which does not work properly for the needs of Japanese corporations.

Table (c) Japan's International Bonds Floating ($ bil.)

Year	bond
1985	13.9
1986	21.7
1987	32.3

Source: MOF, Annual Report, 1988.

Table (d) Japan's Trade Balance ($ bil.)

1985	61.6
1986	101.6
1987	94.0
1988	84.1 (Jan. ~ Nov.)

Source: The Bank of Japan; Economic Statistics Monthly.

C. Diversifying Japanese Corporate Financing Methods;

Japan's Corporate Financing has for many years depended upon bank-loans, in other words, upon indirect financing only. Direct financing through the stock exchange or the debenture markets has been rather minimal. The main reason was Japan's fast change into becoming a highly organized capitalistic country. Surely, indirect financing through bank-loans was an easy and efficient way. The Japanese financial system has been so constructed to cope with these needs. But after the 1980s, this loan-dominating finance market is beginning to change: big, international operating Japanese corporations began to float their bonds in international markets, avoiding the domestic capital market.

This refusal to accept domestic financial-intermediaries means that the services from overseas financial-intermediaries are more beneficial to these companies becuase there are no troublesome YUTAN GENSOKU, no bureaucratic procedures, no bond-floating requirements (rather there are efficient rating services). In addition syndication operations are transparent and if the coupon rate is high, recently introduced financial techniques such as swaps, financial futures and options, can create relatively low yen coupon rates and avoid large foreign exchange losses. As Table (a) shows, with the help of continuous large rises in the average stock-price on the TSE, first with convertible bonds and later with bonds with attached warrants, of which overpresence in international bonds markets became quite conspicious. But, in real sense, these maneuvers are confined to the largest firms, and most ordinary companies still depend on bank-loans. Nevertheless, such large companies' direct contact with the overseas international financial world has been gradually eroding the loan-dependent society in Japan, creating circumstances favorable to foreign financial practices and demolishing the restrictions and regulations found in the Japanese capital market. Though, rarely seen in the 1970s, in the 1980s we see a new fashion in Japanese corporate finance; the overseas finance company. This corporate entity has eight dimentions, as

(1) an international fund-raising company,
(2) an international investment company,
(3) a global funds-controlling company,
(4) a sales-financing company,
(5) a foreign trade financing company,
(6) a company that can hold assets for safe-keeping,
(7) a captive insurance company and
(8) an international "tax-saving" company:

Almost every big trading firm, life-insurance company and exporting Giant (manufacturers of electric equipments, electronic equipments, automobiles, precision machine tools, chemicals, pharmaceuticals, etc.) have their own overseas financing subsidiaries in such places as London, Amsterdam, Luxembourg, the Grand Cayman or other places where tax-haven facilities can be enjoyed. However, in Japan, taxation of tax-havens was introduced in 1978 and strengthened in 1985, shutting up two loopholes. These subsidiaries's actual operations are not so prominent at the moment, but as their parent companies expand their international business, the responsibility and performance of these subsidiaries will also expand. At the present, however, we could say that these firms are still undertaking their "traineeship".

THE FINAL CHAPTER FOR TOKYO: AS AN INTERNATIONAL FINANCIAL MARKET

In 1989, promoting a 24-hour world-trading connection, the Financial Futures and Option Markets will be opened in Tokyo. Although the Tokyo market is still not yet very well organized, it is backed by a still growing economy and the Yen and Japanese financial institutions remain sound and strong. Though we have seen that the Tokyo market is now facing many problems i.e., the financial system must be revised, the capital markets should be more efficiently organized, the short term money markets need a more realistic development, banks must meet BIS capital ratio requirement, and means must be found to cope with the new EC integrated financial market. In addition, from a political standpoint, as the greatest creditor-country "Noblesse oblige" is the expected (though difficult) behavior. Further capital-exports will face more troubles than ever with increasing conflicts between the North and the South. Finally sitting in a corner of the Pacific Rim, Japan's responsibility to the other surrounding States will become more difficult. The Yen has just begun to be considered one of the international currencies, and as is widely believed, it has a critical weak point; that is, in Japan there is a great scarcity of natural resources, especially energy and foodstuffs. But recent political developments in the US, Europe and the socialistic states, are reducing the Japanese Yen's burden. If the present situation continues in the United States through the next few years, the nation's net external indebtedness will reach over one trillion dollars. At that time, Japan, holding over $500 billion net credit, might have become a mature capital-exporting state and Tokyo and New York, across the Pacific, will co-exist as the biggest money centres in the financial world. But this goal is still a distant one, especially considering the present circumstances in Tokyo.

Notes

1) Federation of Bankers Associations of Japan (FBAJ, 1984), pp. 1-14.
2) The word "revolution" firstly appeared in "Time" on June 8, 1981 in the "Saving Revolution" Special Issue.
3) Kyuno (1985), pp. 8-23.
4) Kyuno (1986 a), pp. 54-63.
5) FBAJ (1984), pp. 88-98.
6) FBAJ (1984), pp. 15-6.
7) Ministry of Finance, the Financial System Sub-Committee of the Financial System Research Council, "Report on Specialized Financial Institution System in Japan" (MOF Report 1988), pp. 4-6. This report was presented to the Minister of Finance in Dec. 1987, and English version was published in May 1988 by FBAJ.
8) Ministry of Finance (MOF, 1985), "Nichibei Yen-Doru Iinkai tono Kinyu Kyogi to Yen no Kokusaika (Financial Consultations including the Japan-United Stats Ad Hoc Committee and the Internationalization of Yen)" in The Ministry of Finance, Bureau of International Finance. "Annual report", Vol. 9, Part I, pp. 49-70.
9) Mainichi Shinbun (The Mainichi News Pap.), Feb. 11, 1984. Shukan Toyo Keizai (The Weekly Toyo Keizai), Special Issue of Dec. 16, 1983, pp. 8-13.

10) MOF (1984), "Report of the Joint Japan-US (Ministry of Finance, Japan-the United States Treasury) Special Meeting, working Group on Yen-Dollar Rate, Finance-Capital Markets Issues", addressed to The Minister of Finance and The Secretary of Treasury, by Messrs. Ohba and B.W. Sprinkel, dated May 29, 1984 (revealed and released to the press at 4:00 AM Tokyo time) in the MOF, Bureau of International Finance, "Annual report" Vol. 9.
11) "Large-Amount Time Deposits" are introduced in the market on Oct. 1, 1985 and MMC's on May 1, 1985. CDs appeared on Jan. 1984.
12) As agreed in the above noted US-Japan Ad Hoc Meeting, the study of the introduction of "small-amount time-deposit" (interest-liberalized) began in Oct. 1985, but as stated below in text, still no certain date has been fixed.
13) The dates of the introduction of new financial tools were as follows; banker's acceptance bill–Jun. 1, 1985; national bonds, sold by banks–April, 1983, dealt by banks–Jun. 1984 (full-dealing–Jun. 1985); commercial papers–Nov. 1987; short-term national bonds–Feb. 1986; Japan Offshore Market–Dec. 1986; financial futures and options–within 1989.
14) Swaps (Yenten-Kisei) were in June 1984, Forward exchange transactions (Jitsuju Gensoku) were deregulated in April, 1984.
15) Kyuno, M. (1988), pp. 81-93.
16) The fundamental background for this change was mainly due to the following deregulation measures; The fundamental revision of the "Law concerning Foreign Exchange & Foreign Trade Control" on Dec. 1, 1980 (so-called; "from Fundamental No to Fundamental Yes"), the abolishment of the "Law concerning Foreign Capital" and the liberalization of forward exchange contracts (Jitsuju Gensoku)–see Note 14. Furthermore, as noted, there was the Ad Hoc Committee Report (Note 10).
17) At present, there are no such cases with OECD countries, but in the past, problems arose with W. Germany, Switzerland, Canada, and Australia, to our regret.
18) 6 American, 1 British and 2 firms of Swiss origin's are under Japanese jurisdiction.
19) The TSE, like other countries' Stock Exchanges, had been founded as a private and closed membership entity and until to the beginning of the 1980s, membership was restricted to less than 83. But, these 83 monopolized all the stock-trading in the TSE maintaining relatively high dealing-commission tariffs. (Non-member stock-dealers always should share the trading commissions, when they deal listed stocks on the TSE). Therefore, their posts have been regarded as vested interests. If a Member quits or is mergered with another firm, the membership-right can be traded at a considerable price. When US investment banks approached the TSE in hopes of becoming members (Japanese securities houses had already received memberships in several Stock Exchanges overseas), it is believed that they received a flat refusal. The reason: "TSE was too much narrow and over-clouded." Sure enough, this matter became a political hot-issue, and finally their hopes were fulfilled (See Note 10, US-Japan Ad Hoc Committee report; Chapter 5, B, 1 (Acquisition of TSE Membership by Foreign Securities Houses).
20) When the UK introduced the first stage of the Big Bang, 29.9% of British Securities companies' share-capital was opened to foreigners. Citicorp purchased Vickers' share capital and also gained Vickers' business licence in Tokyo. A new situation developed when this Glass-Steagall ridden US commercial bank acquired a securities licence in the also Glass-Steagall-reigning Tokyo. But the MOF gave tacit approval to the action by Citicorp in February, 1984, and as noted in the text, approved two similar cases.
21) Later, this securities company changed her name to Chase Manhattan Securities Co., Ltd. (Japan) with a juridical address in Jersey. Meanwhile, Vickers' new name is Citicorp Scrimgeour Vickers International Ltd.
22) According to the stipulations of the "Law concerning Foreign Securities Companies", an

overseas subsidiary whose parent bank's capital share is under 50%, can establish a securities-operating branch in Tokyo even if that parent bank is an universal bank. The first one was DB Capital Market (Asia) Ltd. Hong Kong's Tokyo Branch (parent: Deutsche Bank), opened in Dec. 1985. Since then, many foreign banks have opened securities offices in Tokyo; e.g. SBCI, Dresdner, National Westminster, Société Générale, Union Bank of Switzerland, Midland, Amrobank, Commerz, Westdeutsche Landesbank, Paribas, Barclays, Bayerische Vereins, Berliner Handels and Frankfurter Bank and Credit-Lyonnais. U.S. banks are following; i.e. Chemical, Manufacturers Hanover Trust and Bankers Trust.

23) MOF (1988), Bureau of International Finance, "Annual report", Vol. 12, Kinyu Zaisei Jijyo Kenkyukai, p. 53.
24) IFR (1988), Sept. 17, 1988 issue; "All Eurobonds, Bookrunners list" 1. Nomura, 2. CSFB 3. Daiwa, 4. Deutche, 5. Nikko, 6. Yamaichi ... 14. Industrial Bank of Japan .... .
25) In Japan, the financial assets of all corporations sharply increased from 151.2 trillion Yen at 1980 year-end to 270.8 trillion Yen at 1985 year-end.–The Tokukin (special money-trusts) and Fund-Trusts swelled from 10.9 trillion Yen in March, 1987 to 20.4 trillion Yen in Dec. 1987. Within one year from 1987, Investment-Trust funds grew up by 10 trillion Yen reaching new height of 42.9 trillion Yen. (¥1 trillion equivalent to $7.4 billion @¥135/$).
26) From 1985 to 1988, the value of bonds floated by Japanese corporations in overseas markets are shown below;

(mil. $)

	Straight bonds	Bonds w. Warrants	Convertible bonds	Total (%)
1985	11,525.2 (59.5)	2,929.5 (15.1)	4,924.7 (25.4)	19,379.4 (100.0)
1986	12,431.6 (45.6)	12,225.0 (44.8)	2,624.7 (9.6)	27,281.3 (100.0)
1987	12,161.7 (29.8)	21,788.8 (53.4)	6,825.1 (16.8)	40,775.6 (100.0)
1988	13,306.5 (27.2)	28,362.0 (58.0)	7,242.8 (14.8)	48,911.3 (100.0)

excluding Government Guaranteed Bonds: Source, 1985–87; MOF Annual Report, Vol. 12. p. 452. 1988; Mitsui Bank's Estimate.

27) M. Kyuno (1987), pp. 29-32, pp. 128-41.
28) IFR (1988). Sept. 17, 1988 issue.
29) Newly Legitimated US "Revised Foreign Trade Law" and UK's "Financial Service Act" might be the useful tools against such overpresence.
30) MOF (1988), pp. 65-9.
31) MOF Report (1988), pp. 48-54.
32) As an example of Japan bashing, Toshiba, a giant electronic firm, met with some unpleasantness; their machine-tool subsidiary, Toshiba Machine Co., Ltd. was criticized on the basis that a whole set of grinding machines for grinding propulsion-propellers of submarines was intentionally and secretly smuggled into the USSR and US Government suffered billions of dollars of damages in coming with untracable (silenced) Soviet submarines. This might be a serious violation of the COCOM rules: and several grinning members of the House of Representatives, at the Rear Garden of Congress crushed with hammers a Toshiba tape recorder placed on a garbage can. This video-film has been repeatedly televized throughout Japan in homes, offices, schools–everywhere. Two of the associated companies' CEOs were compelled to resign and even the Minister of International Trade & Industries visited Washington to express Japan's apology to the US. What kinds of hammers will appear next in bashing on a garbage can?
33) Mitsui Bank (1988), p. 7.

34) Transparency; openness for market-makings, trading, dealing, participation method of syndication, share-decision of underwriting and also coupon-rate-formation.
35) The latest banking license for new participant was given to The Toyama Bank, Ltd., Takaoka, Toyama, Japan.
36) MOF Report (1988), pp. 22-4.
37) The Bank for International Settlements (1986), Chapter 3 (2).
38) MOF (1988), p. 28.
39) This swap changes indebtedness into equity stocks. For example, in Mexico, an American bank arranged for a Japanese automobile firm to buy that bank's loans. This firm then sold its loan to the Mexican government and by getting a discount on local currency, increased their factory's share capital. Furthermore, on the inter-state level, U.S. Government floats a zero-coupon bond, Mexican government buys it and pledging it, Mexico floats bond and exchanges her debt with creditors' loan: this is called "Debt-Bond-Swap" Scheme.
40) At that time, a rumor in Tokyo went, "In Madrid, the prevailing wind from Bruxelles is felt."
41) Surely, such tests are **NOT** deliberately given only to Japanese banks, but actually this hurdle sometimes hinders Japanese banks' personnel planning in Germany. So, in Tokyo, there was a joke, "Why doesn't the MOF apply the "equal footing" principle and give a Japanese language test in Okinawa or in Hokkaido for German Bank manager candidates?" (See the MOF's annual report. Vol. 12, page 68.)
42) MOF Report (1988), pp. 79-88.
43) MOF Report (1988), pp. 59-78.
44) MOF Report (1988), pp. 98-107.
45) MOF Report (1988), pp. 89-98.
46) City Bank Conference (1986), p.4
47) Kyuno (1988), pp. 89-90.
48) Kyuno (1988), pp. 83-84.
49) Unconfirmable figure; market's estimate.
50) Kyuno (1986 b), pp. 193-230.
51) In Japan, Prime-rates are decided in the following fashion; short-term prime is linked to the central bank discount rate (as of end 1988 2.5% plus 0.875–3.375%pa.) and the long-term prime is geared to the return on 5-year debentures plus 0.9%pa (as of end 1988 5.70%pa). It is interesting to note that, in Feb. 1959 the Bankers Association decided that, following US practice, the short-term prime-rate System should be introduced; linking it to the BOJ Discount Rate. In Oct. 1970, the BOJ discount rate plus 0.25%pa-System was fixed; in Mar. 1981, it was the BOJ rate plus 0.5%pa; in Apr. 1986, BOJ plus 0.625%pa-System, in Nov. 1986 plus 0.75%pa-System and then, in Feb. 1987, BOJ plus 0.875%pa-System. Now, a hot discussion is continuing in the market; the Bankers Association is insisting on cutting the linkage to the current central Bank rate. Coping with long-years-continuing loose money-market, to correct the unrealistic Prime rate and to construct a NEW PRIME RATE SYSTEM (which will reflect actual, fluctuating fund-raising cost) is the earnest wish of the Big City banks, whose capital ratio will be regulated. The most difficult point of the discussion is how to include gains from maintaining compensating balances. In Jan. 1989, finally City Banks offered new prime rate of 4.25%. When this is decided, the review of the long-term prime system will come next.

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