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Will the “Bang” Mean “Big” Changes to Japanese Financial Laws?

By Jessica C. Wiley*

I. Introduction

On November 11, 1996 Japan’s then-Prime Minister, Ryutaro Hashimoto, proposed a fundamental shift of Japanese economic policy that should result in the deregulation of Japan’s financial sector.1 Following British and U.S. examples, the Japanese economy is headed for a “Big Bang.”2 In the financial arena, Big Bang is the term associated with London’s 1986 deregulation measures that brought about large-scale reorganization to the financial sector as well as led to the recovery of London’s international status as an economic power.3 Japan hopes its own version of the Big Bang will do the same for its market.4

Since the early 1990s, Japan’s economy has suffered the effects of a bubble economy and deteriorating international positioning.

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* Member, Class of 1999. B.A., University of California at San Diego, 1996. The author would like to thank Professors Dan Henderson and William Dodge for their suggestions on this Note. This Note would not have been possible without the assistance of her family, in particular her father who spurred her interest in Japan.

Hashimoto actively promoted deregulation to prevent the yen and the Japanese economy in general from being left out of a new global financial order, dominated by the U.S. dollar and the Euro, the new European Union currency.5

The essence of Japan’s Big Bang is the end of highly segmented financial markets in favor of a single market where domestic and foreign banks, securities houses, insurance companies and other financial institutions will be totally free to compete in each other’s business specialties.6 These economic changes will be spurred by legal reforms. The hope is that these legal reforms will solidify Japan’s dominance by allowing it to compete with the emerging markets in Singapore and Hong Kong as well as the established dominant markets of London and New York.7

One of the first reforms that went into effect was changes to the Foreign Exchange and Foreign Trade Control Law, which allow individuals and companies to handle foreign currencies more freely.8 The changes became operative in April 1998 and effectively liberalize foreign currency settlements in place of yen settlements.9 This revision is regarded as the engine behind the rest of the deregulation package and was prompted by fears that an outflow of financial assets of individuals and companies may be triggered by other legal and financial changes unless regulations are sufficiently relaxed.10

However, the question must be asked: will these legal reforms termed “deregulation” truly be a liberalization that opens up Japanese financial markets? The Japanese are known for one hundred percent liberalizations of their financial markets; there have been more than four.11 In order for Hashimoto’s proposals to result in ef-

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6. See Rowley, supra note 5.
9. Id.
10. Id.
effective economic liberalization, however, the government bureaucracy must remove itself from the marketplace and more fundamentally away from its deep business interests.

Part II of this article discusses the economic and political woes of the current Japanese situation. It provides background for the causes of the economic crisis in Japan. Part III introduces the concept of the Big Bang, using the experiences in the United States and London to establish the necessary elements for successful deregulation. The section focuses on the recent Foreign Exchange and Foreign Trade Law (FEFTL) changes as an example of Japanese Big Bang legislation. Part IV analyzes whether these FEFTL changes will be successful in bolstering a full-scale deregulation, and more generally if they will help save the failing Japanese economy. In particular, the section discusses institutional impediments to the success of the changes and prospects for the future. Part V concludes that it is in the best economic interest of Japan to support the FEFTL and other Big Bang reforms regardless of the short-term harm it will bring.

II. The Setting

Some commentators note that "Japan's financial system [is] at a juncture today which is not comparable to any other episode during the past 45 years." The conflict between the financial system and regulatory structure has put tremendous stress on the financial system. After World War II, Japan's economy grew faster than that of any other advanced country. By the 1980s, trade deficits with countries like the United States drove the Group of Five to encourage orderly appreciation of main non-dollar currencies against the dollar through the so-called Plaza Agreement. This agreement resulted in a fifty-three percent devaluation of the dollar against the yen between February 1985 and January 1988. The rise of the yen led to lower interest rates as regulation decreased to offset the economic


13. Id.


16. Id.
slowdown produced by the appreciation. As interest rates fell, stock and land prices surged, and the money supply grew. In late 1986 or 1987, this asset inflation process appeared to become a speculative bubble with little restraint either from financial institutions or regulatory authorities.

A. The Bubble

Japan permitted the expansion of credit out of fear that restraining the flow of Japanese funds to the United States, which depended on such funds to cover its current account deficit, might trigger a stock market crash. Low interest rates coupled with easy credit encouraged individuals and firms to borrow money. The center of the problem was the banks that helped drive up real estate prices by making generous loans to speculators. When the economy slowed and inflated property values fell, the banks were left with bad loan portfolios that tightened their financial status. The government chose to support the banks and their bad loans. Instead of deflating the bubble, the government bailout freed up loans and simply allowed banks to dole out more improper loans. This inflated the bubble even more.

The extent of the problem was not apparent until the burst of the bubble economy in late 1990 and 1991. The deflation of the bubble and asset price decline occurred because of a combination of policy actions and the self-correcting mechanism of the speculative process. Out of concern about asset price inflation, the regulatory agencies raised interest rates while the Ministry of Finance (MOF) slowed land price rises. Once asset prices declined, banks had incentive to reduce lending for real estate and other purposes. As prices

17. Id.
18. Id.
23. Id.
24. Id.
25. Id.
27. Id.
28. Id. Until the late 1980s, corporate institutions remained dependent on bank
dropped, the self-correcting mechanism inherent in the speculative process activated itself, and expectations of further price declines generated selling which in turn led to price declines.²³

By the early 1990s, asset deflation dramatically affected the profitability of Japanese financial institutions, which then cast doubt over the stability of the entire financial system.²⁴ Once the bubble burst, a prolonged recession followed.²⁵ By 1995, the stock market lost half of its value from a 1989 peak, a loss of about $2.5 trillion.²⁶ To compound the problem, MOF, the primary regulatory agency, reacted slowly to the growing non-performing loan problem confronting financial institutions.²⁷

B. The Regulatory Response

The first official response to the economic crisis was a series of specific uncoordinated actions predicated on a short recession and rapid recovery of prices.²⁸ These responses had little impact on the downward trend in asset prices and deterioration of the financial system.²⁹ Fortunately, they were followed with more specific and aggressive actions. For example, the government established the Cooperative Credit Purchasing Company (CPCC) in late 1992 to provide accelerated tax benefits to large banks without requiring the banks to

loans instead of direct issuances of securities. While an increasing number of corporate institutions took advantage of access to international markets to diversify their finance sources over the last fifteen years, individual households remained undiversified in their asset selection and suffered greatly from the decline. See Ernest T. Patrikis, Essay, Japan's Big Bang Financial Reforms, 24 BROOK. J. INT'L L. 577, 580-81 (1998).

³⁰. Id.
³¹. Even in 1995, the stock market was still seen as overvalued. For example, in 1995, Dai-Ichi Kangyo Bank was trading at 174 times earnings. By contrast, U.S. banks were trading at about ten times earnings (i.e. investors pay $10 for every $1 in annual profits). James K. Glassman, Down and Out in Japan, WASH. POST, Sept. 12, 1995, at A19.
³³. See Cargill, supra note 12.
³⁴. Id.
³⁵. Id.
directly write off losses and acknowledge them in public reports.\textsuperscript{56} Unfortunately, sales of the CCPC loans were minimal and there is concern that there will not be enough funds to repay the interest on the loans.\textsuperscript{37}

In 1995, the MOF actually closed some of the lowest-quality institutions by allowing massive write-offs and infusing public funds to cover the costs of closing financial institutions specializing in housing loans.\textsuperscript{38} This action demonstrated a recognition by bureaucrats that bursting the bubble was more important in the long run than sustaining all businesses. However, the response was late and incomplete, and the economic condition continued to worsen. In fact, "government efforts to reinvigorate the economy in the 1990s [caused] the public debt to swell to somewhere around 80\% of the GDP by early 1998."\textsuperscript{39} The government's response prior to the introduction of the Big Bang reforms only postponed the "inevitable reckoning with the country's bad debt."\textsuperscript{40}

C. International Pressures

The international forces driving Japan to deregulate are as important as the domestic forces pushing Japan to reform.\textsuperscript{41} Many countries and intergovernmental organizations believe that Japan's current restrictive market is violative of the international norm.\textsuperscript{42} They are "increasingly worried that Japan's accumulated financial and economic problems are pushing it to the brink of a depression, one replete with deflation, bank runs and tremendous unemployment."\textsuperscript{43} Several of Japan's largest trading partners want access to the Japanese market—access that Japan always promised but never delivered. Japan attempted to internationalize early on by means of membership in organizations like the International Monetary Fund, the General Agreement on Tariffs and Trade and the Organization

\textsuperscript{36} Id.
\textsuperscript{37} Id.
\textsuperscript{38} Id.
\textsuperscript{40} Id.; see Japan's Late Awakening, FIN. TIMES (London), Sept. 9, 1995, at 6.
\textsuperscript{42} Keikichi Honda, Why Japan's Big Bang Is Necessary, JAPAN UPDATE, July 1997, at 8.
for Economic Co-operation and Development. However, the Japanese government was reluctant to pay the price of such memberships, i.e. external economic liberalizations, which implied a threat to domestic controls as well.\(^4^4\)

While entrance through the back door seemed opportunistic at the time, in the end, it may be the downfall of Japan's international status. While the rest of the developed world deregulated its financial industries, Japan's reluctance to give up domestic control means it is now out of step with every other major financial market.\(^4^5\) Its industrial standards in areas ranging from construction to transportation are outside international norms.\(^4^5\) Japanese standards for product safety, health requirements, inspection requirements and government approval processes are more stringent than those in most other industrialized countries and act as a de facto barrier to many exporters wishing to do business in Japan.\(^4^7\)

In fact, along with many foreign companies that stopped trading their shares on the Tokyo Stock Exchange because of the high costs associated with such activity, Japanese investors increasingly buy stock in Japanese companies in London, where transaction fees are lower.\(^4^9\) The international concern of the Ministry of Finance is that as Europe approaches a unified currency, the yen has yet to become established as the currency of preference in its major trading areas.\(^4^9\)

Regionally, Japan faces challenges from the markets of Hong Kong and Singapore, which would both like to become Asia's main financial hub.\(^5^0\) Nonetheless, foreign markets are pushing Japan to open up because they see the estimated $10 trillion in combined fi-

\(^{44}\) LEON HOLLERMAN, JAPAN DISINCORPORATED: THE ECONOMIC LIBERALIZATION PROCESS 123 (1988).

\(^{45}\) "While it has been mired in red tape, the world's two other big financial centres, London and New York, have roared ahead." A Big Bang for Japan: The Japanese Government Has Announced Its Intention to Reform the Financial System. Should Proposals Be Taken Seriously?, ECONOMIST, Nov. 16, 1996, available in 1996 WL 1124712.

\(^{46}\) Gillian Tett, Japan Unveils Next Stage in Its Policy 'Striptease', FIN. TIMES (London), Nov. 18, 1997, at 8.


\(^{48}\) Cameron W. Barr, Japan Promises a "Big Bang:" but Some Say It Could Fizzle: Deregulation Seen as Key to Competitiveness of Financial Industry, CHRISTIAN SCI. MONITOR, Nov. 18, 1996, at 9.

\(^{49}\) Richard Hanson, Strike One to Japan's Finance Ministry, ASIA TIMES, June 16, 1997, at 1.

\(^{50}\) See Barr, supra note 48.
financial assets held by Japanese individuals as a potential gold mine.\footnote{51} Some regional leaders also blame the continuing Asian financial crisis on Japan's slow response to its poor economic situation.\footnote{52} The plain conclusion is that Japan's rigid regulation of its domestic financial markets made it uncompetitive with the world's other major financial centers and created financial institutions that depend more on official protection than the ability to succeed amidst free competition.\footnote{53}

\section*{D. Other Domestic Concerns}

Finally, there is a domestic sense that the high level of regulation makes Japan's industries less able to compete in a globalized economy.\footnote{54} Japan's demise as an international market center would have worse domestic ramifications than the current bad loan crisis. If Japan's international status notably declines, the ability of the government and big companies to pay pensions and provide health care and other social services to the aging populace will be jeopardized.\footnote{55} Nevertheless, the Japanese economy has its strengths. Its debt to gross domestic product level on Maastricht criteria\footnote{56} is about twenty percent against sixty percent for the European centers.\footnote{57} In addition, there is recognition that Japan has the money to be an international financial center.\footnote{58} Until these shortcomings are fixed, financial trans-

\begin{itemize}
\item\footnote{51}{Foreign Banks Restore Interest in Tokyo Market, ASIA PULSE, July 23, 1997, available in 1997 WL 11803050.}
\item\footnote{52}{See Hamilton, supra note 43.}
\item\footnote{53}{See Hanson, supra note 49.}
\item\footnote{54}{See Barr, supra note 48.}
\item\footnote{55}{Id.}
\item\footnote{56}{The Maastricht criteria are the economic convergence criteria that must be met by European Union Member States in order to participate in the Euro. Clifford Chance, European Monetary Union: The Legal Framework, 1086 PRAC. L. INST./CORP. L. & PRAC. COURSE HANDBOOK SERIES 405, 452 (1998). For a description of the criteria, see Dr. Fridrich E.F. Hey, Euro Currency Will Come with a Big Bang: German Tax and Accounting Consequences, 8 J. INT'L TAX'N 396, 402-03 (1997) (Exhibit 3).}
\item\footnote{57}{Patrick Weever, City: The Sinking Samurai Yamaichi Has Collapsed and Many Other Japanese Financial Institutions Are Tottering on the Brink. Patrick Weever Examines the Depth of the Country's Crisis and the Corruption Behind It, SUNDAY TELEGRAPH (London), Nov. 30, 1997, at 6.}
\end{itemize}
actions that otherwise would be expected to take place in the Tokyo market will be conducted elsewhere. Furthermore, various industries may become less competitive due to the inability to obtain necessary financial services, and Japan’s influence in the international arena will be undermined.

III. The Big Bang

A. Goals of Reform

The ultimate goal of any Japanese financial reform is improvement in the overall performance of its financial markets. Using the British and U.S. examples, Japan hopes similar reforms will improve its international status. The lesson from the British is that market deregulation has to proceed boldly, regardless of the short-term pain. Also, new unambiguous rules must be devised to replace old, convoluted regulations as well as administrative guidance. Like Japan, deregulation for both the United States and Britain was necessary for survival in the changing institutional and international economic environment of national financial markets.

B. Deregulation in New York and London

The main difference between deregulation in the United States and Britain rests in the catalyst for reform. In the United States, the impetus was the institutionalization of the market, the increasing importance of financial institutions as opposed to individuals as participants. In Britain, the internationalization of the markets drove reform. In Britain and the United States, the Big Bang reforms accomplished their principal purposes of substantially reducing institutional investors’ transaction costs and maintaining their respective positions as major international financial centers.

59. Id.
60. Id.
62. Id. For discussion of the practice of administrative guidance, see text infra Part IV.E.1.a.
64. Id. at 28.
1. United States

The process of deregulating the world's financial markets began in the United States in 1975 and took several years to complete.\(^{65}\) In 1963, the U.S. Supreme Court ruled in *Silver v. New York Stock Exchange* that a stock exchange may be subject to antitrust laws.\(^{66}\) Although *Silver* did not specifically address exchange rules, it was clear that rules regulating commission rates and restrictions on membership would not satisfy antitrust laws.\(^{67}\) Thus, *Silver* furnished the legal impetus for change in the United States.\(^{68}\)

There was also economic pressure for reform. The growing economic power of institutional investors had the effect of undermining the fixed commission structure on the exchange.\(^{69}\) In response, on May 1, 1975, dubbed Mayday, the Securities and Exchange Commission (SEC) prohibited fixed commissions on all customers' trades.\(^{70}\) A month later, Congress enacted the Securities Acts Amendments of 1975 that ratified the SEC action and further provided that any qualified broker-dealer firm was entitled to stock exchange membership.\(^{71}\)

Mayday's primary effect was to significantly reduce income from the commission on securities transactions. It was the demands of institutional investors that drove commission revenues from their high of $3.163 billion to $2.809 billion in a twelve-month period.\(^{72}\) At the same time, costs rose rapidly, reaching $6.314 billion in 1977.\(^{73}\) Thus, Mayday depressed profits on Wall Street, which fell from $915 million in 1971 to $188 million in 1977.\(^{74}\) As income from commissions fell and competition intensified, Wall Street responded with "creativity and innovation in designing and marketing nontraditional products and services . . . to create new sources of revenue beyond

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68. Id.
69. Id. Between 1960 and 1971, the average size of mutual fund orders on the New York Stock Exchange increased from 550 to 4,206 shares. *Securities Industry Study: Hearings Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing, and Urban Affairs*, 93d Cong. 65 (1973).
73. Id.
74. Id.
simple common stock, straight preferred and long bonds."75 Furthermore, money managers became more aggressive in getting the highest rate of total return on investments.76 Even though U.S. deregulation was a success, the rest of the world did not immediately follow U.S. lead towards deregulation. Britain was the next major economic power to deregulate in a Big Bang fashion eleven years later. However, since 1986, deregulation has occurred at a faster pace throughout the stock markets of the world.77

2. Britain

Like the U.S. reform, British deregulation took place over several years. While the term Big Bang is typically used to refer only to the important changes in the London Stock Exchange's (LSE) rules and procedures that occurred on October 27, 1986, some of the major changes in the London market occurred well before this time.73 Also, like the U.S. experience, it was a series of financial, economic and legal pressures that created the impetus for deregulation.78 The legal catalyst was a lawsuit brought against the LSE by the Director of Fair Trading in 1977 pursuant to his charge as head of the Office of Fair Trading, the government agency responsible for enforcing the Restrictive Practices Act of 1976 (RPA).79 The suit charged that the exchange's fixed commission rates and membership restrictions were illegal under the RPA.79 In July 1983, an agreement was made and the lawsuit terminated under which the exchange was exempted from the RPA.80 The LSE, for its part, agreed to open up membership, abolish fixed commissions and allow company representatives and

75. Id. at 790.
76. Id. at 792.
78. POSER, supra note 63, at 27. Fixed commissions on transactions in foreign securities were scrapped in 1984, brokers were permitted to act as dealers in foreign securities under certain conditions in 1984, and the disassembly of membership restrictions began as early as 1969 and were completed in March 1986. Id.
79. Id. at 25.
80. Id.
81. Id. at 26.
82. Id.
public members on its governing council.\textsuperscript{83} For firms whose activities were deregulated, London’s Big Bang created competitive pressures that cut profit margins and led to substantial operating losses for some.\textsuperscript{84} On the other hand, the Big Bang stimulated competition among firms, increased efficiency and liquidity of the market, reduced costs for investors and enhanced the international role of the London securities market.\textsuperscript{85} It also provided the incentive for a screen-based trading system.\textsuperscript{86} While Britain is no longer one of the most important economic powers, London has retained its status as a major financial center, as a place where many transactions take place, in many ways because of its Big Bang.

\section*{C. Elements of the Big Bang}

The sweeping changes initiated by the LSE in 1986 embody the three principal elements of Big Bang deregulation. Japan’s Big Bang is more extensive, however, and it will produce changes not only in the securities market but in the financial, economic and fiscal systems.\textsuperscript{87} Nevertheless, the British Big Bang remains a useful comparison because the two reform packages are based on similar principles.\textsuperscript{88}

First, the membership structure of the LSE changed, giving access to domestic and foreign investment banks as well as commercial banks.\textsuperscript{89} Before deregulation, membership was restricted and under the control of the LSE governing body.\textsuperscript{90} The need for capital provided the incentive to open up membership.\textsuperscript{91} While member firms were first permitted to obtain capital from non-members in 1969, it was not until the Big Bang that a single non-member shareholder could own one hundred percent of the voting power of a member firm.\textsuperscript{92} This change reflected the perception that the market needed additional capital, especially foreign capital, to participate in large-

\begin{thebibliography}{99}
\bibitem{83} Id.
\bibitem{84} Id. at 74.
\bibitem{85} Id. at 74-75.
\bibitem{86} Id. at 75.
\bibitem{87} See Japan: Review 1998, supra note 41.
\bibitem{89} POSER, supra note 63, at 28.
\bibitem{90} Id. at 12.
\bibitem{91} Id. at 30.
\bibitem{92} Id. at 31.
\end{thebibliography}
scale institutional trading.\textsuperscript{93} Permitting non-members to own member firms brought the capital sought by the LSE, and it also brought some important players into the international equity markets.\textsuperscript{94}

Second, the Big Bang eliminated fixed commissions allowing London to remain competitive with foreign markets that already had a system of negotiated commissions.\textsuperscript{95} Before deregulation, the LSE set the commissions customers paid to their brokers.\textsuperscript{96} The primary purpose of the fixed commission was to make sure customers were charged at least a minimum amount established by the rate schedule.\textsuperscript{97} As the securities market became more complex, so did the rate schedules.\textsuperscript{98} The elimination of fixed commissions in gilt-edged securities and equities was implemented as a condition of the settlement agreement in the RPA lawsuit brought by the Director of Fair Trading against the LSE.\textsuperscript{99} However, the LSE went further than the settlement required and lifted all fixed commissions because of the pressure placed on it by the Bank of England, its informal regulator and advisor.\textsuperscript{100} As the central bank, the Bank of England would have no difficulty disciplining the LSE and members if its advice was refused.\textsuperscript{101}

Replacing fixed commission rates with competitive rates benefited the increasing number of institutional investors who saw a reduction in their commission costs, but it harmed the individual investor who actually saw an increase in commission charges.\textsuperscript{102} In part, higher commissions on the smaller transactions of individual investors was a result of the LSE failure to reduce the costs of clearing and settling transactions.\textsuperscript{103} The heavy emphasis on transferring pieces of paper to clear and settle a sale resulted in an inefficient clearing pro-

\textsuperscript{93} Id.
\textsuperscript{94} Id. at 32.
\textsuperscript{95} Id. at 28; see also Aulana Peters, \textit{The Changing Structure of the Financial Services Industry and the Implications for International Securities Regulation}, 46 \textit{WASH. & LEE L. REV.} 525 (1989).
\textsuperscript{96} POSER, supra note 63, at 13.
\textsuperscript{97} Id.
\textsuperscript{98} Id. London had four different schedules: gilt-edged securities, debentures and bonds, shares other than U.S. or Canadian companies and shares of U.S. or Canadian companies. In addition, brokers had discretion to reduce the commission rate by specified amounts under certain circumstances and for certain types of orders. Id.
\textsuperscript{99} Id. at 26.
\textsuperscript{100} Id. at 29.
\textsuperscript{101} Id. at 30.
\textsuperscript{102} Id. at 55.
\textsuperscript{103} Id.
cess that took two weeks to complete. Its replacement, an electronic three-day system, which eliminated stock certificates and paperwork, did not arrive until 1994.

Third, the Big Bang brought fundamental changes to securities trading, changes that were designed to create a more efficient and fairer market for investors. The elimination of fixed commissions required the LSE to revise its system for trading securities. The revisions resulted in two major changes to the LSE: the abolition of single capacity restrictions and a computerized quotation system.

The single capacity restrictions required every investment firm to choose whether it wished to act as an agent for customers or as a dealer (jobber) for its own account. The single capacity system was seen as preventing London from becoming a center for the trading of international securities. Although it avoided the conflicts of interest inherent in firms that act in multiple capacities, it prevented diversification and the acquisition of capital.

The computerized quotation system replaced the traditional "open-outcry" trading system. The new system allowed market-makers to show their quotations and offers to buy or sell on a computer screen that could be seen by any person who wished to subscribe. The system was chosen primarily because it furthered the LSE goal of becoming a center for international trading. Its main advantage is that it does not depend on the geographical location of the members using it. Both the abolition of the single-capacity system and the move to an automated quotation system created a more efficient and productive London financial market.

The three elements are closely related. The elimination of fixed commissions made the single-capacity system unworkable. Negotiated commissions meant increased competition for business, and increased competition for business meant the desire to diversify skills and abilities to attract business, and that made the single-capacity

104. Id. at 58-59.
105. Id. at 63.
106. Id. at 28.
108. Id.
109. Id.
110. Poser, supra note 70, at 38.
112. Poser, supra note 70, at 42.
system unworkable. The ability to engage in dual capacities made it necessary to modify the trading system. The changes made to the trading system to service the growing number of institutional customers increased the need for capital, and the need for capital necessitated changes in the LSE membership rules. Taken as a whole, these changes made it possible for London to compete in the world securities market.

**IV. Japan’s Plan**

According to Hashimoto, the goal of Japan’s Big Bang is to revitalize the Tokyo market into a financial market comparable to those of New York and London by the year 2001. In order to accomplish that goal, the Big Bang simultaneously promotes market reforms and bad loan disposal by financial institutions. Japan’s plan rests on three principles: free, fair and global. “Free” meaning toward a free market where the market mechanism prevails; “fair” meaning toward a transparent and credible market; “global” meaning toward a leading international market.

Japan believes the reforms must benefit the “users” of the financial market. Thus, the goals underlying each change are the following: expanding the choice of means for investors and borrowers, improving the quality of services and promoting competition among securities firms, developing a market with more depth and establishing a reliable statutory framework as well as a fair and transparent market. These principles, goals and the Big Bang in general represent a movement towards reliance on market mechanisms. The market accounts for the free and fair principles making the Japanese market more attractive to foreign investors and satisfying the final “global” principle. One of the hallmarks of the market system is its demand for efficiency. The Japanese market after the Big Bang will be stable when it reaches efficiency, and that will require the disposal of non-performing assets and freedom from government regulation.

113. Id. at 37.
114. Id. at 28.
116. Id.
117. Id.
118. Id.
119. Ministry of Finance, supra note 5.
Hashimoto's proposals amount to the most significant changes in the Japanese financial system since the U.S. Occupation after World War II. His proposals include scrapping fixed brokerage commissions on stock trades of more than fifty million yen (US$439,000), allowing brokerages' trust-banking units to manage pension funds, allowing brokerages to sell sophisticated financial products, allowing banks' brokerage units to buy and sell stocks and permitting financial institutions to be owned by holding companies. The reforms should liberalize the financial market, break down barriers and improve disclosure and fair-trading practices.

While the details of each proposal are not yet clear, at the core of each is the removal of the MOF and the government in general from the business of regulating markets.

A. Compared to London

The goal of these changes is to accomplish what the LSE was able to do in 1986, namely to remain competitive in the international securities market. Thus, like the LSE, the Japanese market will abolish fixed commissions in 1999. The hope is that negotiated commissions will improve the quality of services and promote competition.

In London, the move to negotiated commissions benefited institutional investors and harmed smaller, individual investors. However, the discrepancy in benefits was the LSE failure to reduce costs associated with clearing and settling transactions.

Like the pre-Big Bang LSE, Japan currently has a single-capacity system. The Big Bang would allow banks' brokerage units to buy and sell stocks as well as underwrite a wider variety of bonds. Currently, they can only trade and underwrite some types of bonds. In addition, similar to British reforms, Tokyo will open up membership to its market. Until now, Japan has not permitted holding companies for financial institutions. As it did in London, this has inhibited the ability to use capital in ways that could repair Japan's economy. An in-

121. Japan Banking on Change, supra note 7.
122. Id.
124. See Hanson, supra note 49.
125. Ministry of Finance, supra note 5.
126. See POSER, supra note 63, at 55.
127. See id.
128. See Japan Banking on the Change, supra note 7.
flux of capital will benefit the domestic as well as international markets.

Domestic consumers also benefit from opening up the management of pension funds because it will increase competition. Brokerages will be able to compete with banks by offering accounts where customers can deposit paychecks and pay bills. The desired result in the market will be efficiency and profitability. Furthermore, as in other countries, Japan is seeing an institutionalization of its market. Thus, making things easier and more profitable for pension funds is an important goal, especially given Japan’s aging society. Increased competition will lower costs and make transactions more efficient as managers move to increase business and profits. The goal of all these reforms, as was the goal in the British Big Bang, is to revitalize the market and boost competitiveness. For this to happen, it is necessary for Japan to establish a free trading environment to match those of the United States and Europe.

B. Foreign Exchange and Foreign Trade Control Law

Improving efficiency and lowering costs to investors are the goals of the first set of reforms, a series of amendments to the Foreign Exchange and Foreign Trade Control Law. The substantial changes made by the Diet took effect in April 1998. The reforms allow Japanese companies and individuals to open overseas bank accounts and settle payments for trades in foreign financial markets freely. In the past, companies and individuals had to go through registered banks to ship money overseas. Shipping included opening deposit accounts with overseas financial institutions to settle export and import payments, making loans, investments and debt guarantees, netting foreign-currency-denominated claims and obligations, trading foreign currencies and making foreign-currency futures contracts. With a monopoly, those registered banks charged excessive

130. Honda, supra note 42.
131. Id.
132. Panel Eyes Full Deregulation of Forex Services, supra note 2.
133. Revision of Foreign Exchange Law Wins Diet Approval, supra note 8.
135. Id.
136. Ministry of International Trade and Industry, Amendment of the Foreign
fees. The changes to the FEFTL completely liberalize all foreign exchange control regulations. In fact, one of the symbolic changes in the law is the removal of the word "control" from its title.

The three principal elements of the amendments are: liberalization of domestic and cross-border foreign exchange transactions, complete liberalization of foreign exchange business and establishment of an ex-post facto reporting system. These changes abolish the system of prior permission and notification for foreign exchange transactions not conducted through authorized foreign exchange banks, which made it more burdensome to deal in foreign currency outside of the few government registered banks. The prior permission and notification systems are replaced with a less invasive retro-active system. Specifically, the amendments state that foreign exchange banks and money exchangers no longer need permission from authorities for foreign exchange transactions, thus abolishing the designated securities firm system.

Liberalization is also accomplished by the abolition of the fixed foreign exchange rate system. It is replaced with the instruction that authorities make efforts to stabilize the exchange rate by buying or selling the means of payment. Reform of the foreign exchange system should help to reduce the cost of overseas business and maintain international competitiveness. At the same, it should increase the number of financial transactions thus contributing to the quality, quantity and sophistication of the market.

C. Re-Regulation

As mentioned earlier, while the Big Bang is noted for its de-


137. But see Andrew Horvat, Japan Investors Tread Warily: Deregulation Hasn't Encouraged the Transfer of Funds Overseas, INT'L HERALD TRIB., Oct. 27, 1998, at 22.


139. MITI Report on FEFTCL Amendments, supra note 136.

140. Id.

141. FEFTL art. 10.

142. FEFTL art. 7.

143. MITI Report on FEFTCL Amendments, supra note 136.
regulation, re-regulation often occurs simultaneously.\textsuperscript{144} However, re-
regulation in the face of deregulation or liberalization may be justi-
fiied as long as the new regulations are meant to improve the condi-
tions for competition.\textsuperscript{145} Under the new FEFTL, the Japanese gov-
ernment still requires prior notification for people who intend to
export or import the means of payment.\textsuperscript{146} In addition, prior notifi-
cation is also required on foreign direct investment in certain indus-
tries.\textsuperscript{147} These industries include leather goods production and weap-
on manufacturing.\textsuperscript{148} Banking and textile production are among the
industries that were de-listed by the amendments.\textsuperscript{149}

Even if prior notification is required, however, the government
promised that a request or order to suspend or modify the proposed
foreign direct investment would be limited.\textsuperscript{150} The amendments fur-
ther simplified reporting information to focus on essentials like data
for balancing payments statistics and information that contributes to
the accurate monitoring of market trends.\textsuperscript{151} In chapter 6 of the
FEFTL law, the amendments develop an ex-post facto reporting sys-
tem. Furthermore, the more limited prior notification system for
protected industries only requires reports of the following: payments,
identification by banks and other financial institutions, capital trans-
actions, direct investment in Japan, importation of technology and
foreign exchange business.\textsuperscript{152}

D. Effects

These reforms will facilitate the flow of money to the market,
maximizing returns and minimizing costs to market participants.\textsuperscript{153} This
does not mean that the Japanese markets will prosper. If the
current fee and tax structures are maintained, at least some trading

\begin{itemize}
  \item \textsuperscript{144} See VOGEL, supra note 3.
  \item \textsuperscript{145} Id. at 17.
  \item \textsuperscript{146} FEFTL, Law No. 228 of 1949, art. 18 (as amended); see Horvat, supra note 137.
  \item \textsuperscript{147} FEFTL art. 26.
  \item \textsuperscript{148} Tomomitsu Oba, Ramifications of Foreign-Exchange Decontrol, JAPAN
  \item \textsuperscript{149} Dai-Ichi Kangyo Bank, Overhaul Set for Foreign Exchange Law: Steam
<http://www.infoweb.or.jp/dkb/infoecon/9706/9706-3e.html>.
  \item \textsuperscript{150} FEFTL arts. 26-31.
  \item \textsuperscript{151} Dai-Ichi Kangyo Bank, supra note 149.
  \item \textsuperscript{152} FEFTL arts. 26-31.
  \item \textsuperscript{153} Dai-Ichi Kangyo Bank, supra note 149.
\end{itemize}
will shift to foreign markets where fees and taxes are lower.\textsuperscript{154} For example, under the amendments, a Japanese citizen can open an overseas account to pay for mail-order purchases or purchase stock.\textsuperscript{155} An investor in Japan would find it beneficial to do their buying and selling overseas, even for Japanese stocks, if the commissions on stock transactions are lower.\textsuperscript{156} Therefore, other reforms must follow the opening up of the foreign currency market in order to prevent the rapid outflow of yen to overseas markets.

Some shift in the amount of holdings abroad and domestically is expected as investors attempt to maximize their options in the market's freer atmosphere. In fact, since the implementation of the FEFTL measures, Japanese individuals and institutions have moved to place money in overseas dollar and other foreign-currency accounts that have a much higher interest rate than domestic yen-dominated accounts.\textsuperscript{157} In April 1998 alone, there was a net capital outflow of 2.8 trillion yen (US$23.3 billion).\textsuperscript{158} However, this figure is only a fraction of the estimated 1,200 trillion yen (US$10 trillion) Japanese individuals have in various forms of savings accounts.\textsuperscript{159} The weakened state of the Japanese economy makes these savings a flight risk as well. The likely effect of the combined changes in the foreign exchange laws without corresponding changes elsewhere may encourage Japanese investors to look to foreign financial markets for better opportunities.

Specifically, if Japan does not abolish the transaction tax and fixed commission system swiftly, the loosening of the foreign exchange laws will result in a loss of business to overseas firms. The reforms must also permit the development of a variety of financial products to compete with international firms. As proposed, some of these changes are part of the Big Bang.\textsuperscript{160} However, they were not implemented at the same time the changes to the Foreign Exchange Law were. Until further changes are implemented, Japan will lose

\textsuperscript{154} Id.
\textsuperscript{155} Oba, supra note 148.
\textsuperscript{156} Id.
\textsuperscript{157} Neil A. Martin, Big Bang, Big Surprises, BARRON'S, May 25, 1998, at 18 (stating that a three-month yen time deposit pays a mere 0.25%-0.35% a year); Dai-Ichi Kangyo Bank, supra note 149.
\textsuperscript{158} Tony Boyd, Japan Invests $36bn Overseas in First Month of Deregulation, AUSTRALIAN FINANCIAL REV., May 12, 1998, at 14.
\textsuperscript{159} Horvat, supra note 137; Japan Banking on Change, supra note 7, at B5.
business to cheaper more diversified overseas business. The barriers shielding Japanese financial markets from overseas rivals must fall, and Tokyo's ability to survive in unfettered global competition tested.  

The FEFTL changes are consistent with the free, fair and global principles of Big Bang reform; it is the global principle that is specifically emphasized in the FEFTL changes. The liberalization of the foreign currency and exchange system effects all cross-border capital transactions, including bank deposits, securities and insurance. For all of these transactions, the revision of the law brings Japan's currency conversion in line with international standards. As discussed above, this does not mean immediate success for the Japanese financial market. After the protective barriers disappear, Japan will continue to lose in the international market if it does not conform to global norms in other regulatory areas like tax and commission rates.

In order for the Japanese financial market to be internationally attractive, it must be efficient and expandable, allowing free entry and exit in the business activities of the participants' choice. The revitalization of the Japanese market requires the authorized foreign exchange bank system be removed allowing the free exchange of foreign currencies and derivative transactions, but it will also require more. The amendments help revitalize the domestic market by the total liberalization of capital transactions, abolition of the system of authorized foreign exchange banks and removal of the prior notification restrictions from most industries. Without complementary reforms in other financial laws, the FEFTL amendments will simply make it easier for domestic investment to move abroad, leaving Japan with the money but none of the other essentials of an international financial center. The Big Bang reforms should avoid this result for the benefit of Japan.

E. Will the FEFTL Reforms Be Successful?

Mindful of criticism that previous deregulation plans have come too little too late, ministry officials insist that these changes are much

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161. Dai-Ichi Kangyo Bank, supra note 149.
164. Asahi Shimbun Interview, supra note 58.
more than a gimmick. 165 Regardless, the Japanese Big Bang will not be taken seriously unless the various reforms originally outlined by Hashimoto are approved and implemented without delay. This will require continued government leadership support of the reforms, which are certain to cause short-term pain. Eisuke Sakakibara, a former vice-minister for Hashimoto and architect of the Big Bang reforms, believes that financial deregulation is necessary in this time of globalization, but some social needs, like high employment, will not be sacrificed to achieve financial goals. 166 While the government continues to pass additional Big Bang reforms 167 under a new Prime Minister, Keizo Obuchi, comments like those of Sakakibara raise some concern by commentators that the government is not willing to remove itself from its financial industries. 168 In addition, there is real concern that the high level of regulation makes Japan’s industries less able to compete in a globalized economy. 169 If Japan is unable to compete, it will be difficult to pay pensions, provide health care and other social services to the aging population, 170 the same social needs that Sakakibara says he will not sacrifice.

The success or failure of the FEFTL amendments is not necessarily a forecast of the success or failure of other Big Bang reforms. The FEFTL amendments are fairly uncontroversial; few companies will be forced out of business because of them. 171 Other reforms, like the end of fixed commissions and the single-capacity system, will be aggressively challenged by securities firms whose income will be reduced and competition increased by the planned reforms. 172 These changes will put many brokers out of business. While supporters of

165. Rowley, supra note 5.


167. Rowley, supra note 5.


169. Barr, supra note 48.

170. Id. Japan is the world's “grayest” country with an estimated seventeen percent of the population sixty-five years old or older by the year 2000. See Japan: Review 1998, supra note 41. In fact, by 2025, one of every four Japanese is expected to be over the age of sixty-five. See Hamilton, supra note 43.


the Big Bang reforms say they are willing to let businesses fail in light of the reforms, in reality, politicians may shy away from the proposed complete liberalization of restrictions and instead go for a more convoluted solution in order to prevent business failures.\textsuperscript{173} Such alternatives include allowing firms to enter markets previously excluded by setting up a new business under the umbrella of a holding company.\textsuperscript{174}

The reforms to the FEFTL were implemented in April 1998. The amendments should provide the impetus for the rest of the reforms only if those changes come swiftly. If they are hampered by the political process and vested governmental interests, the strength of the Japanese market—its high level of available capital—will fly overseas to more investor-friendly markets. The bureaucrats, their administrative guidance,\textsuperscript{175} business and the symbiotic relationship between business and Diet Members\textsuperscript{176} must not be allowed to destroy the Big Bang. There will be pains in the beginning, but if Japan is to remain an international finance center, it must follow the liberalization of the foreign exchange and currency markets with other important deregulation measures.

1. Structural Impediments to Reform

a. Administrative Guidance (Gyosei Shido)

Administrative guidance\textsuperscript{177} is a common Japanese regulatory technique that, although generally non-binding, seeks to conform the behavior of regulated parties to broad administrative goals.\textsuperscript{178} It is commonly used to describe a "category of informal regulation of private industry that is widespread in Japan."\textsuperscript{179} To most observers, it is bureaucratically driven, informal and part of a "carefully orchestrated industrial policy."\textsuperscript{180} To others, "[i]n reality, law is an empty

\textsuperscript{173} Id.
\textsuperscript{174} Id.
\textsuperscript{175} See discussion infra Part IV.D.1.a.
\textsuperscript{176} See Barr, supra note 48; Parry, supra note 172.
\textsuperscript{177} There are five forms of administrative guidance: shiji (directives), yobo (requests), keikoku (warnings), konkoku (suggestions) and kansha (encouragements).
\textsuperscript{178} Paul Lansing & Marlene Wechselblatt, Doing Business in Japan: The Importance of the Unwritten Law, 17 INT'L LAW. 647, 658 (1983).
\textsuperscript{180} See Hurst, supra note 47, at 392.
\textsuperscript{181} YUKIO YANAGIDA ET AL., LAW AND INVESTMENT IN JAPAN: CASES AND MATERIALS 125 (1994).
shell; it is . . . administrative guidance that [has] practical significance.\textsuperscript{181}

Under the recently adopted Administrative Procedures Act, administrative guidance received its first legal recognition. While the Act does not pass judgment on the legality of such guidance, it reiterates the fundamental principles derived from the Japanese concept of "rule of law" as an admonishment, and it provides for some procedural mechanisms to minimize the risk of abuse by administrative bodies.\textsuperscript{182} Whether the Act's general provisions will have a specific impact on the role of administrative guidance in Japanese policy making is questionable, and the new liberalizations run the risk of being overcome by the strength of administrative guidance.\textsuperscript{183}

If administrative guidance is allowed to continue under the Big Bang, the changes will have little impact on the economy because foreigners still will be forced into the less advantageous position in any investment scheme through administrative guidance. As long as government is allowed to protect industry through informal measures and domestic business can rely on ties to bureaucrats to overcome foreign investors, the Big Bang reforms and the Japanese economy will suffer. More than anything else, administrative guidance has the ability to undermine the Big Bang.

\textit{b. Keiretsu System}

The \textit{keiretsu} represent strong, interlinked business group relationships. There are six large horizontally-integrated and numerous other vertically-integrated corporate or distribution \textit{keiretsu}.\textsuperscript{184} Companies within a \textit{keiretsu} are bound together by mutual directors, extensive stock cross-holdings, group-wide financing through one main affiliate bank and other long-term business relationships.\textsuperscript{185} Three of


\textsuperscript{185} See id.; see also Frank A. Weil & Norman D. Glick, \textit{Japan—Is the Market Open? A View of the Japanese Market Drawn from U.S. Corporate Experience}, 11
the six major *keiretsu* have roots in old *zaibatsu*, large commercial and industrial combines outlawed during the U.S. Occupation.\(^1\)

The level of cross-shareholding has the potential for effecting the success or failure of the Big Bang. Cross-shareholding creates a lack of transparency and speculation in shares. It allows Japanese companies in a *keiretsu* to create their own mini-markets; the bank at the center of the *keiretsu* approves the financing for projects, the necessary materials are bought within the group and the product is sold within the group. This system leaves little need for maximizing profits, and that is contrary to market forces and the Big Bang reforms generally.\(^1\)

The current recession, however, demonstrates that cross-shareholding can only be successful if the economy is doing well. Since the recession began in the early 1990s, the percentage of mutually held shares listed on Japan’s stock exchanges has dropped .5 percent every year.\(^2\) *Keiretsu* companies are selling their shares because the prolonged recession is forcing many companies to raise cash quickly, and the slumping stock market diminishes the attraction of buying and holding unprofitable shares.\(^3\)

Cross-shareholding became an institution in Japanese business during the 1970s in response to the Japanese fear that foreigners would try to come into the Japanese market and dominate it through buying stock. The Big Bang reforms will make cross-shareholding less attractive because competition will increase, requiring cost cutting measures. Since cross-shareholding reduces available capital, it is not a good investment, especially when the need for capital arises. If foreigners are truly allowed into the Japanese market through Big Bang deregulation, Japanese companies will have to sell their sister holdings to compete in the new market. It is highly unlikely that an attempt by the *keiretsu* to stay together and successfully block the entry of foreigners into the market would be successful. If that is correct, then a true liberalization of the market will force large Japanese companies to rethink some of the basic ways they do business. However, if permitted to remain a major force in the Japanese financial

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Law & Pol'y in Int'l Bus. 845 (1979).

186. The three are Mitsubishi, Mitsui and Sumitomo. Yanagida et al., supra note 180, at 83.


189. Id.
market, the *keiretsu*’s lack of transparency and speculation of shares will prevent Japan’s achievement of Big Bang goals.\(^{190}\)

2. Social Impediments to Reform: Disdain of Foreigners

Cultural barriers also may effect the success of the Big Bang reforms. The cultural and other non-legal considerations are as important to consider as the structural impediments because it is expected that opening up the Japanese market will increase the number of foreign firms investing in Japan.\(^{191}\) Thus, before the market opens in practice, Japanese attitudes towards foreigners must change. The Japanese do not see themselves as competing with each other. Their goals have been to focus efforts on gaining market share and adversarial trading on a national basis in export markets.\(^{192}\) The Japanese are known for their nationalism, and a series of reforms that open the domestic financial market to international business will threaten cultural norms and test the limits of cultural attitudes.\(^{193}\) It will not be easy for Japanese companies to follow the United States and Britain by adopting Anglo-Saxon market mechanisms and inviting foreigners over for takeovers and acquisitions.\(^{194}\) Foreign investors should not expect to be welcomed with open arms into the Japanese market any time soon regardless of the liberalizations in the law.

V. Conclusion

Before anything else can be said, one must realize that any real change that will happen must be measured in decades, not years.\(^{195}\) It would be overly optimistic to think that the Big Bang would produce an immediate revitalization of the Japanese economy.\(^{196}\) While there appears to be a solid backing by the Prime Minister and his government to the series of reforms that make up the Big Bang, there will be considerable opposition to any serious change. The existing legal obstacles to foreign investment were put in place to avoid foreign

\[^{190}\text{See Milhaupt, supra note 181, at 434 (stating that features of the }keiretsu\text{ conceal the need for investor protection and market oversight).}\]

\[^{191}\text{Patrikis, supra note 28, at 588.}\]

\[^{192}\text{Dan F. Henderson, }Foreign Acquisitions and Takeovers in Japan, 39 St. Louis U. L.J. 897, 902 (1995).}\]

\[^{193}\text{Japan’s Big Bang, WALL ST. J., Apr. 1, 1998, at A18.}\]

\[^{194}\text{See id.}\]

\[^{195}\text{See Henderson, supra note 192, at 901.}\]

control; however, the key to future growth lies in structural reform of the public and private sectors of the economy that increases the level of available capital.\textsuperscript{197} If the results of Japan’s Big Bang are anything like those in London, much of that capital will come from foreign investors. If that happens, then the amount of foreign control will increase at the expense of less competitive domestic companies. In a market-driven economy, those that do it the fastest and cheapest succeed. Japanese companies are not known for their efficiency and will have to make radical changes in the way business is done if they expect to compete openly with foreign companies.

The immediate changes brought about by the amendments to the FEFTL will accelerate the need for further reforms to make Japanese companies more competitive with foreign firms. Without further Big Bang measures, the amendments will create a flight of Japanese capital to overseas markets, taking with it the strength of the Japanese market. The time has come for Japan to realize its closed system with excessive regulation and governmental interference is incompatible with today’s global market. If Japan truly is to recover from its prolonged recession and regain its title as a top international market, it will have to implement the Big Bang reforms by the 2001 deadline or face being hampered by another set of prolonged, posed and ineffective reforms.\textsuperscript{198}


\textsuperscript{198} See generally Silvia Ascarielli & Michael R. Sosit, Investors Scramble to Dump European Stocks to Buy Japanese Shares Due to Restructuring, \textit{Wall St. J.}, Mar. 29, 1999, at C12 (stating that the Nikkei 225 index of leading Japanese shares has gained 25% for the year as compared to a pan European measure of major companies, which is only up 5% year-to-date).