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A historical inquiry into the Japanese financial system and economic performance

Masanobu KONNO

Summary

The first aim of this paper is to draw how Japan has constructed its financial system to modernize its industry. Many observers assert the post-World War II reforms as the baseline from which Japanese financial system evolved. But as in this paper I have examined, the post-World War II financial system was constructed on the prewar base. Not only the financial structure but regulatory ideology has formed at the beginning of the government induced industrialization in the Meiji period.

The second is to examine the effect of such ideology on the policy making and macroeconomic performance. The bubble and bad claims in the 1990s are both necessary consequences of that ideology in a sense. Contemporary changes of Japanese economy are sometimes as those have no historical baseline considered this paper asserts economic performance is deeply connected with the path dependence historically formed.

And the third is to point the financial internationalization is necessary movement after the World War II that forces gradual financial reformations to all countries.

1. Introduction

A historical perspective on the Japanese financial system is an indispensable starting point for any study of contemporary changes of Japanese economy. For foreign observers, of course including economists and students may have a temptation to have a magical key to unlock the door to an unfamiliar and occluded Japanese system. These observers would surely dismiss such a dubious quest not to misunderstand a singularity of one national financial system. In general, a historical perspective on the development of any national financial system is important because current regulatory institutions and practices tend to be informed by those of the past.

Many observers mistakenly assert the post-World War II reforms as the baseline from which contemporary Japanese financial system evolved. The financial system that emerged during the 1950s was shaped the prewar system in both structure and regulatory ideology. A more appropriate starting point is the end of the 19th century[1], the point at which the infrastructure of a modern financial system was first established.

2. Prewar period

The Japanese government implemented economic and financial reforms in order to modernize the newly established state and to ensure its independence from colonial rule after the Meiji Restoration of 1868. Japanese financial authorities Ito Hirobumi (1841-1909)[2] initially adopted the US banking system as a modern model and began to license several private banks to issue the national currency in 1872. The National Banking Act was dated in 1876, which called for the creation of bank notes inconvertible to metal. The result was formation of 151 banks by 1879 based on the act. Matsukata Masayoshi (1835-1924)[3] implemented stock exchanges in Tokyo and Osaka in 1879 based upon London exchange.

Before establishment of the Bank of Japan (Nippon Ginko)[4], the Yokohama Specie Bank (Yokohama Shokin Ginko)[5] was established in 1880.That bank was expected to encourage import substitution and export-oriented manufacture production by means of trade credit to businesses. The formation of more than 150 banks caused inflation and confusion according to the emergent issue of many kinds of bank notes. A central bank with exclusive currency issuing rights was set up in 1882 along the lines of the Belgian model. A new regulatory framework for commercial banking - the Banking Act- went into effect in 1890, and a postal savings system was inaugurated in 1885 along the lines of UK model.

It underwrote the stability of the banking system by frequently calling upon the Bank of Japan to extend help to troubled firms. It was needed to ensure the undisturbed flow of private sector funds to industry. It also sought a direct role in the financial system by establishing government financial institutions for private capital flow.

The Sino-Japanese war (1894-95)[6] ended with the 200 million liang reparation to Japan according to the Shimonoseki Treaty. The Japanese government could place that reparation on deposit with the Bank of England, and could draw deposit by transfer account between the JOB and the BOE. Japan could enter to the already world wide established gold-standard system and could have a chance to reform the compelled trade system to a modern open system[7]. The Hypothecary Bank of Japan （Nihon Kangyo Ginko） was established to promote agricultural and industrial technical improvement by means of loans on mortgage in 1897. The Industrial Bank of Japan（Nihon Kogyo Ginko）was established to finance strategic industrial demands in 1902.

The Bank of Taiwan （Taiwan Ginko）was established in 1897 to finance industrial demand in

Taiwan and to accelerate the trade between South China and the Pacific Islands belong to Japan. The Hokkaido Development Bank (Hokkaido Takushoku Ginko) was also established in 1900 to encourage regional industrial development and to strengthen northern defense line of Japan against Russia. The Bank of Korea (Chosen Ginko) was established with currency issuing rights as a central bank in Korean Peninsula in 1911. The Central Bank of Manchuria (Manshu Chuo Ginko) was also established in 1932 to unify several bank notes issued in the northern China aiming at the stability of prices and to finance industrial demands. Except the Hokkaido Development Bank these three banks were established not only as a central bank but also as a commercial bank for businesses in every commercial area. Ambiguous dual role of those three banks caused confusions to amplify economic instability [8]. Other financial institutions were founded to inflow capital into agricultural and industrial businesses to develop Japanese colonies and invading northern China. The Korea Development Bank (Chosen Shokusan Ginko) was founded in 1918. Military rapid extension out of inland compelled rapid financial institutional formation to supply money for development in those areas [9].

Probably the contribution of the financial system during this period was to facilitate capital formation. Domestic net saving was roughly 4.4 per cent of GNP during the same period. Those savings formed social infrastructure construction, such as the building of port and other transportation facilities through bank loans. Before the Russo-Japanese war (1904-05) much of the public investment flew in armaments related activities. From the World War I (1914-18) boon four banks emerged at the center of the conglomerates (Zaibatsu) [10] by government patronage, while many small sized regional financial institutions had fallen.

Takahashi Korekiyo (1854-1936) played an important role as the president of the BOJ and the finance minister in this era to finance huge funds for war and to establish the gold standard system in Japan. He succeeded in issuing bonds in the UK, France, Germany and the US with the help of the Jewish financiers who resisted the Jewry oppression policy in the Empire Russia. The Russo-Japanese war ended in victory over the Empire Russia for a huge debt and victims. These propose some issues. (1) How is the way that capital flows away in the world? (2) How the financial globalization has proceeded under the control of the UK? (3) What are the terms and conditions to enter to that system?

Post WWI recession was exacerbated by the Kanto Earthquake 1923, and the financial systemic instability was triggered by a bankruptcy of the Tokyo Watanabe Bank caused by a finance minister's slip of the tongue led to a series of bankruptcy in 1927. The government stepped to stem the panic with large- scale public bailouts via the BOJ and promulgated a new Banking Law in 1928. That law provided an objective basis for consolidation by establishing minimum capital requirements. It also increased the regulatory powers of the Ministry of Finance (MOF) against financial institutions, consequently strengthened the reliance of financial institutions on the MOF. It gave the MOF its first legal mandate to license banks, to regulate branching, to authorize mergers, to conduct prudential examinations and to require annual report requirements. But it did not specify a maximum proportion of loans to one customer, minimum cash reserves, and so on.

15 yeas war against China [11] began in 1930s, Japan concentrated its sources on wartime economic system due to the program prepared by the Home Department (Naimusho). Administrative pressure for mergers intensified in 1936 to improve financial efficiency, and the number of banks fell from 1031 in 1928 to 61 in 1945. A Temporary Funds Adjustment Law was enacted in 1937 to concentrate the allocation of industrial credit. In 1942 the BOJ Law was revised along the lines of the German Reichsbank Act of 1939 to strengthen state control over the economy. Forced absorption of militant national bonds and extension of new credit, both of which were carried with disregard for commercial concerns, were underwritten by loans from the BOJ. High inflation injured economic activities and national welfare in this era.

Unlike the development of banking system which emerged endogenously and in response to market incentives in western countries, Japanese modern financial system was developed due to incentives intentionally created by the government. Foundation law of a bank proclaimed based on a Japanese governmental program, which ignored endogenous economic activities and economic principle.

3. Postwar period

US occupation authorities [12] set to normalize the Japanese financial system by rebuilding it on a US model. Financial reform strategy consists of (1) breaking up the zaibatsu legitimated by US anti-trust ideology; (2) reorganizing the securities industry along with US financial reforms, replicating the Glass-Steagall Act of 1933; (3) making the BOJ independent from governmental political pressure as the Federal Reserve to restructure financial regulatory apparatus. But this plan contained some factors lead to failure the reformation of Japanese financial system. Japanese postwar financial system emerged in the 1950s retained many of its prewar characteristics. Not only financial system but also other economic systems depend on their paths historically continue.

US occupation ended in 1952, Japanese special banks endowed by the state with special privileges in return for performing specialized tasks. The Yokohama Specie Bank continues as a specialized foreign exchange bank conforming to the Foreign Exchange Bank Low. The Industry Bank of Japan and the Bank of Korea were reformed as long-term credit banks conforming to the Long Term

Credit Bank Law. The Hypothecary Bank of Japan and the Hokkaido Development Bank turned to commercial banks conforming to the Banking Law. Japan's financial formation is too dependent on the legal system, which is necessary for modern nation states, to constitute democratic commercial society. This may be caused from the power politics of centralized state [13].

Some government financial institutions were established in the 1950s on the same ideas as prewar central planning system formation. The Export Import Bank of Japan was founded in 1951 to finance shipbuilding and trade credit to strengthen Japan's export power and to make sure of import natural resources from abroad under the post war international free trade competition. The Japan Development Bank was established in 1951 to restore electric and shipping industry conforming to the Japan Development Bank Law. The Small Business Finance Corporation was established in 1953 to finance long term credit for investment of small businesses. Including this corporation 10 corporations were established to coordinate private banking activities. These government financial institutions were supplied loan resources through the Trust Fund Bureau of the MOF by the Assets of Postal Life Insurance [14].

Japanese economic high growth period in 1960s was supported by these government financial institutions. Private sector was consisted of 13 City Banks and more than 60 local banks to finance short-term bank loans, 3 long-term credit banks and 8 trust banks for long-term credit, mutual loan and saving banks and credit associations for small and medium sized businesses. Nominal growth rate from 1956 to 1973 was 15.6%. Manufacturers were supplied commercial dealing and investment money through bank loans about 50%, by self-financing was about 40% in this era. This financial system well functioned for the material production increase. A firm deals mainly with a bank out of some banks, bank loans, management, investments, and other business operations were influenced under this bank. So-called main bank system was formed in postwar high growth period. Also indirect financial system was formed.

Temporary Interest Adjustment Law of 1947 provided the BOJ a basis for suppressing lending rates in order to make funds available for economic reconstruction. The BOJ encouraged commercial banks by so-called window guidance to lend to certain industrial sectors that provided a strategic lever for national development and was used until 1970s. While commercial banks could borrow loan resources to businesses from the BOJ by means of support of the so-called intentional low interest policy. Not only were balance sheet, branching and entry regulations all reformulated, but also guidelines were established to regulate the income and expenditure of individual financial institutions. Most commercial banks aimed not to maximize their annual profit but to enlarge market share corresponding to these policies of the BOJ. The centralized bureaucratic control over the financial system deprives private sector of its adaptability for internationalization that may be one of the factors caused depression in 1990s. In the post war period until the middle of 1980s when government financial policy changed to the gradual liberalization, Japanese financial system differs from that of the US by four characteristics: (1) indirect finance, (2) rigid segmentation of financial institutions, (3) administrative guidance, and (4) international isolation.

Post war trade system was managed under the GATT, and financial one was under the IMF agreement. The US has fulfilled a central role to establish these post war global systems before the end of the World War II by a presentation of system design and by supplying funds. The so-called dollar gold standard was ruined in 1971 with the Nixson Doctrine lead industrialized nations to the flexible foreign exchange system. Japan's huge trade surplus accumulated mainly through the export to the US market supported by the fixed foreign exchange rate, one dollar is 360 yen, and the US open market policy for 22 years since 1949. Following the first oil shock in 1973 Japanese government participated in multilateral negotiations to reconstruct some sort of managed foreign exchange system in response to escalating financial instability. The tone of discussions was more congenial but efforts failed due to narrowly defined and conflicting national interests. Japanese economy relatively rapidly recovered from the oil shock as manufacturers made efforts to domestic cost cutting and pursued greater export oriented growth.

Wider developments in the global financial system levied pressure for change on Japan's regulatory regime. The enormous expansion of the euro-dollar market affected its domestic financial system as its domestic banks faced a sharp drop in loans to businesses. Japanese multinational businesses, electronics and car manufactures, could access directly to the new sources of funding at internationally competitive rates. A number of foreign banks licensed to provide short-term impact loans through euro-markets. From the middle of 1970s US financial institutions began to press the MOF for license to compete in domestic business area only opened to domestic banks and to introduce more sophisticated financial products. On the other hand Japanese large banks expanded overseas under relatively unregulated financial markets. But the MOF prohibited Japanese banks to act as overseas securities subsidiaries. Narrow perspective prevented the MOF and the BOJ from considering what domestic financial reformations were needed, so reforms implemented in 1970s till the middle of 1980s were largely piecemeal, reactive and inconsistent.

4. The Plaza Accord [15] and the Bubble

Under the Nakasone Administration his consultative groups paved the way for a change in the ideology governing Japanese financial regulation by their reports for a decrease in the existing formal and informal regulations. The Maekawa Report of 1986 argued the need for the thorough deregulation of cumbersome government rules under the premise ‘freedom in principle, restrictions only as exceptions’. These groups contributed to provoking an intense and long overdue public debate concerning Japan's international roles under a condition of yen appreciation and trade friction. New pressures for the reformation of the Japanese financial system were the Yen Dollar Agreement and the Plaza Accord. Japan and the US governmental representatives began to discuss issues of reciprocity and national treatment of foreign financial institutions operating in Japan. After a series of discussions and the investigation of a US government team, mainly the Department of Commerce, in trade issues, the Jones Report asserted that Japanese regulatory treatment discriminated against foreign institutions. The MOF rejected the conclusions of the report as groundless.

Nevertheless the US administration push ahead with bilateral financial diplomacy and in response to that the Japanese government revised the Banking Low in 1981, there remained administrative segmentation against foreign banks. But many foreign bankers have already realized the legal framework for operation in Japan was less important than the actual response to the Japanese financial market. They could take a comparative advantage of financial products and technique in the operation to Japanese financial institutions. In spite of the US's fiscal and trade deficits, the US government picked up the bilateral trade imbalances between Japan and the US in early 1980s and lodged with a formal list of demands for reform. A protectionism movement gradually rose in the US Congress, Japan accepted the establishment of a bilateral project team known as the Yen Dollar Committee was announced in November 1983. It was the first body to discuss foreign demands for Japanese financial reform.

A joint statement consists of 22 agenda was announced in May 1984. The report outlined five commitments. (1) De-regulation of deposit interest rate, (2) license to financial products that were widely used in western markets, (3) provision greater access to euro-money to finance domestic businesses, (4) permission to foreign banks to participate in domestic trust business, (5) open membership of the Tokyo Stock Exchange to foreign firms. These comments are all concerning to three points. (1) What measures are needed to internationalize a national financial market and the criteria on that these measures depend? (2) What should regulate a government and/or governments in the international financial markets? (3) What are the aims of the internationalization of financial markets? Some realistic solutions are sometimes decided by power politics in the bilateral negotiation forgetting the welfare of nations.

With the international monetary instability precipitated by the second oil shock in 1979 and prolonged global recession in the 1980s, West Germany and other industrialized nations were eager to head off speculation by unilateral interventions. Industrialized nations' monetary authorities have realized a necessary coordinated intervention against speculations from gradually increasing speculative funds to keep every financial market in stability. Under the direction of James Baker the Department of Treasury organized a team to coordinate intervention by means of coordination of basic macroeconomic policies among industrialized nations. This led to an unprecedented agreement struck at the Plaza Hotel in New York in 1985. This accord called for an orderly appreciation of yen against dollar and promised joint intervention to restrain further rises of dollar value in order to set foreign exchange rate reflect fundamental economic conditions. Then yen appreciated against dollar more than 10%.

Many Japanese manufacturers and exporters lost their profits in dollar value that brought these businesses to overseas development in late 1980s. But Japanese consumers were benefited from lower price imports, increased overseas investment, and travel. Dollar had depreciated by an average of 25 % in 1986, but the US's trade deficit had continued its long- term upward trend. The US asked Japan and West Germany for more expansionary economic policies in return to curtail its government fiscal deficit. Consequently this multilateral coordination failed to stop dollar depreciatory trend. The Louvre Accord in 1987 mandated economic stimuli in Japan and West Germany and set up reference zones of target currency ranges for central banks. But this accord was overwhelmed by the wake of the Black Monday in Wall Street on October 19th. The G7 assured the markets that central banks work together to stabilize the dollar value against speculative money movements. Many investors in the markets watch the macroeconomic performance and policies that could enforce a government to take a change of attitude toward the markets.

Japanese businesses, Nomura Securities, Sumitomo Bank, and others took approaches with foreign businesses, JP Morgan, Citibank etc, to a new business area prohibited by the regulatory rules to the MOF. It did not give licenses or permissions to those businesses for the legal incoherence, but after several months it licensed the deal on an exceptional basis. This means that government institutions do not look outside but inside to sustain their bodies for their profits with legally authorized political power. And this tells us that the financial system should hopefully change itself as the international business change not by the rigid legal system.

The existing and already politically sensitive trade imbalance induced the Japanese administration to follow the US proposal to effect sharp increase in the money supply in order to reverse the yen appreciation and to rectify trade imbalance. The BOJ supplied money increasingly posted double digit annual growth rates and cut interest rates to 2.25% under political pressure from the government from the beginning of 1987 until the end of 1990. Both household and corporation could either spend rapidly growing money or put in deposit in low yield saving accounts with officially controlled rates of interest. Japanese firms used the funds to invest in plant and equipment, to acquire foreign businesses and real estate, and to purchase domestic financial assets and real estate. Japanese firms have changed their direct investment plans from inland to overseas searching cheaper labor force hating high wage rate in Japan in the 1970s,especially after the Plaza Accord. Banks were in search of new borrowers as large manufacturers reduced their dependency on bank loans by shifting to retained earnings and direct credit, for example commercial paper. Much of the new lending was for hotels, golf courses, and condominiums. Japanese banks could expect the appreciation of their loan value because their customers, landowners and shareholders, provided good collateral for banks by their inflated properties. Bank loan increased. Even the MOF had licensed banks to deal some new financial products, such as derivatives, under the Yen Dollar Agreement, though many Japanese financial institutions were luck of the financial engineering strategies. A rapid economic expansion and asset price inflation, particularly real estate, prepared the bubble.

The bubble not only inflated the wealth of asset holders but also corrupted the social morals that induced several political scandals and moral hazard of financial institutions. The BOJ belatedly realized what happens, began to ratchet up interest rates and slow the growth rate of the money supply in 1989. Too much money was channeled into speculations of nonproductive and fictitious value. That triggered the domestic economic crush, stock, bond, and land prices, the value of yen rapidly declined. The end of the bubble has left the financial sector in a fragile state with a lot of inferior claims. These debts amounted to 20 trillion yen at the end of the fiscal 1999 still more remain not yet redeemed.

From a closed and bureaucratically controlled structure to a international and market determined one, the Japanese financial system begins to move but sill remains backward far from these of western nations already developed their global networks. Large Japanese banks could develop their overseas branches to finance some joint venture business concerning Japanese corporations in 1980s, but their withdrawals from overseas began in the 1990s.

5. After the Bubble

The fall of the Berlin Wall, a symbol of the Cold War, opened a way to the newly liberalized economic structure for the socialism countries that influenced the US military strategy against the East Countries to change into the one winner global system. Military budgets cut caused layoffs in military related industry and enforced research workers turn into the financial business with the diverted financial engineering technique from the aerospace in the US. This made the financial production research technique rapidly proceed in the 1990s. A critical ideology driving US policy against Japan was the US should press aggressively to create a fairer relationship by strategically managing policy in the early 1990s. A consistent ideology to reconstruct Japan in the US image was apparently implemented as a political pressure on Japan in the business area.

On the other hand, the reformation of the Japanese financial system was delayed by several political and business scandals in the 1990s. The information disclosure of the inferior claims of a bank barely started based on the 21st treaty of the Banking Act in 1992. But Japanese government gradually realized the necessity of financial reformation through negotiations with the US and EU missions, at last the Financial System Reform Act in 1992 and the Japanese style Big Bang in 1996 were announced.

The liberalization of the interest rates of fixed deposits started and the regulation on the ratio of net worth to deposits of a bank was introduced in 1993. The Deposit Insurance Law founded in 1971 was revised more diligently in 1996. In spite of the Finance Recovery Law was enacted in 1998, many financial institutions went bankrupt including large banks like the Long Term Credit Bank of Japan established in 1952. Especially two other long-term credit banks based on the Long Term Credit Bank Law after the World War II needed to change their bodies. One was the Industry Bank of Japan established in 1900 licensed to issue bank bonds for long-term funds merged with other big banks to a commercial bank. The other is the Debentures Bank of Japan succeeded the Bank of Korea established in 1911 that also licensed to issue bank bonds for long-term funds turned a state owned bank after the bubble. With the Hokkaido Development Bank established in 1900 licensed to issue bank bonds for long-term credits in prewar period, these 3 long-term credit banks could not exist after the Bubble.

These troubles imply some problems. (1) What kind of financial institutions finance long-term credit for industrial and regional development? (2) How commercial banks can substitute for the long-term credit institutions including government and UN financial institutions? (3) How manage the short-term speculative money to turn into the long-term investment capital?

The worldwide financial services industry transformed by the introduction of new process and product technologies. Japanese financial market already lost its competitive position for the inefficiency of investment by the rigid government controls. Along with the trend towards securitisation the Banking Bureau and the Securities Bureau of the MOF began to discuss for cross entry between the banking and securities sectors long separated on the 65th treaty of the Securities and Exchange Law influenced by the Glass-Steagall Law of 1933. Large City Banks received the radical reforms enlarge their business area to strengthen their competitiveness against securities firms. But these firms wished to preserve their monopolistic profits without severe competitions.

The result was the permission of mutual interpenetration of traditional business area through the establishment of multiple majority- owned subsidiaries. This introduced many firms belong to those two sectors to reorganize into some holding companies. This holding company was prohibited by the GHQ to reform Japanese companies in democratic structure taking into consideration of centralization harms after the war.

Over-regulation was being employed to protect industry stability by regulating competition and keeping out new entrance at the cost of international competitiveness of the Japanese financial institutions, economic growth, national welfare, and a chance to be a more internationalized country.

6. The Japanese style Big Bang

Liberalized capital markets in the US and UK is responsible for the remarkable revitalization and renewed competitiveness of these economies in the 1990s. There appeared leading industry such as IT industry, computer software, and biotechnology. High technology influenced the commercial trade style to reduce trade costs and made production process more effective and competitive in the old industry. For example, car industry in the US was depressed and lost its competitiveness against the imported small and middle sized cars from Japan in 1980s, but not only by increasing direct investment from Japan to the US also by cutting costs utilizing high technology it revitalized in the late 90s. American car industry developed its strategy over the newly industrializing countries such as China and Vietnam.

Inferior claims (bad debts) had been redeemed very slow, the stock market depressed, enormous 1.2 quadrillion yen in personal savings was benefiting economy little for the luck of routes for channeling funds into growth industry in Japan. These shackled its real economy to reduce growth rate. The postwar economic system geared to having Japan catch up with western nations, but bureaucratic financial administrations do not work under the liberalized market conditions. Singapore and Hong Kong markets continued to take the lead in standardizing their markets according to the US in Asia that deprived Japanese financial market of its competitiveness. Personal savings begin to outflow from Japan to overseas markets in 2000s requiring high interest rates in comparison with low interest rates in Japan.

Former Prime Minister Hashimoto announced in 1996 that Japanese financial industry should undertake its own even more radical version of the UK's Big Bang financial deregulation initiative. The plan was presented as the flagship policy of the new administration as a means to revitalize the financial system. Several newspapers described it as ambitious and shocking. But there seemed to be a consensus among politicians and bureaucrats that Japanese financial system needs radical reform. He presented a document entitled Structural Reform of the Japanese Financial Market: Towards the Revival of the Tokyo Market by the Year 2001. The idea was to bring Japanese financial markets into line with global standards by making them free, fare, and global. Under the rubric of ‘free in principle, restrictions only as exceptions', the plan consisted of 5 agenda. (1) The removal of unnecessary barriers separates the banking, securities and insurance sectors. (2) The liberalization of various charges, commission fees. (3) The galvanization of disclosure rules. (4) The enactment of laws introduces some complex financial products [16] in trade. (5) The reorganization of corporate accounting and taxation rules.

Financial Minister publicly instructed three main financial sector advisory councils, the SEC and others. He instructed the EC to continue its parallel discussions on the Big Bang, and announced the Administrative Reform Council. These councils made their discussions open by holding press conferences after meeting and by soliciting opinions from public via e-mail and others. From this time the style of forming consent on the policy making to some extent has changed in Japan. Broad economic reform program would generate about 7 million new jobs in 15 important areas by 2010. A newspaper asserted financial industry could make about 5% annual growth in 10 years if deregulation were carried out. OECD forecasted that GDP would expand by 6.4% within ten years if comprehensive deregulation were to be carried out in five sectors. Some political scandals, bureaucratic scandals, and the stock market slump have made this governmental initiative reform movement less effective than the Prime Minister expected. The stock market slump in the middle of the 1990s exacerbated the stock value hold by banks that made the bank assets value decreased. This made the notion ‘fair' become equated with a managed type of equal opportunity to protect weaker financial institutions such as trust banks, long term banks, regional banks, and smaller securities and life insurance companies. The five councils submitted their final reports in 1997. The timetable for reformation indicated that a managed transition mapped out in such a way as to protect weaker sectors in order to maintain the traditional system balance. A difference of opinion on some sensitive issues forced the omission of several items from the preliminary reform schedule. (1) The reformation of the public financial sector, (2) legal arrangement for establishing financial holding companies, (3) commissions deregulation.

This was also justified in relation to external competition. Some American and European newspapers and observers pointed that the Japanese government intended to avoid the regulatory change in terms of convergence upon an Anglo-American model to lose its political power. This may be true to some extent. But any historically formed system depends upon its path that holds true to the US and the UK. This Japanese reform procedure contrasted sharply with the UK, where the Big Bang was accompanied by a comprehensive package of new legislation according to the Financial Services Reform Act of 1986. It can be said that the five councils and bureaucrats had lead Japanese public opinion to avoid radical reforms like the UK watching some famous English financial institutions were merged by foreign companies. Japanese gradualism is good for what that is a question.

7. Recommendations

The international trade system has been managed according to the GATT in post war period that has promoted to raise the international trade between nations. International capital transaction has grown along with the trade increase under the guidance of the IMF. Under the so-called IMF-GATT system the liberalization of trade and capital transaction proceeded to the trade globalization such as the unification of the international financial market. Deregulation movements of the financial transactions started at first in the US that accelerated the short-term capital transaction by means of the IT technology. The euro-money market appeared and grew rapidly in post war period that accompanied by the development of the off shore market. Many financial products were generated like options, futures, and derivatives that have widespread and required more sophisticated financial transaction technique. And the probability of world wide financial crisis has grown. The Asian financial crisis of 1997 happened in Thailand widespread to the ASEAN nations, Korea, and Japan.

Avoiding routine rescues such as the IMF emergency credit with requirements of restrictive budget management to a country and devastating defaults will need creating a more orderly way of restructuring problem debts. The difficulties of restructuring are greater in international than domestic markets. Many economists assert the need to do so, but sometimes their opinions are not feasible. What is needed in ordinary financial transactions may be crisis management. The sovereign bankruptcy option is too costly to contemplate under present institutional arrangements. A number of steps might be taken to make international debt restructuring a viable option. From a view point of business management in ordinary economic activity, majority voting and sharing clauses could be added to loan contracts. In general crisis management technique need to be constructed on the basis of business management knowledge and corporate governance. It is also need to argue what kind of legal harmonizing across countries is required concerning to international financial crisis.

Better information in the economic and financial affairs of governments, banks, and businesses will strengthen market discipline and help policymakers to identify the need for corrective action.

In a integrated financial markets international financial stability is impossible without domestic financial stability. Stabilizing the financial system requires institutional reforms extending beyond policies toward external trade and payments. That requires rigorous disclosure requirements and effective supervision of banks and businesses borrowing credit in financial market.

Neither the IMF nor any other international organization has the resources to provide every emerging market with advice. The IMF has its own limited administrative capacity. Strengthening its capacity is an alternative. Another alternative is to encourage the promulgation of standards of acceptable practice by private sector. More than 60 trillion dollar flows from market to market shaking the foreign exchange market that sometimes causes serious financial crisis. So it may be inevitable to accept the international standards for any nations whether the US intentionally leads to make them for its benefit or not. National arrangements may differ countries participating in international financial markets could accept minimum standards. What is the minimum for a country depends on its historical path but the integration of financial markets for a low risk and high return investment chance is no more avoidable for any capitalism countries. Reformation of a financial market may consist of these items from a viewpoint of financial institution management plan.

(1) Utilize the IT technology for financial trades
(2) Build up the knowledge based financial industry: stock, securities, CP, derivatives, and other new financial products
(3) Sophisticate the financial functions of financial institutions: risk management etc.
(4) Adapt to the globalization of financial market
(5) Watch the movements of the BIS, the IMF, the WTO, other international institutions and foreign governmental economic policy
(6) Join to design the international accounting standards

These require radical inside reformation of the financial institutions that means competition for survival.

8. Problems still remained

There are some scholars who insist the Japanese financial system should be quickly reformed along with the Anglo-American style financial system both in Japan and in the US. We considered how the Japanese financial system has been formed historically after the Meiji Restoration that deeply concerns with macro economic performance and international economic stability. In other word present macroeconomic performance is connected with the economic system historically has been formed that is unique to a nation. This is the path dependence. Some nationalistic politicians assert this path dependence against the revisionists in the US to strengthen their political influence among conservative Japanese bankers. Their insistences are sometimes luck of constructive contents for reformation of the Japanese financial system nor useful at making good atmosphere for successful negotiations between Japan and the US. Passive and backward looking attitudes toward exogenous changes are outstanding in the Japanese diplomacy. Why Japanese policy making needs too long time to lose an adjustable response may be a historical and cultural problem. Endogenous system changing mechanism is not built in the Japanese society?

Macroeconomic dump has happened in 1990s is an economic problem that deeply rooted in Japanese culture. But economic problem need to be solved by means of an economic policy, as for a patient needs health recovery treatments. Adaptation for the financial globalization is a necessary condition for the Japanese financial institutions to keep overseas operation for better business chance. How long do they take is an important concern. Many people say that Japanese society needs to activate its adaptability to the exogenous changes again as the Meiji Government positively challenged to reform Japan modernized.

From the middle of the 1990s China has become an important trading partner same as the east-southern Asian nations and the US. Some statistical reports on trade show that facts and we could start at this point to draw our future plans. One reason is domestic investments are fewer, capital outflows are greater in 2000s that shows Japan has already been a creditor country. Especially direct investment into China has increased since the late 1990s that turned to export pressure to Japan with decrease of domestic price level. Economic interdependence begins deeper through trade between Japan and China. Reformation of the Chinese financial institutions will start making participation to the WTO as a trigger. So we need rethink about the historical relationship between Japan and China and the Korean peninsula to set the Far East in stable political situation. There are some questions. (1) What kind of economic coordination is needed to stabilize the Far East? (2) What kind of financial system is needed to accelerate capital movements for regional development in the Far East?

These questions consist of practical contents that may depend on the more feasible questions above mentioned. Still remain some historical questions that require deeper inquiry. (1) What are the differences between the Anglo-Saxon style capital market and the Japanese style one? (2) What is the path dependence for a country? (3) What is the modernization for oriental culture? (4) What is the most adaptive system for capitalization of the oriental land?

9. Notes

1. In the late Edo period there were many kinds of coin made of gold, silver, copper, lead, iron and other materials. Monopolistic coinage was occupied by the Tokugawa administration. About 300 feudal landlords had succeeded the currency issuing rights in their domains up to the Meiji Restoration. The Meiji Administration deprived these feudal landlords involving the Tokugawa administration of their issuing rights for the unification of currency at the first step to modernize the financial system of Japan. See Konno [1997] concerning on the currency turmoil in the late Edo period.

2. Ito Hirobumi is widely known as a politician and a councilor in the early Meiji period. He drafted the Imperial Constitution of 1889 along with the Prussian Constitution, on the other hand he insisted to import the American banking system. Representative Japanese politician might not know the differences of the political, financial, and other social systems between the Imperial Germany and the US where enacted one of the most democratic constitutions. It could be said that the radical reformation has confused the consistency of the systems in Japan.

3. Matsukata Masayoshi is famous for his fiscal policies in this era. He contributed to establish the silver standard system as a finance minister in 1886 and he as a premier made an effort to establish the gold standard system in 1897 in Japan. This system transition deeply connected with the international trade system that the UK had gradually formed since the 19th century. It was buried in the gold and silver bimetallism in the Edo period that appeared after the open door policy to western countries and the export increase to China where the silver standard system was implemented for a long time.

4. See the Bank of Japan [1995]

5. See the Yokohama Specie Bank [1995]

6. There are many dissertations concerning this war. Most of them are historical studies not social systemic ones. One of the factors triggered this war is the systemic differences between China and Japan where social reformation started with replicating the western systems. Nevertheless many efforts were paid for the social reformation by the progressive thinkers like Sun Wen (1866-1925), Tan Sitong (1865-98), and Kang Youwei (1858-1927), both China and Korea remained in the traditional oriental society to keep an ancient diplomatic relationship. What is the modernization for the Orient? See Mutsu Munemitsu [1895]

7. See Bytheway [2002]

8. A financial crisis in the early Showa period was apparently caused by adhesive relationships

between banks and businesses. Especially the Bank of Taiwan was a main bank for the Suzuki Trading Company in spite of the central bank in that commercial area that the financial crisis made serious.

9. These banks founded on every special law are called special banks. Many studies on these banks are published in Japanese are here not shown to avoid troublesome translation in English. Other organizations were established to develop the Taiwan Island, the Korean Peninsula, and the east-northern China. See Kitaoka [1988] and others.

10. There are two implications of Zaibatsu. One is an economic terminology that has three factors. (1) Exclusive family owned capital. (2) Conglomerates (3) Monopolistic or oligopolistic production sharing. The other is a management terminology that has above two factor (1) and (2). According to the former terminology Mitsui, Mitsubishi, and Sumitomo are usually admitted as three zaibatsu in narrower definition.

11.Many studies concerning this invading war have been published. See Shimada [1980] and others. A lot of data how systems functioned to Japanize these areas were destroyed that prevents a whole understanding of this war.

12. See Takemae [1983] for example. We could find out how different ideology concerning with the nation state Japanese people have had from that of American people.

13. This may connect with power allocation in a nation state. Economic efficiency problem of organizations still remains whichever one nation state may take capitalism or central controlling system. See Weber [1924].

14.Efficiency problem of social capital has consistently continued. See Teranishi[1991]
Privatization of the government financial institutions with administrative reforms has been argued as far as the globalization of financial system proceeds in Japan.

15. The Plaza Accord was surely epoch-making that changed Japanese foreign policy from isolation to coordination one for an effective financial policy. The official discount rate of the BOJ has been reduced to near 0% for more than 10 years, but that financial policy has no effect on economic recovery.

16. See IMF [2000] for example.

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(Associate Professor, The Economics Department, Takasaki City University of Economics)