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THE AMERICAN TRADE DEFICIT WITH JAPAN: WHITHER THE ROLE OF JAPANESE FINANCIAL DEREGULATION AND LIBERALIZATION?

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I. INTRODUCTION

The United States, once the world's largest creditor nation in 1981, with net foreign assets of $141 billion, became its largest net debtor nation in 1986, with net external debt of $264 billion.[1] This reversal in net foreign assets of over $400 billion was caused by a series of ever widening current account deficits principally stemming from deepening trade deficits, its major component.[2] In 1987, the global

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1. *Looking Beyond America's Means*, THE ECONOMIST, Sept. 19, 1987, at 76. *See also U.S. Debt to Rest of World Doubles to $236 Bn in 1986*, Financial Times, June 24, 1987, at 1.

2. A trade balance reflects the aggregate of merchandise trade of a country. A trade deficit (surplus) occurs when its imports exceed (do not exceed) its exports. A current account balance is a broader concept, incorporating trade in goods, but also in invisibles, such as insurance, transportation, tourism, investment income, fees and royalties and other services. A current account deficit (surplus) occurs when the aggregate of merchandise trade and invisibles is negative (positive).

trade deficit of the United States was a record $171.2 billion.[3] Although recent statistics provide promising indications that this deficit will not become larger in 1988,[4] the still slow pace envisaged for reducing these unprecedented deficits leaves the prospect that the net external indebtedness of the United States will be in excess of $700 billion by 1990,[5] perhaps fifteen percent of the GNP, and one trillion dollars by the early 1990's.[6]

Japan has had a large bilateral trade and current account surplus with the United States for the previous eight years.[7] In 1987, the trade deficit reached a record of $59.8 billion, the largest in absolute terms of any American trading partner.[8] Although this trade deficit barely increased in 1987,[9] as compared to significant increases for the three previous years,[10] the prospects for a quick, significant reduction in this bilateral deficit, let alone its elimination, like that of the global trade deficit, remain unlikely. Yet, arresting the growth of this deficit has been a major accomplishment in itself, reflecting as it does a rather inadvertent combination of several approaches undertaken by both U.S. and Japanese authorities in the past few years, some of which will be discussed later.

This article will focus on the approach initiated by the U.S.-Japan Financial Accord,[11] which was executed on May 29, 1984, to restructure Japanese financial markets, and augmented in part by other measures which either stem directly from the Financial Accord or are consistent with those of the Financial Accord. This approach, in large part,

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3. This trade deficit reflected imports of $424.1 billion and exports of $252.9 billion in 1987 (as compared to a deficit of $156.2 billion and exports of $226.8 billion). *December Trade Deficit Lowest Since January 1987*, L.A. Times, Feb. 14, 1988, Part I, at 1.

4. The December merchandise trade deficit of $12.2 billion was lower than the November deficit of $13.2 billion, and the October deficit of $17.6 billion, reflecting record exports of $24.8 billion, and steady imports of $37 billion. Although the trade gap for the United States improves in November and December, many analysts attributed the improvement to the devalued U.S. dollar. *See id.*

5. *Looking Beyond America's Means*, *supra* note 1.

6. *Well, Would You Debit It?*, THE ECONOMIST, Aug. 1, 1987, at. 73.

7. Jameson, *U.S. Trade Deficit Eases But Friction with Japan Goes On*, L.A. Times, Feb. 19, 1988, at 1.

8. *Id.*

9. In 1986 the bilateral trade deficit was $58.6 billion. *Id.*

10. The bilateral trade deficits for 1983, 1984 and 1985 were $21.8, $30.7 and $43.6 billion respectively. *Id.*

11. JAPANESE MINISTRY OF FINANCE - U.S. DEP'T OF TREASURY WORKING GROUP, U.S. DEP'T OF TREASURY, REPORT ON YEN/DOLLAR EXCHANGE RATE ISSUES (1984) [hereinafter FINANCIAL ACCORD].

sought to readjust the yen-dollar exchange rate to make the terms of trade more favorable to the United States, and to a lesser extent, facilitate the entry of American and other foreign financial institutions to Japanese financial markets. Section II provides a brief outline of the other concurrent approaches to the U.S.-Japan trade imbalance. Section III provides a brief history of the Financial Accord and its three major objectives. Section IV discusses the Financial Accord and subsequent measures to liberalize domestic Japanese financial markets. Section V covers measures to internationalize the yen, and Section VI reviews measures taken to improve the access of foreign financial institutions to compete in Japan.

II. Other Approaches

The United States has adopted several approaches toward reducing its trade imbalance with Japan, often in a common front with many of its trading partners. An early and often recurrent approach today involves trade conflicts over specific commodities and even entire industries in which the United States has a trade deficit. In many cases, the resolution of these trade conflicts involved invoking GATT machinery to clear away perceived unjust trade practices.[12] In other cases, the resolution involved the imposition of quotas on the import of specific commodities, and even requesting the Japanese producers to exercise voluntary export restraints to the United States. For example, in the automobile trade, Japan has had a trade surplus both in the volume and value of cars for many years.[13] In 1981, a "voluntary" export restraint program for automobiles began, in order to give the U.S. auto industry time to recover from its slump.[14] Although the initial ceiling increased as domestic sales of the U.S. auto industry improved, the ceiling of 2.3 million autos remained unchanged in 1988, in large part due to a sensitive period in U.S.-Japan economic relations, when with strong and comprehensive trade legislation pending, many have called for a lowering of Japan's export ceiling.[15] Other trade conflicts, for in-

12. For instance, *see* Shibayama, *Beef, Orange Talks Go before GATT; Japan Still Seeks Political Settlement*, JAPAN ECON. J., May 14, 1988, at 1, 3. *See also Political Trade Issues, Marketplace Reality - U.S., Japan to Heed GATT Ruling, Eliminate Chip Price Monitoring*," *id.* Apr. 9, 1988, at 2.

13. *Japan Plays It Safe, Extends Symbolic Car Export Quota*, *id.*, Feb. 6, 1988.

14. *See* generally Leo, *An Update of the Japanese Automobile Export Restraint*, 8 BROOKLYN J. INT'L L. 159 (1982). *See also Japan Plays It Safe, Extends 'Symbolic' Car Export Quota*, JAPAN ECON. J. Feb. 6, 1988, at 2.

15. *Japan Plays It Safe, Extends 'Symbolic' Car Export Quota*, JAPAN ECON. J., Feb. 6, 1988, at 2.

stance, have been waged over machine tools and semiconductors,[16] with ongoing and incipient conflicts in the Japanese agricultural and public works industries.[17]

Another approach has been the restructuring of the Japanese economy in order to dismantle, in large part, the export-oriented industrial structure with which Japan has been so successful. To achieve this goal, there must be fewer incentives for Japanese producers to export goods and greater incentives for consumers to save less and consume more goods, both domestic and foreign-made.[18]

This approach has recently been the focus of several Japanese authorities. In April, 1987, Haruo Mayekawa, a former governor of the Bank of Japan, recommended in the New Mayekawa Report submitted to the Nakasone government that in order to promote the smooth restructuring of the Japanese economy, a moderated GNP growth rate in the economy was necessary, with a higher growth rate in domestic demand to counterbalance a lower rate in external demand.[19] More recently, the Japanese government led by then Prime Minister Noboru Takeshita committed itself in the Fall of 1987 to a mid-term economic plan emphasizing domestic-demand oriented growth in order to reduce current account surpluses.[20] This plan has been based in part upon the the New Mayekawa Report[21] and the economic report covering fiscal 1983-90,[22] in which prime importance was given to administrative reform aimed at streamlining government and which the new plan will replace.

The new economic plan was sent to the Economic Council, an ad-

16. For machine tools, *see* Googins & Greene, *The Industrial Targeting Practices of Japan and the Domestic Machine Tool Industry*, 15 CASE W. RES. J. INT'L L. 469 (1983); for semiconductors, *see generally* Chesser, *Semiconductor Chip Protection: Changing Roles for Copyright and Competition*, 71 VA. L. REV. 249 (1985).

17. For instance, the latest dispute in the agricultural industry involves a dispute over beef and citrus import quotas which Japan has maintained. The latest talks on this issue involved Japanese Agriculture, Forestries and Fisheries Minister Takashi Sato meeting with U.S. Agriculture Secretary Richard Lyng, and others March 29, 1988. *See Japan, U.S. Set Minister, - Level Beef, Citrus Talks*, JAPAN ECON. J., Apr. 2, 1988, at 4. Also, the countries are in dispute over foreign enterprises having access to major government and non-government construction projects. *See Construction Remains Barrier*, *id.*

18. *See* Reich, *Why is America Losing the Economic Race with Japan?*, *id.* Apr. 26, 1986, at 7.

19. *Expand Import Demand-Editorial*, *id.* Dec. 12, 1987, at 26.

20. *Takeshita to Stress Domestic Demand*, *id.* Oct. 31, 1987, at 11.

21. *Id.*

22. *Id.*

visory body to the Prime Minister, to determine its framework.[23] In January, 1988, the Council recommended, inter alia, a drastic adjustment of the economy, converting it into a domestic demand-led economy in the next five years, with an acceleration of the growth of domestic demand, and lowering that of external demand.[24]

A third approach, which supplements and is part of the approach of the Financial Accord and which has been implemented in conjunction with monetary authorities in other countries, has been to coordinate monetary policies to affect domestic interest rates, and to realign the various foreign exchange rates in order to affect the price terms of international trade. An earlier manifestation of this approach occurred on September 22, 1985, when, pursuant to the Plaza Accord, Japan, West Germany, France, the United Kingdom and United States launched a coordinated effort to correct their huge external trade imbalances by intervening in the foreign exchange markets to reduce the massive overvaluation of the dollar and undervaluation of the yen and deutschemark, and to foster more rapid growth of domestic demand in Japan and Germany.[25] This approach, aided in part by the Financial Accord measures, was extremely successful in persuading the foreign exchange markets that the dollar was overvalued and that the governments and central banks should coordinate their policies to bring about a downward realignment.[26] The dollar depreciated precipitously against a number of currencies, including the yen, which appreciated alone in the period of September, 1985, to May, 1986, from 242 yen per dollar to 170 yen per dollar.[27] The problem with this approach is that once the realignment process was underway, it was often difficult to prevent market forces from causing a further, unwanted deterioration of the U.S. dollar without having subsequent currency intervention by central banks.[28] For instance, the February, 1987, Louvre Accord of the G-7

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23. *Id.*

24. *Council Advises Takeshita to Reduce Trade Surplus, Raise Quality of Life*, *id.*, Jan. 16, 1988, at 13.

25. Chira, *Pressure on Japan in Dollar Pact*, N.Y. Times, Sept. 27, 1985, at D1, D6.

26. "Japan Adopts Measures To Counter Strong Yen," *Washington Post*, May 31, 1986, at G1 col. 1.

27. *See id.*

28. It seems that before the lagged effects of the "J-curve" can take effect, the dollar is further devalued, restarting the "J-curve" cycle. The "J-curve" refers to the process whereby a devaluation of a currency leads to a worsening of a country's trade accounts in the short-run, and its improvement in the long-term. When a country's currency is devalued, the price of imports increases, and the price of exports falls. Without changes in the volume of imports and exports, the value of imports increases

(the United States, the United Kindom, Japan, Germany, France, Italy and Canada) sought to arrest the decline of the dollar vis-a-vis other currencies in order to provide a stable exchange rate for the dollar, including a yen-dollar target zone of 140-160.[29] Later, in response to the over-sized correction of stock markets globally in October, 1987, the G-7 declared their intentions to coordinate dollar-supporting interventions based on a negative-target zone, which would peg the dollar at a lower level than the Louvre Accord.[30] In addition, Japan and the U.S. had entered into agreements to restore currency rate stability, one of the most recent of which was executed during the January 13, 1988, summit in Washington.[31]

This process of rectifying trade imbalances through the foreign exchange markets has come under criticism from a number of quarters.[32] For instance, the Bank of Japan, in a report entitled "Review and Outlook of World Economy" which was released on January 8, 1988, warned that too much emphasis was being given to the temporary measures of monetary policies to address trade imbalances.[33] It suggested that longer-term policies, such as the restructuring of the economies of surplus countries to reduce their dependence on the demand from other countries for exports, and the reduction of domestic demand of deficit

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over the value of exports, and the trade account worsens. Over time, a country's consumers and producers and those of its trading partners will substitute higher cost for lower cost traded goods. Moreover, as a result of the devaluation, the country's consumers and producers will have less real income with which to purchase imports, and those of its trading partners, will have greater real income to purchase its exports. As a result, the country will export more and import less, and despite the lower price for its exports and higher price for its imports, the trade account will improve, and eventually move from a decreasing deficit to an increasing surplus. In addition, the country's surplus trading partners will find attractive the economic factors for relocating production facilities in the deficit country, causing hitherto imports of the deficit country to become domestically produced, reducing its trade deficit, and also causing a "hollowing-out" of the industrial structure of the surplus country. However, the process underlying the "J-curve" takes time, and every time the process is set in motion for a certain exchange-rate alignment, the dollar is further devalued, the trade adjustment dynamics becomes more complex. As a result, the ultimate impact on the trade deficit becomes uncertain, and the expected improvements are deferred further making the trade account deficit deeper, thereby deferring the remedial effects of the processes underlying the "J-curve."

29. *Dollar-Supporting G-7 Pact Reflects U.S. Fear of Another Stock Crash,*" JAPAN ECON. J. Jan. 16, 1988, at 6.

30. *Id.*

31. *Id.*

32. *Japan-U.S. Dollar Pact Welcomed, but Efficacy Remains in Question, id.* at 5.

33. *BoJ warns Monetary Policy Alone Can't Fix Trade Gap, id.* at 14.

countries, were required.[34]

From another quarter, the devaluation of the dollar is the wrong approach in that classical trade theory, upon which the realignment of foreign currency exchange rates to vary the terms of international trade is based, is no longer credible because international markets in goods are managed and no longer free and competitive.[35] The solution to this changed structure of international trade lies in subsidizing exports, restricting imports, and targetting domestic industries for expansion in a scramble for shares of stagnant world markets.[36]

III. History and Objectives of the Financial Accord

The financial authorities of the Japanese Ministry of Finance ("MoF") and the United States Department of the Treasury jointly issued the "Report on the Yen/Dollar Exchange Rate Issues" ("Financial Accord") on May 29, 1984.[37] While the Financial Accord reflected an ostensible quid pro quo between the interests of Japan and the United States, the larger part of its substance was devoted to U.S. points of interest and the corresponding obligations of the Japanese. These obligations were threefold: 1) deregulation of domestic financial markets, especially "Regulation-Q" type constraints on interest rates for deposits; 2) internationalization of the yen; and 3) greater access of American and foreign financial institutions to the Japanese financial services industry.[38]

Initially, the U.S. supported only the two objectives of interest rate liberalization and the internationalization of the yen. In October, 1983, Lee Morgan, Chairman of Caterpillar Tractor, and leader of the Businessman's Round Table, a prestigious business trade organization, informed President Reagan that due to a misaligned yen/dollar exchange rate which left the yen undervalued, hundreds of U.S. companies, including his own, were losing billions of dollars annually in domestic and international orders to Japanese competitors.[39] Morgan cited the Murchison-Solomon Report,[40] the principal conclusion of which was that

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34. *Id.*

35. Erdman, *Only Mutual Trust Can Avert Economic Disaster*, *id.* at 23.

36. *Id.*

37. Financial Accord, *supra* note 11.

38. *See generally id.* § V.

39. Katz, *Industrial Policy Implications of Japan's Credit Structure is More Important than Yen Rate*," Japan Econ. J., May 8, 1984, at 20.

40. Murchison & Solomon, The Misalignment of the United States Dollar and the Japanese Yen: The Problem and Its Solution (Graduate School of Business, Stanford University, Sept. 19, 1983).

the undervaluation of the yen was primarily the consequence of Japanese financial policies that made the yen both difficult and undesirable for foreigners to obtain.[41] Morgan recommended that the United States encourage the Japanese Government to adopt the detailed list of technical changes in Japan's banking and financial laws provided by the Murchison-Solomon Report.[42]

During the economic summit in Tokyo on November 9-11, 1983, President Reagan addressed the issue of the yen-dollar misalignment, and pressured Japan both to internationalize the yen and to liberalize its domestic capital markets.[43] Following the Nakasone-Reagan summit, the then Finance Minister Noboru Takeshita and U.S. Treasury Secretary Donald Regan, having met to discuss specific proposals to cure the yen-dollar misalignment, announced several financial measures designed to effect the principle that "open, liberal capital markets and the free movement of capital are important to the operation of an effectively functioning international monetary system.[44]

In order to monitor the execution of these measures and implement additional ones, a joint, ad hoc Working Group was established to study the yen-dollar exchange rate issues.[45] During its six meetings between February and May, 1984, the Working Group expanded and clarified the American demands for the liberalization of the Japanese domestic financial market and the internationalization of the yen.[46]

The third objective of the Financial Accord, the greater access of American and other foreign financial institutions to the domestic Japanese financial services industry, arose during the Working Group discussions in 1984 when the MoF rejected a proposed joint venture between Morgan Guaranty Trust Bank and Nomura Securities to participate in the trust business, particularly in the lucrative manage-

41. *Id.* at 21-22.

42. The authors of the Murchison-Solomon Report proposed six measures to remove artificial curbs on the demand for yen, including elimination of interest rate controls and constraints on short-term financing. *See id.* at 36-38. In subsequent negotiations with the Japanese Government, many of these changes were adopted.

43. *Japan-U.S. Summit Talks*, ORIENTAL ECONOMIST, Dec. 1983, at 2.

44. U.S. DEPT. OF TREASURY, JOINT PRESS ANNOUNCEMENT, TREAS. NEWS 1 (Nov. 10, 1983).

45. *Id.* at 3. The official name of the Working Group is The Japanese Ministry of Finance-Department of the Treasury Group on Yen-Dollar Exchange Issues.

46. During the Working Group discussions, the U.S. emphasis shifted from the Murchison-Solomon demands of deregulating Japanese money and capital markets to the deregulation of the Euroyen market. *See* Kondoh, *The Yen Dollar Commissions Report and MoF Prospects*, in STUDY ON THE TOKYO CAPITAL MARKETS 24 (Japan Center for International Finance Policy Study Series No. 2).

ment of corporate pension trusts.[47] The MoF strongly opposed the joint ventures between foreign banks and domestic financial firms that were not licensed to participate in the trust business in large part because of the historical separation in Japan between trust and commercial banking.[48] However, the perception of the United States and other foreign countries was that the MoF was unfairly restricting the entry of foreign financial institutions into the domestic activities of the domestic financial services industry. As a result, several measures aimed at improving the access of foreign financial institutions to the Japanese industry were incorporated into the Financial Accord.

IV. Liberalization of Japanese Financial Markets

In the negotiations leading to the Financial Accord, the Working Group proposed to liberalize Japanese financial markets by deregulating short-term interest rates, easing restrictions on the issuance of certificates of deposit, and creating new financial instruments.[49] These three measures were designed to increase the amounts not subject to interest rate controls.[50] The economic rationale behind these proposals is that interest rate deregulation would cause Japanese interest rates to reach a higher level than they otherwise would under the contemporaneous domestic monetary policy, and in turn, would stimulate foreign investment in Japanese financial instruments and would discourage Japanese investment in foreign financial instruments. Thus, the deregu-

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47. In June, 1983, Morgan Guaranty Trust Bank and Nomura Securities proposed to operate a joint venture for the management of pension trust funds in Japan. *See Finance Minister Proposes OK To Nomura Morgan Plan; Says It's Long-Range Issue*, JAPAN ECON. J., Mar. 20, 1984, at 2. At the time of the Nomura-Guaranty proposal, other joint ventures were proposed between Citicorp and Daiwa Securities, Chemical Bank and Yamaichi Securities, and Bank America and Nikko Securities. *See Citicorp Plans to Enter Trust Business in Japan*, *id.* Jan. 10, 1984, at 1.

48. Katz, *Industrial Policy Implications of Japan's Credit Structure Is More Important than Yen Rate*, *id.* May 8, 1984, at 20.

49. *See infra*, notes 51-56 and accompanying text.

50. In Japan, under the Temporary Interest Rate Adjustment Law [Rinji Kinri Chosei Ho], Law No. 181 of 1947, the MoF is authorized to control interest rates on deposits. This deregulation has had significant effects since being introduced. For instance, the lowering of minimum denominations on time deposits to 100 million yen not subject to interest rate controls has increased the balance of deposits 2.7 fold in a year to 43 trillion yen. In addition, the lowering of the minimum denomination of new financial instruments, called money market certificates ("MMCs"), to 10 million yen, has increased this instrument's balance of deposits to 15 trillion yen by the end of 1987, when a few years earlier, MMCs did not exist. *See Deregulating Savings*, *id.*, Mar. 12, 1988, at 25.

lation of interest rates would diminish capital outflows from Japan and appreciate the yen vis-a-vis the dollar.

The MoF agreed to deregulate interest rate ceilings on large denomination deposits within two to three years, and to consider the removal of ceilings on small denomination deposits.[51] The schedule for interest rate deregulation on large denomination deposits was introduced in July, 1985, as part of the Action Program for Improved Market Access, pursuant to which interest rates on deposits in excess of one billion yen were to be deregulated in October, 1985,[52] and those in excess of 500 million were to be deregulated in April, 1986.[53] Interest rates on deposits in excess of 300 million yen were deregulated in September, 1987,[54] and those in excess of 100 million yen were deregulated in April, 1987.[55] The MoF also planed to lower the minimum denomination of large scale time deposits to thirty million yen by October, 1988.[56]

In addition, the pool of financial instruments not subject to interest rate ceilings was expanded with the liberalization of the restrictive conditions underlying the issuance of certificates of deposit ("CDs") by commercial banks, a power permitted since 1979.[57] These measures entailed lowering the minimum denomination on CDs, enlarging the ceiling on each bank's issuance of CDs which had been restricted to a multiple of shareholder's equity, and, shortening the minimum maturity on CDs.[58]

The creation of new financial instruments occurred in March,

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51. *See* FINANCIAL ACCORD, *supra* note 11, § V(A).

52. GOVERNMENT-RULING PARTIES JOINT HEADQUARTERS FOR THE PROMOTION OF EXTERNAL ECONOMIC MEASURES, THE OUTLINE OF THE ACTION PROGRAM FOR IMPROVED MARKET ACCESS 24 (July 30, 1985) (provisional translation available from the U.S. Department of the Treasury) [hereinafter THE OUTLINE OF THE ACTION PROGRAM]. The Action Program of July 30, 1985, is the seventh such program undertaken to correct trade imbalances between Japan and its trading partners. Reforms were proposed in six different areas including Japanese financial and capital markets. *See International Trade: Reforming Japanese Trade Policy*, 27 HARV. INT'L L.J. 295, 295-96.

53. R. JONES, CAPITAL MARKET LIBERALIZATION IN JAPAN 6, 9 (Japan Economic Institute Report No. 8(A), 1986).

54. *Liberalization Draws Horde of Cash Into Money Market*, JAPAN ECON. J., Mar. 19, 1988, at 3.

55. *Id.*

56. *Ministries Delay Freeing of Small Deposit Rates*, *id.* Mar. 19, 1988, at 15.

57. Negotiable Certificates of Deposit (Jotosei Yokin No Toriatsukai Ni Tsuite, Kura Gin No. 650 of Mar. 30, 1979). The interest rates on CDs are not subject to regulation under the Temporary Interest Rate Adjustment Law. *Id.*

58. *See* FINANCIAL ACCORD, *supra* note 11, § V(A).

1985, when money market certificates ("MMCs") were created.[59] MMCs are nonnegotiable, interest-bearing financial instruments with a higher interest rate than ordinary deposits.[60] While the initial minimum denomination for MMCs had been fifty million yen, subsequent deregulation reduced the minimum denomination to thirty million yen and in October, 1987, to ten million yen, progessively enlarging the financial amount not subject to interest rate controls.[61]

Further deregulation of interest rate controls depends on two major developments. First, an improved deposit insurance system for small depositors must be introduced, in case too rapid a deregulation causes higher funding costs for banks, leading to increased bank failures, especially among the smaller banks.[62] Second, there must be a bureaucratic reconciliation of competing bureaucratic interests between the MoF and the Ministry of Posts and Telecommunications ("MPT"), which has jurisdiction over the Postal Savings System ("PSS").[63] Although the MoF and MPT have been negotiating the liberalization of interest rates on small denomination deposits and on the PSS savings certificates (teigaku), they failed to present legislation to the Diet aimed at reforming current postal savings legislation.[64]

V. INTERNATIONALIZATION OF THE YEN

Prior to the Financial Accord, international demand for the yen as a unit of account,[65] a medium of international payment,[66] and a store

59. *See id.* § V(A)(2).

60. *Id.*

61. *Deregulating Savings*, JAPAN ECON. J., March 12, 1988, at 25.

62. Japan's Deposit Insurance Organization has a limited fund of 200 million yen and a small staff. In order to bolster the deposit insurance system, the Financial System Research Council of Japan had recommended that the government increase the level of insurable deposits from three to ten million yen, an amount which would fully insure 90% of all depositors. *See Research Council Goes for Rapid Liberalization*, ORIENTAL ECONOMIST, July 1985, at 8.

63. Semkow, *The Deregulation of Japan's Financial Markets*, INT'L FINANCIAL L. REV., Aug. 1987, at 36. The PSS roughly has the same amount of deposits as all the commercial banks, with over 116 trillion yen at the end of 1987, (an amount approaching one trillion dollars in deposits). The PSS sets its own interest rates, which are higher than those set by the MoF." *See 1987 Postal Savings Hit Y116 Trillion*, JAPAN ECON. J., Jan. 16, 1988, at 16.

64. *Ministries Delay Freeing of Small Deposit Rates*, JAPAN ECON. J., March 19, 1988, at 14.

65. A "unit of account" is an instrument that serves as the measure of the value of obligations of the parties to an agreement. INTERNATIONAL FINANCE FOR MULTINATIONAL BUSINESS 504 (L.C. Nehart ed. 1967).

66. A currency is used as a "medium of payment" when it is actually used as an

of international value[67] was surprisingly low in light of Japan's having the second largest economy in the world. For instance, in January, 1984, only forty percent of Japan's exports and two to three percent of its imports were denominated in yen, compared to other advanced noncommunist countries in which sixty to seventy percent of exports and forty to fifty percent of imports were denominated in the domestic currency.[68]

The Financial Accord provided several measures to internationalize the yen, including the establishment of a yen-denominated bankers' acceptance ("BA") market, the removal of restrictions on offshore yen lending, and the liberalization of the Euroyen market.[69] Each measure was designed to increase the international demand for the yen vis-a-vis other currencies, causing the yen to appreciate in value, especially since interest rate deregulation would diminish capital outflows and reduce the supply of yen internationally.

A yen-based BA market opened on June 1, 1985. Its creation was designed to increase the demand for yen funds in trade financing by permitting Japanese companies to settle trade transactions in low cost yen funds, rather than using dollar loans from Japanese banks.[70] In addition, a BA market was expected to liberalize short-term prime rates by promoting lending competition for the banks.[71] For a number of reasons, including the relatively high costs stemming from a stamp duty levied on BA transactions, and preferred corporate practices of settling in dollars for imports of raw materials,[72] the BA market was virtually still-born, with outstanding balances of only ten to eleven billion yen.[73] It was only in October, 1987, that this market showed some signs of life, with a small increase in balances attributable to a reduced

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instrument of exchange between nations. *See* C.P. KINDLEBERGER, INTERNATIONAL MONEY: A COLLECTION OF ESSAYS 20 (1981).

67. A currency is used as a "store of value" when it is held as reserves. *See id.* at 17-20. This value is measured by the official foreign exchange reserve assets held by governments and public organizations. *Id.*

68. *See* Yoshitomi, *Adjusting the Yen to Japan's Role of International Creditor*, THE BANKER, Jan. 1984, at 90.

69. *See* FINANCIAL ACCORD, *supra* note 11, § 5(A)(2) for Yen-Denominated BA Market; *id.* § 5(A)(4), for the removal of restrictions on offshore yen lending; and *id.* § V(C) for the liberalization of The Euroyen market.

70. *Yen-Based BA Market Expected to Help Internationalize Yen*, JAPAN ECON. J., June 4, 1985, at 24.

71. *Id.*

72. Semkow, *supra* note 63, at 36.

73. *BA Outstanding Balance Higher*," JAPAN ECON. J., Nov. 21, 1987, at 19.

stamp duty which became effective at that time.[74]

The elimination of many of the restrictions on offshore yen-lending by Japanese and foreign banks on April 1, 1984,[75] was designed to increase the demand for the yen as a settlement and reserve currency.[76] The restrictions eliminated by the MoF included those on loan ceilings, interest rates, commissions, financing charges and currency swaps.[77] The MoF simultaneously relaxed restrictions on syndicated lending.[78]

Finally, the MoF liberalized the Euroyen market[79] by, inter alia, relaxing or removing restrictions on 1) the issuance of Euroyen bonds,[80] 2) the issuance of Euroyen CDs,[81] and 3) the lending of Euroyen.[82]

Relaxing restrictions on Euroyen bonds has become a complicated and ongoing process. Pursuant to the Financial Accord, the MoF expanded the number of potential Euroyen bond issuers, once limited to a select group of national governments and international financial institutions, to include a limited number of Japanese corporations,[83] and non-Japanese corporations, state and local governments and government agencies.[84] In addition, the MoF relaxed requirements regarding the size and number of issues, interest rates, maturity, currency and interest rate swap features, underwriting fees and commissions and transferability, the selection of co-lead managers and the composition of underwriting or selling groups as well as the domicile of distribution.[85] More

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74. *Id.*

75. *See* FINANCIAL ACCORD, *supra* note 11, § V(A)(4).

76. *Id.*

77. *See id.* app. 1.

78. *Id.*

79. The Euroyen market is an international financial market in which yen-denominated financial instruments are issued and managed outside Japan. *See* INTERNATIONAL BANKING HANDBOOK 20 (W. Baugh & D. Mendick eds. 1984).

80. Euroyen bonds are long-term debt instruments denominated in yen and issued and sold outside Japan. *Id.* at 10.

81. Euroyen CDs are yen-denominated CDs issued by banks outside Japan. *Id.*

82. Euroyen are yen deposited in and managed by banks outside Japan. *Id.*

83. On April 1, 1984, the MoF relaxed the eligibility criteria for domestic corporations and allowed private Japanese firms to issue Euroyen bonds. This liberalization enabled 108 Japanese corporations to issue Euroyen convertible bonds. In addition, 30 Japanese firms were permitted to issue straight Euroyen bonds. All these firms have excellent financial records. *See 108 Companies Are Eligible to Issue Euroyen Convertibles*, JAPAN ECON. J., Apr. 3, 1984, at 1.

84. On December 1, 1984, the MoF relaxed the eligibility criteria for these entities. *See* R. JONES, RISING CONCERN IN TOKYO OVER YEN'S APPRECIATION, NATIONAL SECURITY AND INTERNATIONAL AFFAIRS DIVISION, GENERAL ACCOUNTING OFFICE, IMPLEMENTATION OF THE YEN/DOLLAR AGREEMENT 18 (1986).

85. Semkow, *The 1984 American/Japanese Financial Agreement: Implications and Results*, 19 GEO. WASH. J. L. & ECON., 741, 780 (1985).

important, the MoF removed the withholding tax on Euroyen bonds issued by residents in April, 1985, a crucial area of contention, since the hitherto continued imposition of the tax made Euroyen bonds issued by residents less attractive than other Eurocurrency bonds, which were not generally subject to a withholding tax.[86] Moreover, in June, 1985, the MoF permitted non-residents to issue different types of Euroyen bonds, including zero-coupon, floating rate, and dual currency[87] Euroyen bond issues.[88] These steps allowed the outstanding issue of Euroyen bonds to increase substantially from Y70 billion in 1983 to Y1.587 trillion in 1985.[89]

Subsequent liberalization of the Euroyen bond market has focussed on easing the restrictions on the issuance of the bonds. In April, 1986, the criteria for the issuance of Euroyen bonds by foreign companies were relaxed, increasing the number of such companies from 150 to 210.[90] Foreign companies need only have a credit rating of A or better from one of five agencies, two foreign and three Japanese; whereas at one time, they needed either a double A rating from Standard & Poor's, and Moody's Investor Services, or a single A rating while meeting specific additional financial tests.[91] In addition, a larger number of Japanese companies may issue Euroyen bonds.[92]

Under the Financial Accord, the MoF also agreed to liberalize the issuance of Euroyen CDs.[93] Among the more important steps taken, the MoF permitted foreign and Japanese banks to issue short-term negotiable Euroyen CDs to nonresidents from bank offices outside Japan,[94] and permitted banks without branches or representative offices in Japan to issue or purchase Euroyen CDs.[95] Subsequent to the Financial Accord, the MoF authorized banks to issue Euroyen CDs of six months or less in December, 1984, and given the lack of market growth due to the short, six-month maturity period, the MoF extended the maximum period to one year in April, 1986.[96] The Euroyen CD market, however,

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86. *Id.* at 781.

87. Dual currency Euroyen bonds have yen-based subscription and interest payments and dollar-based principal redemption. *See* Semkow, *supra* note 63, at 36-37.

88. *Id.* at 36.

89. *Id.*

90. *Id.*

91. H. TROUGHTON, JAPANESE FINANCE: THE IMPACT OF DEREGULATION 46, 51-53 (Euromoney Publications, London 1986).

92. *Id.*

93. FINANCIAL ACCORD, *supra* note 11, § V(C)(4).

94. *Id.*

95. *Id.*

96. Semkow, *supra* note 63, at 36.

has remained small, due, in large part, to the high issuance cost, and the lack of underwriters due to an undeveloped secondary market.[97]

The MoF also agreed to liberalize Euroyen lending.[98] Pursuant to the Financial Accord, the MoF in June, 1984, authorized foreign and domestic banks to syndicate Euroyen loans to Japanese residents. This measure enlarged the market accordingly since these banks had been able to syndicate short-term Euroyen loans to non-residents since June, 1983.[99]

VI. Access of Foreign Financial Institutions

A. *Introduction*

The Financial Accord, in large part, addressed the increasingly important issue of liberalizing the access of foreign financial institutions to financial markets in Japan. Since financial services are not physical goods capable of being transported across borders, entry into a country and its financial markets is necessary for foreign financial institutions to compete; otherwise, in most circumstances, financial services can only be provided with extraordinary difficulty and costs, or not at all.[100] Although the measures of the Financial Accord are relatively modest in their scope, these and other subsequent measures represent an important transition from an earlier period. Previously, Japanese financial markets were relatively undeveloped, with only a few foreign financial institutions with an insignificant market share. However, these measures permitted Japanese finacial markets to move toward a more developed financial market, becoming almost commensurate with those of London and New York in the type and volume of financial transactions, including hundreds of foreign financial institutions, with a cumulatively larger market share.

Under the Financial Accord, the MoF agreed to apply two principles in the treatment of foreign financial institutions.[101] First, the principle of "national treatment" would be applied to foreign financial in-

97. *Id.*

98. *Id.*

99. Semkow, *supra* note 85, at 782-83.

100. A loan by a New York bank to a private borrower in Japan involves a financial service produced by residents of one country and sold to residents of another. Without some physical presence in Japan to provide contact with the customer and facilitate credit evaluation, such a transaction - while not impossible - would be extraordinarily difficult. *See* I. Walter, Barriers to Trade in Banking and Financial Service 13, (Trade Policy Research Centre, London 1985).

101. Financial Accord, *supra* note 11, § V(B) Introduction.

stitutions "engaged in existing and newly emerging financial business areas" so that they would "be afforded equal competitive opportunity with domestic firms."[102] Second, the principle of "transparency" would be applied "toward entry into and operation in Japanese capital markets" so that foreign financial institutions would have "equal effective opportunity."[103] To further the first principle, the Financial Accord sought 1) to enable foreign firms to join the Tokyo Stock Exchange; 2) to permit foreign financial firms to participate in Japanese trust and government securities markets; 3) to permit foreign financial firms to participate in government securities markets; and 4) to abolish swap limits on the conversion of foreign currencies into yen.[104] To further the second principle, the MoF agreed to provide financial institutions with clear written guidelines and rule interpretations to ensure that both domestic and foreign firms could compete in a more equal environment.[105]

The approach of "national treatment" is one of the major approaches taken toward the entry of foreign financial institutions in Japan; the other is reciprocity.[106] The reciprocity approach means that

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102. *Id.*

103. *Id.*

104. With respect to TSE memberships, *see id.* § V(B)(1); for entry into Japanese trust banking, *see id.* § V(B)(2); for entry into government securities markets, *see id.* §V(A)(4); and for the abolition of swap limits, *see id.* § V(A)(3). GOVERNMENT ACCOUNTING OFFICE, THE MARKET ACCESS CONCERNS OF U.S. FINANCIAL INSTITUTIONS IN JAPAN 9, GAO, NSIAD-88-108BR INTERNATIONAL FINANCE, [hereinafter MARKET ACCESS CONCERNS REPORT], concurs with the Department of Treasury, which in its *National Treatment Study, 1986 Update*, finds that the Japanese continue to observe the commitments under the 1984 Yen/Dollar Agreement and generally provide national treatment for foreign banks. See DEPT. OF TREASURY, NATIONAL TREATMENT STUDY, 1986 UPDATE.

105. *See* FINANCIAL ACCORD, *supra* note 11, § V(B)(3). According to the GOVERNMENT ACCOUNTING OFFICE, IMPLEMENTATION OF THE YEN/DOLLAR AGREEMENT 23, GAO, NSIAD-86-107 INTERNATIONAL FINANCE, JUNE 1986, transparency in Japan had improved, as rulings were sent to all foreign banks, and special meetings are held to examine more complicated issues. Problems still arise, but these are recognized to be more a result of misunderstandings rather than a deliberate attempt to mislead. *Id.*

106. The reciprocity approach has been applied in a number of instances. In commercial banking, which entails the taking of deposits and making of commercial loans, the MoF has applied reciprocity in the examination of a foreign commercial bank's application for a license. *See Japan's National Study on Trade in Services*, JAPAN ECON. J., Oct. 1984, at 55. As stated in the *Report of the Federation of the Banker's Association of Japan*, BANKING SYSTEM IN JAPAN (1982), "[I]n actual application of the law, the principle of reciprocity with the country from which the foreign bank comes will be given more importance than anything else." *See* also Friesen, *The Regulation and Supervision of International Lending: Part I*, 19 INT'L LAW. 116 (1985).

foreign financial institutions in Japan would be accorded the same treatment as Japanese financial institutions in the foreign country with respect to regulation and supervision as well as business powers. The national treatment approach means that foreign financial institutions in Japan are treated in the same way as the domestic financial institutions. Because business powers and regulations affecting financial institutions vary among countries, the selection of approach is important. This is notably applicable to the foreign financial institutions wishing to enter Japan, and also to the MoF as Japan's primary financial regulator, as it attempts to preserve its jurisdiction and its own schedule for financial reform.

In principle, the financial institutions of the country which has a more open and liberalized regulatory framework will favor the reciprocity approach when locating in the country with the more restrictive regulatory regime. They will receive greater business powers in the more restrictive country under reciprocity than under national treatment and if they can, through reciprocal access, "export" their wider business powers to the country with the more restrictive regime. On the other hand, the financial institutions of the more restrictive jurisdiction will favor national treatment when locating in the country with the less restrictive regime. They will receive greater business powers in the less restrictive country under national treatment than under their more restrictive regimes at home.

The unevenness of regulatory regimes among the different countries, especially the differences in business powers, will lead to differences of opinion and some tension among the financial regulators. For instance, the regulators in a more restrictive regime will resist the reci-

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Other factors considered by the MoF are the financial strength and credit status of the bank, the length of time the bank has had a representative office in Japan, and the impact of the proposed branch in Japanese financial institutions. *Id.*

The reciprocity approach toward entry has been intended to encourage the country in which the headquarters of foreign banks are domiciled to open its market. *See Japan's National Study on Trade in Services*, JAPAN ECON. J., Oct. 1984, at 55. For instance, the MoF excluded direct participation by Canadian banks in Japan until Canada's 1967 Bank Act had been revised in 1981 to permit Japanese and other foreign banks to enter as Schedule B banks. Until this revision, Canadian banks had only representative offices in Japan. *See* R. WRIGHT, A YEN FOR PROFIT: CANADIAN FINANCIAL INSTITUTIONS IN JAPAN 13 (Institute for Research on Public Policy 1987).

Foreign commercial banks, once licensed to do banking in Japan, are treated in the same manner in large part as domestic commercial banks under the New Banking Law (Ginkoho), Law No. 59 of 1981. For instance, when a foreign bank wishes to establish a branch agency, the foreign bank like a domestic must obtain a banking license from the MoF for each branch or agency as an independent bank. *See* Article 47, paragraph 1 and Article 4, Paragraph 1 of the New Banking Law.

procity approach of the entering foreign financial institutions and their sponsoring regulators and governments in order not to undermine its carefully calibrated regulatory system, and timetable for reform. On the other hand, the financial regulators in the less restrictive regime may condition entry into its system upon business power reciprocity being granted by the regulators of the more restrictive regulatory regime. Otherwise, the financial institutions from the more restrictive regimes will have the benefit of greater business powers in the less restrictive system while those from the less restricted country will be at a disadvantage in the more restrictive regime.

Since Japan has only begun to liberalize its rigidly compartmentalized financial services industry, which for the most part has a specialized type of financial institution for each different part of the financial market spectrum,[107] as a result, it has not reached the "universal banking"[108] regime of the type found in West Germany, France, England, and those currently being implemented in Canada and Italy. Japan has a much more restrictive regime with respect to business powers. As a result, while well-diversified foreign financial institutions will find the prospect of being granted narrower business powers under the national treatment approach unattractive as compared to what full reciprocity might entail, this modified entry is better than no entry at all.

107. There are five very important and major financial market segments which are serviced by specialized types of financial institutions. The first is the taking of deposits and making commercial loans according to tenor, or length of contract. Short-term lending and taking of deposits are the province of the commercial banks, a category comprised of city and regional banks, both of which are domestic Japanese financial institutions, and foreign banks. Long-term lending and funding is the province of long-term credit banks.

Second, trust banks engage in both trust and commercial banking, though they are primarily engaged in the former. Trust banking involves the transfer of a right in property from owner to trustee, or a trust bank, who administers or manages that property on behalf of the hitherto owner, now a beneficiary. Third, the securities industry (or interchangeably, the investment banking industry) engages in a number of primary and secondary market activities, including the underwriting and distribution of government debt, corporate debt and equity securities (a primary market activity), the trading on the account of the firm in these securities in order to make a profit, as well as executing trades *qua* broker on behalf of clients, both of which are secondary market activities. Fourth, the pooling of risks occasioned by losses either through premature death, or by accidental injury to persons or property is the business of the insurance industry. Fifth, the investment advisory and management services industry provides investment advice to and manages funds on behalf of clients.

108. "Universal banking" generally means financial institutions which can provide all types of financial services, through either a bank or the bank and its various financial service subsidiaries.

On the other hand, Japanese financial institutions with narrower powers at home find attractive the exercise of wider business powers abroad under national treatment because they have the opportunity to learn the other finacial service businesses they may eventually get at home.[109]

B. *Foreign Firms Joining the Tokyo Stock Exchange*

Prior to the Financial Accord, foreign securities firms operating in Tokyo were unable to obtain membership in the Tokyo Stock Exchange ("TSE") because no seats were available.[110] Generally, this exclusion worked a hardship because most foreign securities firms were unable to finalize contracts, accept fees, or underwrite primary offerings of Japanese securities.[111] Moreover, without a TSE seat, foreign securities firms could not execute securities orders as brokerage agents without paying twenty-seven percent of their commissions to TSE members to formally execute the transactions.[112]

Pursuant to the recommendations of the Working Group, the MoF requested the TSE, an autonomous, nongovernmental body over which it had no jurisdiction, to study potential methods of expanding membership opportunities for both domestic and foreign nonmember firms.[113] In August, 1985, the TSE formally increased its membership from eighty-three to ninety-three seats.[114] On November 29, 1985, the TSE selected six foreign and four Japanese securities firms as new members.[115] Although the price for each seat was a very high 1.2 bil-

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109. *Japanese Foreign District Investment, the Moneyman's Pursuit of Money, The Economist*, Mar. 5, 1988, at 83.

110. *See MoF Decides to Allow Foreign Members to TSE*, JAPAN ECON. J., May 28, 1985, at 4; and, Browinging and Chipello, *Non-Japanese Firms Begin Push to Win Seats on Tokyo Exchange*, Wall St. J., Oct. 28, 1985, at 27. The TSE, which had been founded on April 1, 1949, opened up membership to foreign firms in April, 1982, by deleting constitutional provisions against foreign membership. *See* MARKET ACCESS CONCERNS REPORT, *supra* note 104, at 13.

111. Thomas, "Capital Formation in Japan and the United States: A Comparative Assessment, 21 *Colum. J. Transnat'l L.* 227, 234 (1983). These restrictions applied to the majority of foreign brokerages that operated representative offices in Japan. In order to provide full operations, foreign firms first had to obtain a license from the MoF to operate a branch office and then had to maintain a large staff to meet the MoF's reporting requirements. As of 1983, only three foreign firms had sought branch status. *See id* at 234.

112. Browning, *Tokyo Exchange: To Join or Not to Join*, Wall St. J., Sept. 27, 1985, at 32.

113. FINANCIAL ACCORD *supra*, note 11, § V(B).

114. *Tokyo Stock Exchange to Accept Foreign Members as It Adds 10 Seats*, JAPAN ECON. J., Sept. 7, 1985, at 1.

115. Browning, *Tokyo Bourse Grants Seats to 6 Foreigners*, Wall St. J., Dec. 2,

lion yen, each new member could, with sufficiently high trading volumes, save on the commissions previously paid to Japanese members to formally execute trades.[116]

Despite the increased number of TSE seats, the governments of, and some licensed securities firms from, the United States and Europe began applying pressure for an additional increase in membership.[117] In December, 1986, the TSE announced plans to expand membership and admit more foreign members when an annex to the TSE's main building was completed[118] and the computer systems were upgraded in the Spring of 1988.[119] Despite this schedule, in April, 1987, the U.K. Government threatened to revoke the licenses of Japanese banks and insurance companies operating in the U.K. under the provisions of the Financial Services Act of 1986, unless the Japanese admitted three U.K. securities firms by May or June of 1987.[120] This dispute was resolved in June, 1987, when the Japanese finance officials agreed to accelerate their review of TSE memberships to enable U.K. applicants to join in 1988.[121]

1985, at 25.

116. Semkow, *supra* note 63.

117. The number of foreign securities firms in Japan had increased from 14 in 1985 to 36 at the end of March, 1987, with 14 from the United Kingdom, 12 from the United States, five from West Germany, two apiece from Switzerland and France, and one from the Netherlands. *See* Makino, *TSE's Widening Gates Buttered by Foreign Firms Seeking Entrance*, JAPAN ECON. J., Apr. 18, 1987, at 1. American pressure arose when in December, 1986, the Federal Reserve Bank of New York granted the applications of two Japanese securities firms, Nomura Securities Co. and Daiwa Securities Co., to become primary dealers in government securities, and approved the acquisition of Aubrey G. Lanston & Co., another extant primary dealer, by the Industrial Bank of Japan. *See* Sesit & Herman, *'Fed to Designate Several Japanese Firms as Primary Bond Dealers,' Sources Say*, Wall St. J., Dec. 11, 1986, at 2.

118. *TSE Decides to Expand Membership*, JAPAN ECON. J., Dec. 27, 1986, at 1.

119. *Tokyo Market to Offer More Seats to Foreign Firms by Next May*, Asia Wall St. J. Wkly, May 18, 1987, at 10. According to TSE officials, the lack of floor space prevented any additional membership at this time because the TSE's stock trading procedures required that its members be physically present on the trading floor rather than linked electronically to the exchange. *See* MARKET ACCESS CONCERNS REPORT, *supra* note 104, at 13.

120. *Japan Snubs UK over Brokers Plan*, Financial Times, Apr. 9, 1987, at 26. Under the reciprocity provisions of the Financial Services Act, 1986, Ch. 60, namely, §§ 183-186 of Part IX, the Secretary of State or the Treasury may, if it is in the national interest, revoke or restrict the licenses of foreign banks, insurance companies, and investment businesses if the laws of their country, or the actions taken by its government or any governmental body do not permit British enterprises from carrying on similar business on terms as favorable as carrying them on in the United Kingdom.

121. Lascelles, *Japan to Speed Review of Exchange Membership*, *id.*, June 3,

In October, 1987, the TSE announced it would admit twenty-two more members to the TSE before the end of 1987, bringing the total number of seats to 114.[122] The criteria used in awarding seats would include an evaluation of the broker's assets and the degree of their participation on the exchange.[123] Having accepted applications in the previous month,[124] on December 16, 1987, the TSE announced the names of the new members, sixteen of which were from five foreign countries.[125] The President of the TSE mentioned that the new members were selected "on the basis of their business scale, performance and history of operation in Japan and financial conditions."[126] The new members paid about 1.2 billion yen for their memberships, which became effective in May, 1988.[127]

C. *Trust Banking*

Despite the MoF's rejection of the proposed merger between Nomura and Morgan Guaranty Trust Bank to enter trust banking, the MoF announced under the Financial Accord its new policy to license qualified foreign banks to participate in the same range of trust banking activities performed by Japanese trust banks.[128] In doing so, the MoF provided foreign commercial banks wider business powers than their domestic counterparts.

1987, at 7. The TSE also was able to computerize between 50 and 100 of its most actively traded stocks, which removed the need for floor traders in these stocks and opened up space for additional members. *See* MARKET ACCESS CONCERNS REPORT, *supra* note 104, at 13.

122. An earlier merger between Toishi Securities Co. and Taiyo Securities Co. brought the number of seats to 92. *Tokyo Bourse Members Increase by 22*, JAPAN ECON. J., Oct. 24, 1987, at 13.

123. *TSE to Admit 20 New Members*, Financial Times, Oct. 7, 1987, at 22.

124. *Foreign Cos. to Dominate 22 Seats Added by the TSE*, JAPAN ECON. J., Oct. 31, 1987, at 3, 26.

125. The foreign firms according to country were: 1) United States - First Boston (Asia) Ltd., Kidder Peabody International Corp., Prudential-Bache Securities (Japan) Ltd., Shearson Lehman Brothers Asia Inc., Smith Barney, Harris Upham International Inc., and Salomon Brothers Asia Ltd.; 2) United Kingdom - Baring Securities Ltd., County Nat West Securities Japan Ltd., Kleinwort Benson International Inc. and Schroeder Securities (Japan) Ltd.; 3) West Germany - DB Capital Markets (Asia) Ltd. and Dresdner - ABD Securities Ltd.; 4) Switzerland -SBCI Securities (Asia) Ltd. and UBS Phillips & Drew International Ltd.; 5) France - Sogen Securities (North Pacific) Ltd. and W.I. Carr (Overseas) Ltd. *Tokyo Stock Exchange Names New Members*, *id.* Dec. 26, 1987, at 2.

126. *Id.*

127. *Id.*

128. FINANCIAL ACCORD, *supra* note 11, § V(B)(2).

The MoF mentioned that participation could include partnership with Japanese trust banks, but not with non-licensed firms,[129] an approach that purportedly reinforced the historical separation in Japan between trust and commercial banking.[130] The new policy, however, was due in part to the U.S. Government's authorization of nine Japanese banks to enter the trust business in the United States.[131]

The MoF established criteria for the entry of foreign trust banks, including that the foreign banks be engaged in the trust business in their home country, and have an asset balance exceeding the average balance of Japanese trust banks.[132] Although the MoF originally intended to restrict the number of foreign trust banks to eight, one for each of the eight Japanese trust banks, the MoF accepted all nine applications in June, 1985.[133]

Foreign trust bank entry has been timely, in large part, due to the growing pension needs of Japan's more rapidly aging and longer-living population.[134] Pension fund growth has been substantial, growing on average over twenty percent per year, with public and private sector funds amounting to over $200 billion in 1985.[135] Moreover, the management of corporate pension trusts, which have grown from Y10 trillion in 1983 to Y20 trillion in 1986, is expected to grow to Y60 trillion by 1990.[136] Trust banks and insurance companies, so far, have had exclusive management over pension funds.[137] The foreign trust banks have had some limited success with the corporate pension trust market, amounting, however, to only .1% of that of domestic trust banks.[138] However, these foreign trust banks have established a strong presence in foreign currency dominated trust funds, which involve the management of U.S. stocks on behalf of individuals, and also specified money

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129. *Id.*

130. In the United States, national commercial banks undertook trust banking pursuant to the Federal Reserve Act of 1913 and Federal Reserve Board regulations which were promulgated in 1915. State commercial banks were able to engage in this activity earlier. *See* W. A. LOVETT, BANKING AND FINANCIAL INSTITUTIONS 138 (1984).

131. *Only U.S. Banks Acting on Their Own Can Enter Japan's Trust Market: BoJ*, JAPAN ECON. J., May 8, 1984, at 1.

132. *9 Foreign Banks Allowed into Trust Banking Field*, *id.* July 1, 1985, at 1.

133. *Id.*

134. *Id.*

135. *Survey of Investment Management*, THE ECONOMIST, Nov. 8, 1986, at 4.

136. Semkow, *supra* note 63, at 35.

137. Marsh, *Japan's Next Export Success: The Financial Services Industry*, THE ECONOMIST, Sept. 7, 1986, at 63.

138. *Foreign Trust Banks Bolster Japan Presence*, JAPAN ECON. J., Aug. 29, 1987.

in trust, of which the investor directs the management.[139]

D. *Government Bond Trading*

Under the Financial Accord, the MoF announced that on June 1, 1984, qualified Japanese banks will be able to buy and sell government securities to the secondary market,[140] an activity hitherto undertaken primarily by securities firms, and that within months, qualified Japanese branches of foreign banks could do the same.[141] In October, 1984, the MoF licensed Citibank, Bank of America, and Chase Manhattan to trade previously-issued government securities in Japan.[142]

Subsequent to the Financial Accord, the MoF further liberalized the role of foreign financial institutions in the underwriting of government securities.[143] The problem was that the foreign financial institutions had a very limited role in the government underwriting syndicate, under which members were allocated bonds through a set formula. This syndicate was comprised of approximately 800 financial institutions, including as of April, 1987, twelve U.S. banks and twelve U.S. securities firms.[144] In April, 1987, the allotment of ten-year bonds underwritten by foreign securities was increased from .3 to over one percent.[145] Moreover, in November, 1987, a limited "auction" had been introduced for twenty percent of each ten-year bond issue, under which bids on the volume of bonds were made and accepted by the MoF prior to the conclusion of negotiations on terms and conditions of the forthcom-

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139. *Foreign Banks Expand Fund Trusts*, *id.* Mar. 21, 1987, at 3.

140. FINANCIAL ACCORD, *supra* note 11, § V(A)(Interest Rates)(4).

141. *Id.*

142. *Three U.S. Banks to be Allowed to Deal in Japanese Treasury Bonds*, JAPAN ECON. J., Oct. 2, 1984, at 3.

143. In response to the Federal Reserve Bank of New York granting primary dealer status to the subsidiaries of two Japanese securities firms as discussed *id.*, the MoF announced in December, 1986, to undertake three additional measures to liberalize Japanese financial markets. Two of these measures dealt with the underwriting of medium-term and long-term government bonds respectively which are discussed above; *see* notes 140 to 149 and the accompanying text. The other measure dealt with the granting of securities licenses to subsidiaries of U.S. banks. *See Mid-Term Gov't Bonds Open Bids Among Market Opening Moves*, JAPAN ECON. J., Dec. 27, 1986, at 2. At this time, 25 foreign banks and 17 foreign securities firms were part of the syndicate that could underwrite long-term and medium-term bonds, having increasing in number from nine foreign banks and six foreign securities firms since 1984, the year foreign financial institutions were first permitted to underwrite these bonds. *See Japanese Bonds - Yearning to Breathe Free*, THE ECONOMIST, Nov. 8, 1986, at 93-94.

144. MARKET ACCESS CONCERNS REPORT, *supra* note 104, at 16.

145. *Id.*

ing bond issue.[146] Under this scheme, foreign institutions increased their share of November, 1987, ten-year issues from 1.5 to about five percent.[147]

In addition, the MoF switched from an underwriting syndicate to a public auction for twenty-year government bonds in August, 1987.[148] Unfortunately, the twenty-year government bonds comprise less than five percent of newly issued government bonds.[149]

E. *Elimination of Swap Limits*

The Financial Accord also addressed restrictions on the conversion of foreign currencies into yen.[150] Prior to the effective date of the Financial Accord, foreign banks operating in Japan were unable to easily raise sufficient funds for loans, in large part due to the paucity of branches per foreign bank as a means of gathering retail deposits.[151] In order to raise more funds, foreign bank subsidiaries would convert into yen foreign currency obtained from their offshore parents.[152] The Bank of Japan, however, imposed swap limits on the foreign currency that could be converted into yen.[153] Although originally intended to insulate foreign exchange and domestic interests rates from undesirable fluctuations caused by unlimited conversions, the swap limits constrained the foreign banks' ability to raise funds. In an effort to promote interna-

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146. *MoF to Up Non-Competitive Bids for 10-Year Government Bonds*, JAPAN ECON. J., May 30, 1987, at 2.

147. MARKET ACCESS CONCERNS REPORT, *supra* note 104, at 16.

148. Shibata, *Tokyo Adopts Auction for Bond Issue*, Financial Times, May 19, 1987, at 29; *see also* MARKET ACCESS CONCERNS REPORT, *supra* note 104, at 15 n.7.

149. In the fiscal year ended March 31, 1986, Japan sold $155.94 billion in government debt securities, 76.6% of which was in 10-year bonds and 4.6% in 20-year government bonds. See Seiset, *Japanese Plan Auction Sale of Some Bonds*, Wall St. J., May 13, 1987, at 29. Japanese government bonds are issued through an auction, an underwriting syndicate, and by direct placement with official accounts such as the Trust Fund Bureau and the Ministry of Posts and Telecommunications. In 1987, about 29% of all government bonds were issued through an auction and about 37% placed in official accounts. See MARKET ACCESS CONCERNS REPORT, *supra* note 104, at 15 n.7. Public auction also extend to medium-term bonds of up to four years' maturity. *See* Shibata, *supra* note 148.

150. Financial Accord, supra note 11, § V(3).

151. In November, 1983, there were 74 foreign banks in Japan, operating through 102 branches. *Japanese Banks - Their Type and Functions*, JAPAN ECON. J., Dec. 6, 1983, at 37. As of March 31, 1986 there were 77 foreign banks operating through 112 branches. Nakamura, *Is There Any Future for Foreign Banks in Japan?*, Tokyo Bus. Today, Sept. 1986, at 43.

152. BRONTE, JAPANESE FINANCE: MARKETS AND INSTITUTIONS 70 (1983).

153. *Id.*

tional capital flows, the MoF announced pursuant to the Financial Accord, that effective June 1, 1984, swap limits would be abolished for foreign and Japanese banks.[154]

F. *Foreign Securities Firms and Commercial Banks*

Another area in which the Japanese have bowed to the foreign pressures for reciprocal access, rather than national treatment, is the recent granting of securities licenses to foreign commercial banks, and in the case of Citibank, through its securities subsidiary in Japan, a seat on the Tokyo Stock Exchange. These business powers are more extensive than those currently enjoyed by the domestic Japanese banks which only have limited securities powers beyond underwriting and trading in government securities.

Pursuant to the Law on Foreign Securities Firms, in 1972 the MoF started granting securities licenses to foreign financial institutions, with ten granted between 1972 and 1984, and another eighteen by October, 1986.[155] While this law permitted foreign bank owned companies to do business with Japan, provided that they were doing business in their home countries or elsewhere for more than three years and the parent's interest was not greater than fifty percent, the MoF blocked the application of this rule through administrative guidance until December, 1985, when DeutscheBank obtained a securities license for a securities branch in Japan, effective only so long as it was half-owned by a non-financial institution.[156] By June, 1987, ten other foreign banks, all from universal banking regimes in which Japanese commercial banks could undertake a broad range of securities activities, had successfully argued that on the basis of reciprocal access that they should be granted securities licenses.[157] At this time, the MoF tentatively approved securities licenses for ten more foreign institutions, including subsidiaries of four U.S. banks, with J.P. Morgan Securities (Asia) Ltd., the first U.S. affiliated institution to receive a license,[158] to

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154. FINANCIAL ACCORD, *supra* note 11, § V(A)(4).

155. *Finance Ministry OKs 8 Offices for Europe Banks, Securities Firms*, JAPAN ECON. J., Nov. 15, 1986, at 2.

156. Initially, DeutscheBank asked the MoF to open a branch of a wholly-owned subsidiary in light of Japanese financial institutions being able to do the same under the broader business powers regime of universal banking in West Germany. *See Foreign Bank-Owned Securities Firms to be Allowed to Set up Branches*, *id.*, Oct. 12, 1985, at 1.

157. H. TROUGHTON, JAPANESE FINANCE: THE IMPACT OF DEREGULATION 89 (1986).

158. *MoF: J.P. Morgan Okay to Run Securities Firm*, JAPAN ECON. J., Aug. 22,

underwrite, distribute, trade and broker debt and equity securities.[159]

American banks that had acquired existing British securities firms in Japan, however, preceded the American banks which entered de novo, and in the case of Citibank, preceded all foreign banks.[160] Citibank acquired Vickers de Costa Ltd., a British securities firm which had been operating in Japan prior to the DeutscheBank application, and which had been among the first of the six foreign financial institutions to acquire a seat on the Tokyo Stock Exchange on November 19, 1985.[161] The MoF considered the Vickers case an exception to the existing ban on banks entering the securities industry because to have excluded Citicorp would have meant the discontinuation of Vicker's existing business in Japan.[162] In addition, Security Pacific opened a securities branch through Hoare Grovett Ltd., and Chase Manhattan through Laurie Milbank.[163]

The interesting implication of the U.S. bank entry into the securities business, either by de novo entry or by acquisition, is that the MoF adopted a policy of equal treatment of foreign financial institutions in Japan, changing the past policy of reciprocity with respect to certain universal banking countries, the banking institutions of which were able to gain access to Japan's securities market, and further exacerbating the discrepancy in business powers between what the domestic and foreign commercial banks can do in Japan. When DeutscheBank applied for a securities license, arguments were made that it would be unfair for the MoF to deny this application since the Japanese banks with branches and subsidiaries in West Germany could avail themselves of the power of universal banks in that country in both commercial and investment banking. With the granting of the DeutscheBank application, financial institutions from countries with universal banking regimes made similar applications, and a policy of reciprocity was

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1987, at 18.

159. Horowitz, *Banks Win Securities Nod*, AMERICAN BANKER, June 4, 1987, at 1. Until this time, U.S. banks in Japan could trade in some securities, but were confined to dealing with the 120 largest Japanese financial institutions, and had neither retail customers nor corporations. With a securities license, these foreign financial institutions have a broader distribution base to market foreign as well as domestic yen securities. *See* Seiset & Rubinfein, *Japan Signals Entry for Banks into Securities*, Wall St. J., June 4, 1987, at 3.

160. *See* Semkow, *supra* note 85, at 770 n.232.

161. *Id.*

162. *See Foreign Bank-Owned Securities Firms to be Allowed to Set-Up Branches*, *supra* note 156.

163. Chipello, *Japan Gives Broker Permits to 8 Europe-Based Firms*, Wall St. J., Nov. 18, 1986, at 28.

adopted in granting securities licenses to financial institutions of these countries.

The entry of American financial institutions, however, could not be rationalized on the basis of reciprocity since the Glass-Steagall Act provisions separate commercial and investment banking. American entry by acquisition was accepted because to do otherwise would mean discontinuing an extant and viable operation of foreign financial institutions in Japan, a policy that would be fraught with political peril given the issue of greater access of foreign financial institutions to Japan. The de novo entry of the American banks, however, marked a new phase regarding the issue of greater entry of U.S. and other foreign financial institutions. It is unlikely, however, that this new phase will apply to financial institutions of other foreign countries. The American financial market is the most important financial market in which Japanese financial institutions can grow. Moreover, the MoF has taken measured steps to assuage American legislators who have introduced amendments to pending trade legislation that would preclude entry into the United States if similar access is not granted to American financial institutions in the foreign country.[164]

While a growing number of foreign financial institutions can now engage in both commercial and banking activities, the separation of investment and commercial banking by Article 65 of the Securities and Exchange Law ("SEL")[165] for domestic financial institutions in Japan has come under attack from Japanese commercial banks.[166] Japanese banks, which are precluded by the Anti-Monopoly Law[167] from owning more than five percent of a securities firm, have been concerned about foreign bank entry into the securities business.[168] The Industrial Bank

164. Earlier in the year, both the House and the Senate each passed omnibus trade legislation that had reciprocity provisions aimed at countries which restricted access to their financial markets. The House bill, given the Schumer Amendment, would deny primary dealer status to foreign firms if their own countries restrict U.S. entities from equal access to their markets within six months. The Senate bill contained a similar amendment, except that it required equal access within two years and would exempt institutions from countries that have or are negotiating free trade agreements with the United States. *See* Langley & Sesit, *Panel Votes to Curb Japanese Dealings in U.S. Securities*, Wall St. J., May 21, 1987, at 18.

165. Securities and Exchange Law [Shoken Torihiki Ho], Law No. 25 of 1948, as amended by the 1981 Amendment to the Securities and Exchange Law [Shoken Torihiki-ho no Ichibu o Kaisei suru Horitsu], Law No. 62 of 1981.

166. *See infra* note 171, at 1, 6.

167. Prohibition of Private Monopoly and Maintenance of Fair Trade Law, Law No. 54 (1947). For further discussion of this law, see IYORI & UESUGI, THE ANTIMONOPOLY LAWS OF JAPAN (1983).

168. Sulkin, *New Lanston Office in Tokyo Irks Japan Securities Firms*, Asian

of Japan, however, circumvented these restrictions recently when its New York subsidiary, Aubrey G. Lanston & Co., one of forty primary dealers in U.S. government securities, the activities of which are limited to providing advice and information, was permitted to open a securities representative office in Japan.[169] Although MoF officials consider Lanston a special case,[170] the question remains whether Lanston represents ultimately a transitional case by which the repatriation of foreign securities subsidiaries of Japanese banks will lead to the eventual demise of Article 65 of the SEL.[171]

G. *Foreign Investment Advisory and Management Services Firms*

Foreign investment advisory and management service firms have fared very well in the newly emerging and regulated investment advisory and management industry in Japan. This industry provides advice to and manages funds on behalf of clients, earning fees in the process for such services.

In May, 1986, Japan enacted the Law for Regulating Securities Investment Advisory Business (hereinafter "LRSIAB"), which took effect on November 25, 1986.[172] The purpose of the LRSIAB is to protect investors "by a system of registering persons who are engaged in the business of providing securities advice and necessary regulation of their such business."[173]

Under the provisions of the LRSIAB, all firms wishing to engage in the investment advisory business of providing advice to a customer under an investment advisory contract must register with the MoF in order to become an investment adviser.[174] The registration requirements for Japan's investment advisers, which are dominated by a small number of major advisors, most of which are subsidiaries of stock bro-

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Wall St. J. Wkly, July 27, 1987, at 20.

169. *Id.*

170. *Id.*

171. The city banks have tried to overcome these legislative restrictions in other ways, such as seconding their employees to the securities firm affiliate, having the offices of the securities affiliate in close proximity to the bank's offices, or in networking securities business through its affiliate. *See* Takahashi, *Japanese Banks Using Affiliates to Muscle in on Securities Field*, JAPAN ECON. J., Dec. 5, 1987, at 1, 6.

172. Law For Regulating Securities Investment Advisory Business, Law No. 74 of May 27, 1986 [hereinafter "Law No. 74"].

173. Art. 1, Law No. 74, *id.* The LRSIAB was prompted by Japan's worst case of securities fraud, the 1983-1984 Toshi Journal scandal, when 8000 small savers lost Y18.4 billion. *Why Japan is Worshipping Foreign Fund Managers*, THE ECONOMIST, Mar. 7, 1987, at 79.

174. *See* Semkow, *supra* note 63, at 38.

kerages, banks and insurance companies, are easy with which to comply.[175]

The licensing requirements for those investment advisers who wish to engage in the discretionary investment business are more difficult with which to comply. This business involves granting an investment adviser the discretionary powers necessary to make investment judgments in whole or in part, on the basis of its analysis of the value of a security and make an investment on behalf, and for the account, of its customer.[176]

Only trust banks and insurance companies could manage discretionary accounts prior to the passage of the LRSIAB.[177] Under its provisions, the MoF will grant licenses to those investment advisers which have a strong financial base and personnel with an adequate level of expertise and experience to carry out this type of business.[178] Guidelines released in February, 1987, required that discretionary management license holders will be required to have a minimum capital of Y100 million in equity capital, and in excess of Y20 billion in managed or entrusted assets by their third year of operation.[179] One shortcoming of the LRSIAB, however, has been the exclusion of management of corporate pension funds from its provisions, an activity that is the exclusive province of trust banks and insurance companies.[180]

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175. *Id.*

176. Law No. 74, *supra* note 172, Art. 2.

177. Semkow, *supra* note 63, at 36.

178. *Discretionary Account Firms Must Keep Y20 Billion Assets*, JAPAN ECON. J., Feb. 14, 1987, at 2.

179. *Id.*

180. Dixon & Bruce, *UK Welcomes Tokyo Decision to Open Fund Managment Market*, Financial Times, May 27, 1987, at 28. There are some undercurrents for reform of the current practices pension fund management. In July, 1987, an advisory body of the Ministry of Health and Welfare recommended expanding the scope of pension fund management. In January, 1988, the Japan Securities Investment Advisors submitted a report to the MoF and Ministry of Health and Welfare, describing current corporate pension management practices lagging behind that of the U.S. and Europe by 20 years, and called for the elimination of the monopoly over corporate pension fund management by the trust banks and life insurance companies. *See* Takahashi, *Investment Advisors Challenge Pension Management Monopoly*, JAPAN ECON. J., Feb. 6, 1988, at 2. The MoF is currently planning in 1988 to relax restrictions on the managment of public pension funds, which are currently managed by the Fund Trust Bureau of the MoF, in order to permit part of these funds to be invested in money market instruments under the managment of life insurance companies and trust banks. *See Investment Advisers Want Pension Business*," *id.* Jan. 23, 1988, at 5. In addition, the Ministry of Health and Welfare has introduced draft legislation that would permit city banks and securities firms to provide advisory services to corporate fund managers on the management of pension funds. *See Banks, Securities Firms Get OK to Handle*

Under the LRSIAB, the investment advisory industry had grown quickly with 273 firms having registered with the MoF as of August 31, 1987.[181] On February 20, 1987, 135 successful firms, including forty-four banks, seventeen insurance companies, twenty-four securities companies and sixteen foreign firms were granted registrations;[182] all of these applied before the deadline of December 2, 1986.[183] Of this group, the MoF granted in May, 1987, fifty-nine discretionary investment licenses, seventeen of which were foreign registrants, including ten from the U.K. and six from the U.S.A.[184] The new licensees have been authorized to commence business since June, 1987.[185] New discretionary investment licenses will be granted later from the pool of successful subsequent registrants.

In February, 1987, the MoF published guidelines for awarding licenses to discretionary investment firms.[186] The rules pertaining to foreign firms have been substantially relaxed. For instance, foreign firms need not comply with the condition that they must have Y20 billion in managed assets by their third year of operation, as long as their parent company has over Y100 billion in managed assets.[187] Moreover, initial concerns that the foreign parent and its subsidiary would each have to apply for a license, as well as certain staffing requirements designed to keep the subsidiary at arm's length from the parent company were subsequently relaxed by supplementary rules issued March 2, 1987.[188] In addition, the trade body of the investment advisory and management industry, the Japan Securities Investment Advisors Association, which was established on September 22, 1987,[189] has, by dint of the MoF, a foreign firm on its steering committee, a significant honor in Japan.[190]

Pensions, *id.* Feb. 13, 1988, at 12.

181. Takahashi, *Investment Advisory Group of 223 Firms Starts to Halt Fraudulent Practices*, *id.* Oct. 3, 1987, at 2.

182. *135 Firms Registered as Investment Advisers*, *id.* Mar. 31, 1987, at 3.

183. *Why Japan is Worshipping Foreign Fund Managers*, THE ECONOMIST, Mar. 7, 1987, at 80.

184. The remaining licenses were granted to 14 security company subsidiaries, 12 city banks, two long-term credit banks, nine insurance companies and two others. *See* Dixon, Rodger & Bruce, *UK Welcomes Tokyo Decision to Open Fund Management Market*, Financial Times, May 27, 1987, at 28. *See also 17 Foreign Firms into Discretion Managment*, JAPAN ECON. J., May 30, 1987, at 2.

185. Japan Econ. J., *supra* note 184.

186. *Id.*

187. *Discretionary Account Firms Must Keep Y20 Bil. Assets*," *id.* Feb. 14, 1987, at 2.

188. *Why Japan is Worshipping Foreign Fund Managers*, *supra* note 183.

189. Tokahashi, *supra* note 181.

190. *Why Japan is Worshipping Foreign Fund Managers*, *supra* note 183.

The liberal treatment of foreign firms in the investment advisory and management industry is perhaps due for a few reasons. For instance, Japan's current account surpluses have grown rapidly recently, permitting unprecedented capital outflows to be invested in foreign assets, including debt and equity securities of foreign corporations and debt equities of foreign governments. If Japan is to emerge as an international financial center commensurate with its emerging role as the world's foremost *rentier* nation, foreign firms with specific expertise in managing these types of assets in their own countries will be needed.[191]

In addition, fund management in Japan is not as well developed as it is abroad, particularly compared with that of the U.S. and the U.K.[192] In Japan, there are several types of funds, which are managed by different financial institutions; security companies handle investment trust funds; life insurance companies and trust banks handle pension funds; and investment advisory companies handle funds for individuals.[193] These funds are managed very much like high-interest rate deposit accounts, informally offering an ensured return, rather than using active investment management techniques to outperform the total market indices.[194] For instance, most Japanese pension fund managers offer returns on investments within half a percentage point of each other,[195] a result which suggests the industry is like a cartel, with set returns, which is in need of foreign competition.[196]

191. *Investment Management, on Top of the World, a Survey*, THE ECONOMIST, Nov. 8, 1986, at 4, 24, 25.

192. *Why Japan is Worshipping Foreign Fund Managers*, *supra* note 183, Mar. 7, 1987.

193. *Id.*

194. *Id.*

195. The Japan Pension Fund Association, which is attempting to get more active performance measurements, has estimated that in 1985, 90% of all pension funds reported an investment return of between 9.28% and 9.7%, despite being invested in different stocks. *See Investment Management, on Top of the World, a Survey*, *supra* note 191. On the other hand, active fund management may not yield significant dividends net of the costs of active management, i.e., commissions for buying and selling financial instruments and salaries of analysts to ascertain which financial instruments yield a higher amount for a given level of risk, because it is difficult to outperform broad-based market indices. For instance, SEI Funds Evaluation Services, a pension fund consultant, claimed that the S&P 500 index outperformed 87% of all managers in the decade ending in 1979 and 66⅔% for the decade ending in 1982. Moreover, the same consultant estimated that the S&P index outperformed 64% of all pension accounts in 1983, 75% of these accounts in 1984, and 66% in 1985. *See* BEVIS LONGSTRETH, MODERN INVESTMENT MANAGEMENT AND THE PRUDENT MAN RULE 9 n.1. (1986).

196. *Id.* at 22-24.

VII. Conclusion

The restructuring of the Japanese financial markets and industry neither began nor ended with the Financial Accord and the other consistent measures in its train.[197] However, these are significant in that they represent primarily an American perception that by restructuring the financial industry and market, the U.S.-Japan trade imbalance could be resolved. These measures had two prongs: 1) like trade conflict over autos, citrus, beef, government contracts and so on, greater access to the financial industry by foreign companies was sought; 2) unlike these other industries, restructuring the financial services industry and its related markets for financial services and instruments affected the yen/dollar exchange rate.

The complexity of the dynamics underlying the trade adjustment process, however, has deferred the remedial effects of these measures. The irony lies in the fact that Japan's continued position as America's largest trade creditor has now been parlayed into that of America's largest investor.

197. For instance, in December, 1987, the MoF received a report from the Financial System Subcomittee of the Financial System Research Council, a consultative body to the MoF. The Report called for a drastic overhaul of Japan postwar banking system. *See Ministry Set to Alter Postwar Bank System*, JAPAN ECON. J., Dec. 12, 1987, at 14.