THE POLITICAL ECONOMY OF INTERNATIONALIZING
THE JAPANESE FINANCIAL SYSTEM:
THE CASE OF THE BOND MARKET

Frances Rosenbluth

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Frances Rosenbluth is Post-Doctoral Fellow
and Assistant Director of the Center on
Japanese Economy and Business, Columbia
University, New York

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Graduate School of Business
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I. Introduction

On November 28 1986, the Ministry of Finance's Securities Exchange Advisory Council proposed a significant relaxation of restrictions on domestic corporate bond issuance. The number of corporations eligible for issuing unsecured straight bonds would triple to 180, the issuing unit of privately placed bonds would quintuple to 10 billion yen, and firms would be permitted to issue at any time during the month instead of at month's end as formerly stipulated. Moreover, in a break with a long tradition, firms with a high enough corporate rating would be allowed to issue unsecured bonds even though they do not meet the conventional standards of eligibility. 1

At first glance, this would appear to be a serious blow to the interests of the banking community: the easier it is for corporations to issue bonds, the less they must depend on banks loans for their external financing. In fact, however, most banks

did not fight the change. This chapter will explain why not. 
The story line will unfold as follows: banks succeed in 
squelching the domestic bond market, to the benefit of their loan 
business. Once firms become strong enough to raise funds in the 
Euromarket, however, they take their business overseas. Banks 
follow them abroad and recapture some of the business, but suffer 
nevertheless from the abandonment of the domestic market. In 
attempting to stem the trend towards securitization, banks cut 
their spreads on domestic loans. With the domestic loan market 
consequently less profitable and hence less worth fighting for, 
the banks finally agree to woo firms back home by making the 
domestic bond market more attractive, in exchange for a larger 
role for banks in the private placement market.

Deregulation of the bond market, however, is more than an 
interesting story. Changes in the bond market help to explain 
the trend towards direct finance in Japan. Secondly, an 
examination of the process helps to generate more general 
propositions as to the how and why of financial deregulation. 
Thirdly, this case study affords a penetrating look at the 
government-business nexus in Japan.

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2 It should be noted that in this chapter we are primarily 
referring to large banks and their blue chip customers. Small 
banks are not directly affected by changes in bond market rules 
since small firms, their main clientele, do not have ready access 
to bond markets anyway.
II. The History of the Bond Market

The 1920s were the "golden age" of Japan's bond market. Buoyed by the demand for industrial and consumer goods from war-stricken Europe, Japanese manufacturers enjoyed an unprecedented production boom. And to finance capacity expansion, large corporations turned to the domestic bond market for one third to one half of their funding needs. Firms were attracted to the convenience of the bond market since they were free to choose among maturities of one to thirty years, and among numerous denominations, large and small. Banks, moreover, did not mind that bank loans accounted for only 5% or so of the large corporate finance market; banks were free to underwrite corporate bonds, and keep them in their own portfolios or pass them along to securities firms for distribution to the public.

Once Europe's economy recovered from the devastation of World War I, the floor dropped out from under Japan's expanded export sector. Many firms defaulted on their bonds, leaving bondholders including banks with nothing. Beginning with the collapse of the Bank of Taiwan and the subsequent bank panic in 1927, hundreds of banks folded in the following years. The total

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number of banks shrank from 1,283 banks in 1927 to 538 banks in 1932.  

The Ministry of Finance was caught by surprise; there was no creditor protection mechanism in place, and the Ministry was forced to subsidize numerous ailing banks from government coffers to contain the disruption in financial markets.

Politicians, meanwhile, were concerned about their small constituents who claimed that they were bearing the brunt of the recession. In May 1929 the Giichi Tanaka Cabinet responded to the small business sector's massive lobbying by drafting "An Outline for Restructuring Small Business Finance," which was a design for ensuring that the consolidation of the financial sector did not eliminate the flow of funds to small enterprises. In a policy measure that is maintained to the present day, the smallest tier of financial institutions was prohibited from lending to firms larger than a given size. In the following year the MOF with funds gathered from postal savings was ordered to disburse 50 million yen to small business. At the same time, the Ministry of Commerce and Industry attempted to organize cartels and industry associations to help small business deal with "excess competition."  


6 Koji Arisawa, ed., *op cit.*, p. 62
To prevent such a financial debacle from recurring, the MOF took advantage of the widespread uncertainty to draft a new banking law in 1927. The new legislation gave MOF broad, vaguely specified powers of oversight. In exchange for tolerating more extensive government intervention, however, banks obtained the MOF's protection and assurance of no further entries into the banking business. For this, the banks would thank their friends in the Kenseikai, Seiyu Honto, and the Seiyukai.

The MOF was not able to reduce drastically the number of banks as it desired. The Seiyukai spearheaded a movement in the Diet, later joined by the Kenseikai and Seiyu Honto, to lower the MOF's proposed minimum figure for banks' mandatory capital base. Thus a tier of small banks on the MOF's black list survived the post-crash consolidation. The alternative to protective legislation would have been the establishment of a robust depositor insurance scheme and the imposition of strict balance sheet rules that would limit bank risk-taking to a certain proportion of their portfolios. Only a powerful, politically-independent MOF could have obtained such a bill. Instead, banks received protectionist legislation. It was this Banking Law of 1927, then, rather than the postwar reform, that established the "convoy system" of bank protection.  

Now banks, though there were fewer of them, were on more solid ground with the MOF as their guarantor. Their next move was to strengthen their position against corporate borrowers. With the MOF's blessing, about 30 of the largest bond-underwriting banks formed the Kisskai or Bond Issue Arrangement Committee (hereafter Bond Committee) soon after the bank panic in order to "clean up the bond market". The Bond Committee established the collateral principle which persists in modified form to the present day: "Corporate bonds shall not be issued without sufficient collateral." In a successful power play, the banks then gained another source of income: according to the Bond Committee's rules, only "trustee banks" (jutaku ginko) would be permitted to manage the collateral until the maturity of the bond, for a fee.

At the core of the Bond Committee were eight banks, with the Industrial Bank of Japan central among them. Security firms were given a cut of the market as underwriting members of the Bond Committee, but only banks could earn the collateral fee. When Yamaichi Securities attempted in the late 1920s to take over a

trustee bank to capture some of the collateral-management business, the MOF blocked the move.  

One of the most enduring effects of the Bond Committee's rules was the shift it engendered in Japanese corporate finance to reliance on bank loans. Naturally, corporations responded to the new collateral requirement by reducing their reliance on bond issuance for financing. In 1931 bonds accounted for 29.9% of corporate external funding, and bank loans for 13.6%. In 1934, bonds accounted for 6.3% of external funding; in 1936 corporations issued almost no bonds at all, depending instead on bank loans for 40.6% of their funding needs.  

Firms continued, however, to rely on equity issues for a substantial part of their financing. In 1933 equity accounted for 31.1% of corporate funding, and in 1936, 33.5%. The figure only dropped dramatically during World War II when savings were channeled into savings banks for the war effort, from 22.6% in 1943 to 9.1% in 1944 and 6.1% in 1945.  

In the decade between 1936 and 1945, banks lost any autonomy they may have had, and the question of bank power in the economy  

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9 Yuichiro Nagatomi, op cit., pp. 16-17  

10 Yuichiro Nagatomi, ibid.
became a moot point. Beginning with the "Temporary Law of Credit Allocation" enacted in 1937, the military seized increasing control of the nation's financial mechanisms. Manufacturers of military hardware were ensured preferential access to money, be it through bank lending or through the bond market. In fact, the military found the Bond Committee a convenient apparatus through with to operate.

III. The Recovery and Rapid Growth Years

In December 1945, the MOF's Financial System Research Council established a subcommittee to study the bond market. Representatives from the securities industry argued that banks should not be allowed to underwrite bonds as they had in the prewar years, because their aim would be to stifle the market in favor of bank loans. Bankers insisted otherwise. Because of the sharp disagreement, the deliberations sputtered to a near halt; the purge in 1946 of those "implicated in the war effort" delivered a final blow to the discussion when it removed most members of the Council and its securities market subcommittee.11

SCAP bypassed the dispute with its blueprint for the 1948 Securities Exchange Law. SCAP's purpose, drawn from the Glass-Steagall Act in the U.S., was 1) to protect bank depositors from banks' risky portfolio management and potential conflicts of

11 Yasuji Abe, op cit., p. 52
interest, and 2) to promote greater competition between indirect financing through bank loans and direct financing on the bond and equity markets. Although Article 65 of the Securities Exchange Law precluded banks from underwriting public placement bonds, banks were allowed participation in the private placement market as in the U.S., since the buyers would be knowledgeable institutional investors. But this was a minimal concession, because there were few incentives for corporations to seek private placements of their bonds. First, the volume for each issue was severely limited. Secondly, the "no return rule" prohibited corporations from ever resorting to private placement once they had placed bonds publicly. A more important concession to the banks was the admission of the collateral principle in the bond market. The Bond Committee survived not only the war, but the Occupation as well.\textsuperscript{12}

The government played a sizable role in allocating capital through the bond market in the earliest postwar years. But this should not be exaggerated, either in scope or in duration. Soon after the war ended, Prime Minister Yoshida appointed Koji Arisawa, an economics professor at the University of Tokyo, to head a group to examine strategies for resuscitating Japan's basic industries such as coal and petroleum. Also in the group were young bureaucrats who would later make their mark in their respective ministries, including Yoichi Oshima from MOF,

\textsuperscript{12} Hanju Takeuchi, op cit., pp. 68-69;
Toshihiko Yoshino from the Bank of Japan, Saburo Okita from the Ministry of Foreign Affairs, Masato Toru from SCAP, and Shuzo Inaba from the National Economic Research Council.\textsuperscript{13}

In May 1946, Tanzan Ishibashi, known for his preference for fiscal stimulation, became Finance Minister. Ishibashi lost no time in expanding the work and authority of the Coal Committee, and in June 1946 the Cabinet approved his "Provisional Financial Policy for Postwar Industrial Reconstruction" (Sengo Sangyo Saiken no tame no Okyuteki Kinyu Tasaku). In July, Ishibashi converted the Coal Committee into the Reconstruction Finance Committee, under his chairmanship. This group drafted the Reconstruction Bank Bill and the Temporary Law for Credit Allocation, which were passed into law in January 1947. The Credit Allocation Law placed the Bond Committee physically inside the Bank of Japan, and added as Committee members representatives from the Ministry of Finance, Bank of Japan, and the Economic Stabilization Board. Once a month the Bond Committee met to set the terms of bond issuance, giving preference to fuel industries, steel, and utilities companies.

In November 1948, SCAP issued a nine-point memorandum calling for even stricter credit rationing measures than the Bond Committee had been implementing. Citing inflation as an imminent

\textsuperscript{13} Toshihiko Yoshino, Sengo Kinyushi no Omoide, (Tokyo: Nihon Keizai Shimbunsha, 1975), pp. 119-127
danger, "only business contributing to Japan's recovery should be funded," the memorandum instructed. In 1949 the Temporary Law for Credit Allocation was scrapped, but the Bank of Japan continued to exert influence on bond issuance until 1955 by granting lowest interest loans to the banks that could put up "priority bonds" as collateral. The banks did not mind the government's hand in credit allocation, as long as the government guaranteed payment in full upon maturity of the bonds.

The government, or at least parts of it, was not entirely content to leave credit allocation solely to the banks after 1955. In August 1962, a MITI advisory board, the Industrial Order Committee, advocated greater "public-private cooperation" in financing Japanese industry. By December MITI had drafted a "Law of Special Measures for Strengthening the International Competitive Ability of Designated Industries," (Tokutei Sangyo Kyosoryoku Kyoka Tokubetsususochi Hoan). Jigen Sahashi, Director of MITI's Enterprise Bureau and architect of the plan, was seeking legal authority to tighten up Japan's industrial structure with government-facilitated mergers. Banks, under this law, would have no choice but to support financing plans for industries designated by MITI. Banks fought tenaciously for their autonomy, and were joined in opposition to the law by

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14 Toshihiko Yoshino, op cit., pp. 195-199

weaker industries that would fall prey to MITI's consolidation plan. MITI nevertheless submitted the law to the Diet, diluting certain provisions by way of compromise. But bank lobbying was successful, and MITI was forced to beat a full retreat. The Diet refused to pass the bill in three consecutive sessions.\textsuperscript{16}

After the government had removed its hand from credit allocation in 1955, the Bond Committee screened corporations on the basis of a matrix of capital ratios, granting eligibility to very few corporations. In the early postwar years, most bonds were floated by the electric utility companies and heavy industrial firms since they met the demanding capital requirements, and by certain financial institutions themselves.\textsuperscript{17}

In 1946 SCAP had banned financial institutions from issuing bonds, on grounds that banks would crowd other corporations out of the bond market. But this measure was overturned in 1950 at the insistence of the Industrial Bank of Japan, and a heated debate ensued within the financial sector as to which institutions should be allowed to issue debentures. The Bank of


\textsuperscript{17} Shoken Dantai Kyogikai, "Shasai Hakko Shijo no Genjo to Kongo no Kadai," (May 6, 1986), pp. 19-21
Tokyo, which specialized in international finance and also had few domestic branches, wished to raise money on the bond market as well. Most banks, however, preferred that they not be allowed to issue bonds because this would spur competition among them and thus erode their profits. The MOF argued, on the other hand, that such competition was desirable.

Because the MOF and banks were unable to come to terms, the debate reached the halls of the Diet. In 1951, just before general elections in April, a young Minshuto politician named Yasuhiro Nakasone spearheaded an attack in the Diet against the Jiyuto administration for allowing the Bank of Tokyo to issue debentures. This would lead to, in Nakasone's words, "excessive competition" among the banks. Ultimately, a compromise allowed the three long term credit banks, eight trust banks, the Bank of Tokyo, and quasi-governmental institutions to issue debentures since these all had few branches from which to collect deposits. So as not to compete with bank deposits, the maturity of the debentures were set at five and seven years for the long term credit banks, and three years for the Bank of Tokyo.

18 Kinyu Zaisei Jiio recorded the spirited exchanges on the floor of the Diet: (February 12, 1951), pp. 20-21; (February 26, 1951), pp. 7-9; (March 5, 1951), p. 7; (March 12, 1951), pp. 10-11

19 This compromise was enshrined only in administrative guidance, not in statute. But it was challenged only decades later when city banks, limited to short term deposits, wanted to raise long term funds for loans in the Euromarket.
Banks reabsorbed over half of all corporate bonds and financial debentures themselves. As investors, then, they had a decisive voice in determining the volume that could be issued each month. And they made sure the amount was not enough to cut into their lending business. The Commercial Code, moreover, prohibited a corporation from issuing bonds in excess of twice its capital base.

Why was there not a revolt against the banks? Would not some group be better off without the Bond Committee? Certainly the small saver would benefit if market-yield bond instruments were to provide an alternative to below-market bank deposits. But predictably, the free rider problem prevailed. Because the payoffs of reform to any individual would amount to, say, a few hundred yen a year, mounting a costly campaign to overturn the status quo would simply not be worth the expense unless the costs could be distributed widely. No political entrepreneurship was forthcoming.

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20 Note that interest rates on bonds were low (lower than on long-term loans) so many corporations wanted to issue, but there were no takers. The MOF wanted low interest rates, and did not want a secondary market to develop that would put upward pressure on the government bond issuance rate. Banks bought a disproportionate share of new corporate issues, and agreed not to sell them on the secondary market. See Hugh Patrick, "Finance, Capital Markets and Economic Growth in Japan," in Arnold W. Sametz, ed., Financial Development and Economic Growth (New York: New York University Press, 1972)

21 Hanju Takeuchi, op cit., pp. 70-71
The other institutional investors, such as the life and casualty insurance companies and trust banks, also got higher yields on their long-term loans to the corporations under the regulated system. Even the representatives from the securities industry on the Bond Committee, which happened to be the "Big Four", did not protest vociferously. Although there were over 250 securities houses, these four, Nomura, Nikko, Daiwa, and Yamaichi, took turns lead-managing most issues, and captured 75% of all underwriting commissions. These commissions, moreover, were fixed, precluding competition. Were they to rock the boat, they would certainly also get wet.²²

Nor did the MOF have reason to object. First, the market was orderly and stable. There was little chance of another bond market disaster with the collateral principle in operation. Secondly, in the early postwar years, the Committee agreed to undertake bond issuance for the basic industries targeted for rapid recovery. Thirdly, after the government began issuing bonds in 1965, and in greater volume in 1975, the MOF had more reason to appreciate the Committee. A constricted corporate bond market made it easier for the MOF to place its own bonds. By the early 1980s, 95% of all new bond issues in Japan were made either

by governmental units or one of the banks themselves. This was an acceptable barter for both the banks and the MOF: banks would not lose their corporate loan business, and the MOF would have the bulk of the domestic bond market for its own issues. It is no mistake that the Bond Committee forms the core of the Government Bond Syndicate as well.

Only industry had reason to object to the Bond Committee's deliberate suppression of the bond market's development. But even industry did not begin to voice strong objections until the 1970s. During the recovery and rapid growth years in the postwar economy, firms wanted access to a steady stream of credit more than anything else. Especially in the sectors in which investment was virtually synonymous with growth, leveraging with debt made a great deal of sense. Bank debt in particular could provide the stability for long term planning. Second, firms wanted the availability of extra credit in bad times. For these assurances, firms were willing to pay a premium, as it were, to their main bank. But in any case, bank trustee fees for collateral reduced the cost differential for firms between the interest rates on bonds and on long term loans. Third, the alternative, which was a bond market based on a rating system, would require continuous disclosure for investor protection. And

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24 Interviews with bankers and Ministry of Finance officials.
fourth, heavy industry was actually favored by the domestic bond market rules because of importance accorded to plant and equipment. Steel corporations, for example, would have more difficulty placing bonds for a reasonable price in Europe than in Japan because the Euromarket rating system operates on the basis of corporate health rather than on volume of capital stock.25

IV. Leakage to the Euromarket

The deceleration of the Japanese economy brought to an end industry's insatiable demand for bank loans. Japan emerged from the post oil shock recession of 1975, but with real GNP growth rates in the 3% to 6% range rather than the 10% to 12% range of an era gone by. Because slower growth meant lower profit rates and fewer lucrative investment opportunities for most corporations, interest payments on bank loans had become a unwieldy portion of corporate earnings. The interest payments on

25 Iwao Nakatani claims that the grouping of firms does not generally increase the rates of profit or growth of the firms, but that volatility of performance is significantly reduced. This is made possible, he asserts, by the implicit mutual insurance scheme among member firms and banks. Iwao Nakatani, "The Economic Role of Financial Corporate Grouping" in M. Aoki, ed., The Economic Analysis of the Japanese Firm, (North-Holland, 1984), pp. 227-258; Other scholars have stressed the protection provided by a main bank against bankruptcy: Paul Sheard, "Main Banks and Structural Adjustment in Japan," manuscript for the Australia-Japan Research Centre; S. Suzuki and R. Wright, "Financial Structure and Bankruptcy Risk in Japanese Companies," manuscript, July 15, 1983; Sadahiko Suzuki, "Kyusai Yushi ni okeru Main Bank Chikara, Keio Keiei Ronso, (December 1980), pp. 18-39; Still others, such as economists Horiuchi and Wakasugi of the University of Tokyo, emphasize the economies of information that attend a main bank relationship.
large bank debt, which had been a reasonable insurance premium for steady credit, had become an unworkable burden.26

In what seemed to banks to be a stampede, firms began paring down their bank loans in the mid 1970s. Some firms managed to work within the limits of their retained earnings and depreciation allowances. Others that still needed outside financing turned to the equity market, to a limited extent to the domestic bond market, or increasingly to the Euromarket. The ratio of new direct financing from all sources to new indirect financing jumped from 11.49% in 1973 to 20.44% in 1975.27 Only the small business sector and the structurally depressed industries such as steel had no real alternative to bank borrowing, or in the case of heavy industry, to the domestic bond market.28

Even as Japan's economy was entering a phase of slower growth, at least the larger Japanese corporations were securing market share and name recognition abroad. And with that came access to foreign financial markets. The possibility of

26 Nagatomi, op cit., pp. 34-37


28 Nagatomi, op cit., p. 37
financing abroad spurred the trend towards smaller bank debt, not only because it was an alternative. Two other factors were instrumental. First, in international markets the best corporate ratings, and hence the cheapest money, go to firms with a strong capital base, or low debt-equity ratio. Secondly, for a mature corporation in a slower growth era, an assured stream of credit is not as urgent as considerations of cost and flexibility.

This is not to say that the typically high debt-equity structure of Japanese corporations has transformed over night. Some extraordinarily strong firms, such as Toyota Motors and Matsushita Electric have managed to cut their bank loans down to zero on the strength of their retained earnings. Few firms, however, have resorted to large stock issues to retire debt. In Japan, where cross share holding is frequently a means of protecting management from takeover, equity capital is more costly than it might otherwise be. The stable share holders are often compensated by way of a below-market purchase price of each new issuance of shares.29

Given the cost of domestic bond and equity issuance, the Eurobond market where are no collateral requirements began to look attractive to Japanese corporations. The Ministry of

29 Colin McKinsey, research scholar at the Bank of Japan Institute of Monetary Policy. Interviews with bankers and securities dealers. Others argue that stable shareholding is declining, though it is difficult to measure with precision. *Toyo Keizai*, (October 26, 1985), pp. 30-38
Finance did enforce a matrix of capital and asset requirements, mirroring the domestic rules, for Japanese corporations issuing bonds even in foreign currencies in the Euromarket. Not to do so would have been to render domestic restrictions meaningless. But even with similar asset requirements, funding abroad was cheaper because there was no collateral requirement, no mandatory prospectus, and because there was a panoply of flexible rate instruments and swaps that reduced interest rate and exchange rate risks to corporations. Over the years as a growing number of corporations became large enough to qualify and the desire for flexibility increased, the leakage to foreign markets escalated. Beginning in the mid 1970s, when slow growth set in, the number of Japanese corporate bond issues in the Euromarket actually began to skyrocket.

A few firms had issued bonds abroad, beginning with Sumitomo Metals and Kawasaki Steel in 1961, but the total volume was small. In the early 1970s, the Euromarket accounted for a total of 1.7% of Japanese corporate financing; the figure for the latter half of the 1970s was 19.6%. By 1984 the figure was 36.2% of all corporate financing. As a percentage of all Japanese corporate bonds issued, the Euromarket accounted for 51.9% in 1984. As chart * shows, Swiss Franc convertible bonds accounted for a large portion of Japanese Euromarket fund raising, because far more companies qualified for this category of issuance under
the MOF's matrix. In January 1986, for example, 700 Japanese companies were authorized to issue foreign currency convertible bonds in Europe, but only 80 were permitted to issue unsecured straight Eurocurrency bonds.

While smaller corporations did not pass the minimum capital requirement, large trading companies passed on a portion of their foreign-raised funds in the form of trade credits to subcontractors. The flight from Japan's domestic loan market was serious.

Japanese banks responded, not by relinquishing restrictions on the domestic bond market, but by following the corporations abroad in hopes of recapturing some of the business. Unlike at home, the Euromarket had no Article 65 equivalent barring banks from securities activities. Abroad, Japanese banks were free to ride the wave of securitization. In the early 1970s most of the large banks either established wholly owned investment bank subsidiaries, or joined in joint ventures with British merchant

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banks. All was well after all, it seemed. Until the Japanese securities industry cried foul.

V. The Three Bureaus Agreement

In April 1969, in the early stages of Japanese entry into the Euromarket, a fully owned subsidiary of the Bank of Tokyo participated in an underwriting syndicate for a Eurodollar issuance by Honda Motors. Although Goldman Sachs and Nikko Securities were the lead underwriters, the securities industry argued that any Japanese bank participation in underwriting syndicates for Japanese corporate bonds ran counter to Article 65 of the Securities Exchange Law. Banks would most certainly carry out most of their negotiations with the issuing firm on Japanese soil and simply book the transaction in Europe. Moreover, said the securities industry, banks would use their "main bank power" to ensure Japanese firms chose banks over securities firms.

What disturbed the securities industry was not the legal technicalities, but the loss of their direct finance monopoly to the banking industry. Tough luck if indirect finance was upon hard times. Banks knew precisely what the securities firms meant to communicate, but countered on a level of legality and logic. Because Bank of Tokyo's subsidiary was incorporated under French corporate law, Japan's Article 65 should not apply to its activities.
The MOF's response is revealing. It advised the Bank of Tokyo not to pursue Japanese clients "too actively" in the Eurobond market. Foreign clients would be fair game for either side. For the MOF as for the disputing sides, the underlying issue was not so much the letter of the law as it was market share and invasion of segmented markets. Maintaining a balance between the banking and securities industries was critical to the smooth functioning of financial policy. Should either side force the matter into a full-blown political problem, the MOF would lose credibility with the regulated parties and subsequently have difficulty mending the fissures.

During the transition between fixed and floating exchange rates from 1971 to 1973, the MOF exercised its emergency powers to prohibit Japanese firms from issuing any bonds overseas. No sooner had the ban been lifted than banks and securities became embroiled in another jurisdictional dispute. On April 24, 1974 Fuji-Kleinwort Benson became one of the managing underwriters for a convertible bond issuance for Cannon in the Euromarket. Once again, the securities industry objected. Banks joining underwriting syndicates was bad enough, but for them to become a managing underwriter was going too far, the securities firms declared. (Managing underwriters have more responsibility for

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32 "Sankyoku Shido no Keii to Point", Nomura Securities in-house material, (March 5, 1985), p. 1
the issue's success, and for which they get substantially higher commissions.) Moreover, they said, Fuji was more likely to abuse its power as a lending institution than the Bank of Tokyo, since the latter specializes in international finance and has a weaker domestic client base.\textsuperscript{33}

With tempers rising in both the banking and securities industries, in April 1974 the MOF's Banking Bureau, the Securities Bureau, and the International Finance Bureau issued a joint circular to "clarify" the government's position. Actually, the MOF was deliberately vague because it was still not sure where the line should be drawn to silence the dispute. The circular's two brief paragraphs advised that 1) When participating in the Eurobond market (especially as managing underwriters), foreign subsidiaries of Japanese banks should take care not to break the spirit of the Securities Exchange Law; and 2) Banks in joint venture arrangements with foreign investment or merchant banks should be equipped to handle Eurobond placements without straining their own portfolios.\textsuperscript{34}

Because the MOF was noncommittal, banks continued to test the waters. In 1974 the Industrial Bank of Japan submitted an

\textsuperscript{33} \textit{Nikkei}, April 27, 1974

\textsuperscript{34} The point here was that Japanese banks lacking placement power would likely hold too much of a given issue in their own investment portfolios. Okurasho Ginko Kyoku, \textit{Kinyu Nenkan}, 1974; (The Ministry of Finance Banking Bureau, \textit{Annual Report})
application to the International Finance Bureau for a 100% subsidiary to engage exclusively in securities activities in the Euromarket. Permission would require agreement among the three overseeing bureaus, but the Securities Bureau opposed while the Banking Bureau supported IBJ's plan. The Securities Bureau, in agreement with the securities industry, argued that because this subsidiary would be located physically within the IBJ's London branch office, and because it would be capitalized only at 6 million yen, it was clearly intended as a paper company for the Bank. Furthermore, if this subsidiary received a banking license in addition, it would have a great advantage over securities firms in raising capital.35

Permission for the establishment of IBJ International was granted in June 1975, but when it became the assistant lead underwriter for New Nippon Steel's Eurodollar bond issuance two months later, the Securities Bureau expressed reservations. On August 29, the three bureaus called in for consultation representatives from nine banks and eleven securities firms. The MOF gave to the financial institutions two documents, one of which read:

1. Japanese banks participating in foreign corporate bond underwriting syndicates shall pay due respect to

35 The memo written by the Assistant Director of the Coordination Division in the Securities Bureau is recorded in "Sankyo Shido no Keii to Point," op cit., p 5
the experience gained by and the mandate given to the Japanese securities firms. Banks shall not act against the spirit of Article 65 of the Securities Exchange Act.

2. In implementing the intent expressed herein, banks shall pay regard to the order of institutions listed on issuance announcements and tombstones.

The second document reiterated the concern that banks not rely on their lending power to drum up customers for their securities operations in the Euromarket, and that banks not carry out their negotiations with their issuing clients on Japanese soil. In closing, the statement urged banks and securities firms to cooperate rather than fight for the same business in the Euromarket.36

Rather than lay the bank-securities rivalry to rest, this meeting merely set out the game rules a little more clearly. Or more accurately, the MOF suggested a desirable goal line but left the means to the institutions themselves. Banks could underwrite Eurobonds for Japanese corporations, as long as they did not upstage the Japanese securities houses. Securities firms later interpreted the MOF's mention of the tombstone and announcement

36 "Hogin no Kaigai Genchi Hojin no Shoken Hikiuke Gyomu nitsuite," Internal Memorandum of the Banking Division, Banking Bureau, Ministry of Finance, August 29, 1980
listings as an injunction against banks becoming book-runners or lead managers; but banks also had to be careful not to win a greater market share than the securities firms.37

For a while the Three Bureau Agreement presided over peaceful coexistence in the Euromarket, incorporating minor clarifications as further disputes arose. Banks won free rein in the private placement market, for example, but securities firms established their supremacy in equity-linked instruments such as convertible bonds and warrant bonds.38

Meanwhile, Japanese corporations' attraction to the Eurobond market continued unabated. On the other side of the coin, banks experienced more difficulty at home lending their available funds, which put pressure on their profit margins. The MOF could not ignore the changing profitability structure which favored the securities firms over the banks, lest the banks circumvent the MOF in seeking a political solution. In 1981 the MOF sent signals to the private sector to the effect that the Three Bureau's Agreement perhaps had served its function. Corporations now had sufficient resources, MOF officials suggested, that banks


would be unable to corner an undue share of the Eurobond market. In a break with precedent, bank subsidiaries were permitted to underwrite the parent bank's bonds in the Euromarket.39

The timing was premature. In exchange for banks entry into government bond dealing, securities firms were given a second lease on the Three Bureau Agreement.40

In 1984 other events tipped the balance. In April, the MOF loosened restrictions on corporate issuances of yen-denominated bonds in the Euromarket, and in June the MOF lifted the ceiling on the amount of foreign currency that corporations could exchange into yen. Both of these measures had the effect of spurring the trend towards Euromarket financing.41 Also in 1984 the MOF announced that foreign securities houses would be permitted to act as the lead underwriter for Japanese corporate bond issues in the Euromarket.42

39 Kazumoto Adachi, (Director of the Banking Bureau Coordination Division), "Jishusei no Hakkyaku o Tou," Kinyu Zaisei Jijo, (July 6, 1981), pp. 20-24

40 Interviews with MOF officials and bankers.

41 Yutaka Kato, (Director of Research, Mitsui Bank), "Kinyu Jiyuka no Genjo to Tenbo," (November 18, 1985), p. 1

42 "Kinyu Kakumei Zenya ni Oarare no Okura Kanryo," Zaikai, (October 26, 1984), pp. 36-39; The next chapter will examine foreign reciprocity threats, which were instrumental in wresting from Japan this concession for foreign underwriters.
Banks were no match for the entire corporate world that wanted easier access to the Euromarket. But banks latched onto the MOF's permission for foreign securities firms to lead manage Japanese Eurobond issuances. This was reverse discrimination, protested the National Federation of Bank Associations in a memo to the MOF. If foreign financial institutions were allowed to compete with Japanese securities firms, Japanese banks should surely be allowed to as well. Moreover, the banks remonstrated, because it was the MOF's job to consider the international competitiveness of Japanese financial institutions, the MOF should remember that American and European banks were bound by no equivalent of the Three Bureaus Agreement.

The Banking Bureau was ready to meet the banks' demands, but the Securities Bureau was still under strong pressure from the securities industry to hold the line. The MOF would have to search for an acceptable barter.

43 Banks did succeed, however, in reducing the number of corporations eligible for access to the Euroyen market by insisting on high capital ratios. *Nikkei*, (March 5, 1985)

44 Although the U.S. banks were bound by the Glass-Steagall Act at home, there was no extraterritorial application of that statute. National Federation of Bank Associations, "Sankyoku Goi Teppai ni Kansuru Yobosho," (July 16, 1984), pp. 1-2; "Sankyoku Goi no Norikoe," *Kinyu Zaisei Jijo*, (January 6, 1986), p. 110

In March 1985 the MOF announced a "Comprehensive Settlement" of the bank-securities rivalry, lowering the dividing line between the two industries. The securities industry could keep the Three Bureaus Agreement for the time being; in addition, securities firms were granted permission to trade in the secondary market for CDs, broker in the new BA market, and lend to customers who had government bonds as collateral. In exchange, banks were permitted to offer government bond accounts to their customers, participate in the new bond futures market, and become brokers' brokers. In addition, about thirty banks in the second tier of the banking industry were allowed to deal in government bonds.46

Anxious for the Three Bureaus Agreement to be lifted, banks were sorely disappointed. But securities firms contended that the only fair trade for the Agreement would be freedom to engage in foreign exchange transactions without bank intermediation. No go, cried the banks.47

VI. The Three Bureaus Agreement Assaulted


Despite the stalemate, Sumitomo Bank decided to test the limits of the Three Bureau Agreement. In August 1984, Sumitomo had purchased a majority share in Gottardo, a Switzerland-based universal bank. On March 28, 1985, Gottardo announced it was to be the lead underwriter for a Swiss franc issuance for Itohman, an Osaka-based trading company with strong ties to Sumitomo Bank. The fact that Itohman and Sumitomo had a long-standing relationship actually worked against Sumitomo in this case, since Sumitomo would have difficulty establishing that it won the bid without exerting "main bank pressure." Indeed, it later became known that Sumitomo had attempted to recruit other trading companies without success: companies were afraid of alienating the securities firms that had been underwriting for them.48

On April 4, representatives from the Big Four securities firms met to join in declaring opposition to Sumitomo's circumvention of the Three Bureaus Agreement. Obviously a case of a main bank exercising its market power, said the securities firms. They demanded that at least the bond issue be changed into a private placement, since that would be within the game rules. Anything but an unfortunate precedent, the securities firms reasoned.49

48 Interviews with MOF officials and journalists; "Sankyoku Goi," Nikkei Newsletter on Bond and Money, (April 8, 1985), pp. 2-5

The MOF, pressed from both industries, decided to let the Gottardo case pass as a "special exception" to the rule of no lead management of Japanese corporate bonds by Japanese banks. The MOF cited Gottardo's history as an underwriter before Sumitomo bought its shares; it had placement power on its own right. While both industries accepted this solution, they interpreted the measure to suit their own purposes. "It was a clear indication that the Three Bureaus Agreement is on the wane. We will just have to give it time," said Hajime Yamada, Chairman of the Federation of Bank Associations. Shoga Watanabe, Chairman of the Securities Association, declared that "The Three Bureaus Agreement is as solid as ever."\(^{50}\)

They were both right. The Three Bureaus Agreement was a provisional measure to prevent banks from taking an "undue" share of the bond business in the Euromarket. It will be revoked when either of two conditions are met. 1) Banks' domestic profits fall so much lower than those of the securities industry that the Agreement no longer serves its intended equilibrating function; or 2) Banks are willing to barter away another source of income, such as monopoly of the foreign exchange business.

\(^{50}\) "Gottardo Mondai ni Keri," *Kinyu Business*, (June 1985), p. 62
Although the rancor between the two sectors reached several high points, neither side brought the problem to the politicians for a quick cure. As with the government bond dispute finally resolved in the Banking Law of 1982, the politicians are happy to defer delicate balancing of this sort to the MOF. From the standpoint of net support, either the banks or the securities firms would have to be so rankled as to far out-perform the other in political lobbying. Apparently, both sides judged that the amount of money required in this potentially spiraling competition for political patronage would overshoot the amount of income forgone by compromising. And because the MOF could monitor the compliance to the compromise, there was little risk of being cheated.

VII. Deregulating the Domestic Bond Market

Even as banks were struggling for market share in the Eurobond market, the domestic bond market was relatively stagnant. Japanese corporations had been raising money in foreign bond markets with increasing regularity since the mid 1970s. This was because banks, long after making their inroads abroad, continued to protect their domestic loan business by limiting access to and the attractiveness of the domestic bond market.
By the end of 1984 the Japanese bond market was second in size only to the U.S., with an annual transaction volume of over 12 trillion dollars in the secondary market. Almost all of the transactions, however, were in government bonds. The outstanding amount of corporate bonds was a mere 13% of the corresponding U.S. figure, and corporations raised only 4% of their funds on the domestic bond market.51

Corporations' post-oil-shock shift towards direct finance instruments such as bonds and equity, as well as a greater diversity in the performance of Japanese industries and firms, were structural changes that attended economic maturity and slower growth. For firms no longer needing a bank's apron strings, bonds were a sensible alternative to bank debt because of the lower cost and flexibility in length of term they afforded.

Banks began to fight for their corporate customers. In the late 1970s, compensating balances began to shrink and loan spreads narrowed. To provide more attractive financial instruments, banks began issuing CDs in 1979, MMCs in 1985, and longer term CDs and MMCs in 1986. But banks did not loosen their grip on the domestic bond market until it no longer made sense for them not to.

In 1971 the Keidanren's Capital Policy Committee suggested that the rules for corporate bond issuance be relaxed, that bonds be offered in a greater variety of maturities, and that a corporate rating system replace the Bond Committee's set of self-styled rules. Six years later, when a MOF advisory group made similar recommendations for bond market reform, the Bond Committee's rules were still much as they had been for over forty years. These reports were little more than exercises in wishful thinking, because many firms still depended on bank debt for viability, and because the banking industry was still not feeling sufficient pressure from the Euromarket to reform the domestic rules.

By 1982, when MITI's Industrial Structure Council recommended that bond issuance rules be relaxed, bank resistance to change had begun to soften. Trustee banks' revenues from managing collateral on domestic issuances had fallen off as firms went to the Euromarket where issuing bonds was easier and cheaper. In 1981 domestically issued bonds increased 4.2% over the previous year, while Eurobonds increased 2.7%. By 1982

52 Nagatomi, op cit., pp. 206-207
domestic bonds increased by 4.7%, and Eurobonds by 10.%. By 1983, domestic bonds actually dropped by 1% while external bonds increased by 22.9%. Because Japanese firms were not trapped by the banks' domestic bond rules, they did not press for reform with urgency; rather, it was the banks which had cause for consternation.

Simultaneously to changes in corporate funding patterns, the U.S. government began pressing for freer Japanese financial markets. American motives and tactics will be discussed in greater detail in the next chapter, but suffice it here to say that the MOF agreed to relax restrictions on the issuance of and investment in Euroyen bonds over the course of 1984 and 1985. While this would not generate drastic changes in Japan's financial markets since corporations had already been issuing bonds abroad in foreign currencies, the development of a mature Euroyen bond market at least incrementally increased the pressure on banks to ease the domestic system. The ability to raise funds in yen was an automatic hedge against foreign exchange risk, and therefore an added attraction to Euromarket financing for Japanese firms.

56 Interviews with MITI officials in MITI's Industrial Finance Division, bankers.
Since 1983, banks had been negotiating with the MOF about how to deregulate the domestic bond market. If terms were to be made easier for corporate issues, securities firms would benefit so there would have to be some quid pro quo for the banks. The private placement market where banks had free rein, for example, should be enlarged. Moreover, the banks argued, a new rating system should not cut banks out of their traditional function of maintaining high standards for the domestic bond market. 58

In January 1984, the MOF commissioned a "Bond Study Group" (Shasai Mondai Kenkyukai), under the chairmanship of Hitoshi Hanamura, Vice Chairman of the Keidanren, to examine the possibilities of reform in the domestic market. On the committee were representatives from the major groups with an interest in the problem: IBJ and the top six city banks, which were also the seven key members of the Bond Issuance Committee; the Big Four securities houses; the largest insurance companies and trust banks; and managers of the following large corporations: Toyota, Hitachi, Mitsubishi Trading Company, Nippon Steel, Toray, and Tokyo Electric. 59

58 Interviews with MOF officials, bankers, securities people; "Henkakuki ni Chokumenshita Kokunai Kisai Shijo," Zaikei Shoho, (January 28, 1985), p. 15

After a year of monthly meetings, the group drafted what could variously be called a compromise, a stalemate, or an agglomeration of conflicting views. Most in the group wanted to stress the importance of replacing the Bond Committee's rules with a system of independently conducted bond ratings. The banks, however, added their caveat to the report that bank management of collateral since 1933 was responsible for maintaining the safety and stability of the bond market, and that bond rating agencies were not necessary for the domestic market.\textsuperscript{60}

The trustee banks were afraid of two things: 1) losing their loan business if bond issuance were to become too easy, and 2) losing their trustee commission income if the collateral principle were to be reconsidered. But their position was becoming less tenable. Already, firms were voting with their feet, as it were, in favor of the flexibility of the Eurobond market. And banks had already been forced to respond, albeit with great reluctance. In 1973, for example, Mitsubishi Trading, Komatsu, Marubeni and Kawasaki Steel had requested the right to issue unsecured convertible bonds on the domestic market. Banks accommodated to the extent of expanding their definition of collateral.\textsuperscript{61} In 1979 Sears Roebuck successfully invoked

\textsuperscript{60} Iida, ibid.

\textsuperscript{61} Ichiro Aoki, (MOF Securities Bureau, Capital Markets Division) "Kokunai Kanzen Muynanpo Futsu Shasai no Hakko ni Tsuite," \textit{Zaikei Shoho}, (February 18, 1985), p. 10
reciprocity in obtaining permission to issue an unsecured straight bond in Tokyo.62

In 1983 and 1984, banks agreed to loosen the collateral restrictions on domestic straight bonds and convertible bonds. By the end of 1984, 20 companies were eligible to issue straight bonds, and 110 qualified for issues of convertible bonds. Of the latter, nearly half were permitted to issue convertible bonds without collateral. Because firms could issue without collateral on the Euromarket, the collateral principle also began to weaken at home. 63

Nonetheless, banks were not prepared to relinquish their control of the domestic bond market altogether. When, in the summer of 1984, the Securities Bureau suggested that Japanese bond rating agencies be established for the Euroyen market, banks objected. Banks feared bond rating would take root in the domestic market as well and render the Bond Committee obsolescent.


The Securities Bureau proposed a compromise: the IBJ and other trustee banks could join the Big Four securities firms to form a bond rating agency, the "Japan Investment Service."  

There was some disagreement within the MOF, not to mention industry, as to the appropriateness of a bond rating agency comprised of the underwriters and trustees. The Securities Bureau, however, sensing that this was necessary compensation for cooperation, wanted to give the group its imprimatur. Meanwhile, the International Finance Bureau favored another group of large institutional investors including the Long Term Credit Bank of Japan, the trust banks, and the insurance companies.

The MOF was concerned that there would not be enough business to keep both prospective bond rating agencies in the black. In addition to these two, there were others already in existence. The Japan Bond Research Institute, a subsidiary of Nihon Keizai Shimbun, had been operating since the 1970s, though primarily as a publisher of bond-related information. Two American raters, Standard & Poor's and Moody's, also had offices in Tokyo since the 1980s, to gather information for Eurobond ratings. A fourth, Mikuni Investment Advisory Service, provided information to foreign investors on Japanese firms. Ultimately,  

however, the MOF granted licenses to the two newcomers as well. It would worry about a shake out, or perhaps avoid one by establishing a division of labor, when the circumstances required. For the time being, the MOF bureaucrats reasoned, at least the machinery was in place for a gradual transition from the Bond Committee's rules to a bond rating system. 65

Despite some easing of collateral requirements since the 1970s, corporations were not returning to the domestic bond market from abroad. First, the number of corporations eligible to issue unsecured bonds was still small. In January 1985, TDK became the first company to issue an unsecured straight bond in the domestic market since 1932; only 23 other firms were similarly eligible. For the others, issuance was more costly. Until the high capital requirements were lowered, even corporations such as Mitsubishi Shoji and Hitachi, with AAA ratings in foreign markets, would not qualify for unsecured straight bond issuance in Japan. The standard indeed was relaxed in October 1985, but still only 57 corporations were now eligible to issue unsecured bonds.66 Secondly, there were rigidities in issuing conditions, such as a single issue date each month.

65  "Togin-Shoken Irimidareru Shasai Kakuzuke Senso," Zaikai, (November 23, 1984), pp. 86-87

Third, and this was a legal provision rather than a customary rule established by the Bond Committee, firms could not issue in excess of twice their net worth.67

The MOF's Securities Exchange Council, which had issued the 1977 report proposing easier issuance terms, reconvened in May 1985 to have another look at the problem. And this time, the situation was ripe for change. But as corporations and securities firms knew, an expansion of the domestic bond market would not come without some cost to themselves. Along with the Council's proposal to "eventually abolish" the collateral rule, was its call for tougher corporate disclosure rules to ensure market stability. The Council also stated that the Big Four's monopoly on underwriting, on fixed commissions, should be corrected. The MOF still would have to work out the implementation of these pronouncements, but this was the basic compromise.68

Banks accepted, if reluctantly, the decision to double the number of corporations eligible for unsecured straight bonds and


convertible bonds, to 120 and 360 respectively. In exchange, banks received an expanded private placement market. The "no return rule" which prevented corporations from returning to the private placement market was to be abolished, allowing banks to place issues for firms an unlimited number of times. Furthermore, the concept of private placement itself had become more attractive to corporations since disclosure requirements, which were to be tightened for public placement, would be laxer where only institutional investors were involved. 69

An important matter left unaddressed, because no compromise between the banking and securities industry could yet be forged, was the domestic commercial paper market. Though commercial paper, as a type of short term security, was on the Council's agenda for deregulation, the banking community was adamantly opposed to its introduction into Japan unless banks could underwrite them. Judging from the American market, where commercial paper has virtually replaced short term bank loans, Japanese banks feared the worst. And indeed, because city banks are barred from making long term loans in deference to the long term credit banks' and trust banks' special niche, CPs would probably hurt them considerably. But the price the banks demanded in compensation -- the right to underwrite them and deal in them in the secondary market -- was more than the securities industry was willing to grant. As with the Three Bureaus

69 Nikkei, November 7, 1986
Agreement, the dispute ended in stalemate as both sides awaited a preferable solution.\textsuperscript{70}

VIII. Conclusion

Deregulation of the domestic bond market is not complete. By mid 1987 only 120 corporations, a small fragment of Japan's corporate world, are eligible to issue unsecured straight bonds in Japan. Considering that no corporations could issue without collateral until 1983, however, the pace of change is rapid indeed.

\textbf{Why Deregulation?}

The argument advanced here is that banks were forced by their own self interest to relax domestic issuance rules because corporations had the alternative of the Euromarket. Once corporations began to value the flexibility of the bond market over the security of bank indebtedness, banks' second best option was to recapture some of the bond business in the domestic private placement market. Banks were thus willing to trade away some control over domestic bond issuance.

To state the proposition in more general terms, Japan's international environment has effected significant changes in Japan's domestic market structure. This reverses the usual line of causality cited in foreign policy literature where domestic politics is shown to generate changes in the international arena. Gourevitch, who conceived the phrase the "second image reversed," posits that "the international system is not only a consequence of domestic politics and structures but a cause of them".  

Gourevitch also concedes that, "however compelling external pressures may be, they are unlikely to be fully determining." Even market forces must filter through the domestic political system before they take on power to change institutions and structures. If banks possessed a monopoly of domestic political resources, for example, they would simply ensure that leakage to the Euromarket be cut off: no firms would be allowed to raise funds abroad. In fact, banks are one of a number of powerful domestic interest groups. And indeed, other groups were willing to tolerate a highly regulated financial market for reasons of their own. Japanese corporations appreciated the convenience of bank loans during their rapid growth period, but also took increasing advantage of the Euromarket alternative. Non-bank institutional investors such as the insurance companies were

satisfied with stable, predictable returns until recently.\textsuperscript{72} And the securities firms were not eager to force change lest they forfeit their own protection including fixed underwriting and brokering commissions.

Once banks found that corporations were not compelled to rely on bank borrowing merely because the domestic bond market was hard to access, the Bond Committee's control began to lose its perceived economic value. There is little point in holding the bottle neck if the bottle has a leak elsewhere.

Deregulation of the domestic bond market was a reaction to, rather than a cause of, changes in Japanese corporate finance. Maturing Japanese corporations were moving away from bank dependence in favor of flexibility of direct financing since the early 1970s; the pressure on banks to accommodate increased as a growing number of firms began scaling down their bank debt and obtained access to the Euromarket.

\textbf{The Government-Business Nexus}

Through most of this narrative, the MOF has been an orchestrater, facilitater, or equilibrater; rarely an initiator. MOF's role varies, naturally, with its stake in issue areas.

\textsuperscript{72} For evidence of change, see for example, "Trust Banks to Face Stiffer Pension Fund Yardstick," \textit{Japan Economic Journal}, (July 1986)
Given the MOF's overarching goal of smooth regulation, its subsidiary goals with respect to the bond market are 1) market stability and 2) good relations with the financial institutions. Only more recently, since the mid 1970s, did the MOF have its own interest in ensuring that corporate bonds did not crowd out government bonds in the issuing market. But because of the large pool of private sector savings, this has never become a pressing concern.

The MOF was content to entrust the problem of bond market stability to the banks. Since the Bond Committee formed in 1933, the market had functioned well, and trustee banks ensured that investors received payment. The MOF permitted the banks to institutionalize their influence because this was a means of harnessing their commitment to the stability of the system. Thus the Bond Committee functioned as a sort of parapublic organization that simultaneously served a public and a private purpose. Without the MOF's sanction the Bond Committee could not have functioned.73

The MOF's second goal, of maintaining good relations with the financial institutions that it regulates, was perhaps more delicate than the first. Securities firms had a direct interest in an expansion of the bond market as surely as banks did not.

73 See P. J. Katzenstein on parapublic institutions in Germany. Policy and Politics in West Germany: A Semi-Sovereign State, forthcoming, chapter 1.
Placating, or at least silencing the securities industry did not prove to be an indomitable task, however. The bond market continued to grow steadily in the postwar decades, even though the Euromarket issuances of Japanese corporations overtook the domestic issuances in the early 1980s. At least securities firms could not complain of falling profits. Secondly, the Three Bureaus Agreement ensured that securities firms would not lose the Eurobond market to the Japanese banks. Thirdly, the securities industry enjoyed its own protection in the form of fixed bond underwriting and brokering commissions. If the securities industry forced the banks' hand on the bond market, the banks doubtless would agitate for competitive commissions. Finally, the politically most powerful securities companies, unlike in the banking industry where the small are strong in their own right, are the Big Four. These top four securities firms take three quarters of all bond underwriting commissions, partly because of their membership in the Bond Committee.

Demand for change in the domestic bond market existed in both the securities industry and among would-be bond issuers, though both groups had reason for patience. Their demand was a constant; it was banks' acceptance of a barter that opened the way to bond market reform. Banks obtained a five-fold increase in the private placement market, in which they had free rein, in exchange for a doubling of the number of corporations that could issue unsecured domestic bonds. Securities firms accepted this
as a step towards an increasingly free bond market in which the Bond Committee would be replaced by bond rating agencies. Corporations were pleased at the expansion of the private placement market since the disclosure requirements are more lenient; but they, too, took the agreement as transitional towards greater freedom.

The trajectory of further changes in the domestic bond market is quite clear. As a growing number of Japanese firms secure access to Euromarket financing, banks will be forced to provide the funding needs and preferences of their clientele. The relaxation of bond market rules was but one in a succession of competitive accommodations, including the introduction of market-based deposit instruments, and the slashing of compensating balance requirements. Furthermore, as Japan's financial system becomes increasingly open, a growing share of bank loans are to the small business sector and to the declining industries.