.b2572254 (E)

UNCLASSIFIED

*Department of Foreign Affairs
and International Trade*

POLICY STAFF PAPER

NO. 94/16

The Japanese Way: The Relationship Between Financial Institutions and Non-Financial Firms

by

James McCormack
Economist
Economic and Trade Policy (CPE)
Policy Staff

(June 1994)

Policy Staff papers are intended to foster discussion of international trends and issues within the foreign policy community. The opinions expressed are not necessarily those of the Government of Canada.

Please address any comments and questions concerning this paper to Policy Staff (CPB), Foreign Affairs and International Trade, 125 Sussex Drive, Ottawa, Ontario K1A 0G2. (Tel.: (613) 944-0367; fax: (613) 944-0375.) For copies of this paper, please contact the Department's Info Export centre (MKI) (fax: (613) 996-9709) and indicate Code SP51A.

Ce document est également disponible en français.

POLICY STAFF PAPERS/DOCUMENTS DU GROUPE DES POLITIQUES

Recent Papers on Economic and Trade Policy Issues/Récents documents sur des questions économiques et de politique commerciale:

A) TRADE POLICY SERIES

1. Globalization and Public Policy in Canada: In Search of a Paradigm, by Keith H. Christie. 93/01 (January 1993) * SP19

2. Trade and the Environment: Dialogue of the Deaf or Scope for Cooperation?, by Michael Hart and Sushma Gera. 92/11 (June 1992) SP18

3. Globalization: The Impact on the Trade and Investment Dynamic, by Dennis Seebach. 93/07 (June 1993) * SP25

4. Merger Control Under Trade Liberalization: Convergence or Cooperation? by Nicolas Dimic. 93/09 (August 1993) * SP27

5. Technology Consortia: A Prisoner's Dilemma? by Rhoda Caldwell. 93/10 (August 1993) * SP28

6. Optimal Patent Term and Trade: Some Considerations on the Road Ahead by I. Prakash Sharma. 93/12 (October 1993) * SP30

7. And the Devil Take the Hindmost: The Emergence of Strategic Trade Policy by I. Prakash Sharma and Keith H. Christie. 93/14 (December 1993) * SP32

8. Stacking the Deck: Compliance and Dispute Settlement in International Environmental Agreements by Keith H. Christie. 93/15 (December 1993) * SP33

9. Financial Market Integration: The Effects on Trade and the Responses of Trade Policy, by James McCormack. 94/01 (February 1994) * SP35

10. The New Jerusalem: Globalization, Trade Liberalization, and Some Implications for Canadian Labour Policy, by Rob Stranks. 94/02 (February 1994) * SP36

11. Competition Policy Convergence: The Case of Export Cartels, by William Ehrlich and I. Prakash Sharma. 94/03 (April 1994) SP37

12. The Day After: An Agenda for Diversifying Free Trade, by Keith H. Christie. 94/04 (January 1994) * SP38

13. Global Strategies and Foreign Direct Investment: Implications for Trade and the Canadian Economy, by Julie Fujimura. 94/07 (March 1994) * SP41

14. Competition and Trade Policy Interface: Some Issues in Vertical Restraints, by I. Prakash Sharma and Prue Thomson. 94/11 (forthcoming) SP45

15. Competition Policy Convergence: Abuse of Dominant Position, by I. Prakash Sharma, Prue Thomson and Nicolas Dimic. 94/12 (forthcoming) SP46

The Japanese Way: The Relationship Between Financial Institutions and Non-Financial Firms

Executive Summary

Inter-corporate relationships between financial institutions and non-financial firms are much closer in Japan than in North America. This Paper identifies the special relationships that exist between financial institutions and non-financial firms in the Japanese market, determines whether those relationships are limited to Japanese participants and considers their effects on trade as well as the appropriate response of trade policy.

The main findings of the Paper can be summarized as follows:

- Inter-corporate relationships in Japan are based on locally accepted business practices, and are not explicitly designed to exclude or discriminate against foreign firms.

- Nonetheless, there are a number of effective barriers to international trade, or at least circumstances that make entering the Japanese market more difficult than other foreign markets, that are a direct or indirect result of close inter-corporate ties in Japan.

- There is a role for trade policy in pressing for change in Japan. It is essential that close inter-corporate as well as government-industry relationships are open to all firms, foreign and domestic.

- Trade policy initiatives alone will not increase foreign participation in the Japanese market. The onus remains largely on foreign firms to adapt to Japanese practices and develop the type of long-term business relationships that are so highly valued in Japan.

As an example of the relatively close inter-corporate ties, about 20% of outstanding equity in Japan is held by commercial banks, compared to less than 1% of total U.S. equity held by U.S. banks. Close inter-corporate linkages are not restricted to commercial banks, however; two-thirds of total Japanese equity is held by corporations. In the U.S., corporations hold only 38% of all equity.

Although Japan's Anti-Monopoly Law allows a given financial institution to hold only 5% of the shares of other firms (10% in the case of insurance companies), the inter-corporate linkages that have evolved since the Second World War resemble the family-centred *zaibatsu* that existed prior to and during the war. Occupation leaders attempted to dismantle the *zaibatsu*, citing them as dangerous concentrations of economic and other powers. While the family-based corporate circles quickly

succumbed to new regulatory controls, other groups emerged, known as *keiretsu*, that were based on close relationships between banks and non-bank firms.

The close relationships that evolved between banks and non-financial corporations were inevitable in the reconstruction of Japan. Financially, Japan was internationally isolated; it had no well-developed securities markets and it maintained strict interest rate controls. Most savers and borrowers had no options other than placing money with, or borrowing money from, commercial banks.

Due to the lack of alternatives, corporate borrowers relied heavily on commercial banks. Even though banks could hold only 5% of the equity of other firms, and typically held less, the long-term debt financing banks provided over extended periods of time made their relationships more closely resemble those of equity holders than creditors. Equity ties between any two firms in the same *keiretsu* are usually small (normally 2% to 5% of outstanding shares), but across a *keiretsu* network, they can be quite large. Due to extensive cross shareholding and "stable shareholding" agreements, 60% to 80% of *keiretsu* company shares are never traded.

The ability of Japanese firms to borrow extensively from banks, particularly if they are fellow *keiretsu* members, raises the question as to whether they have access to cheaper, more patient capital, and thus enjoy a competitive advantage. Available evidence indicates that Japanese firms do have access to more patient capital, but it is less clear whether capital is (or ever has been) truly cheaper in Japan.

There are a number of factors that suggest that *keiretsu*, while still a dominant institution in the Japanese economy, are declining in importance. With alternative sources of capital now widely available to Japanese firms (including from overseas sources), the customer base of banks is changing. After four years of declining profits, Japanese companies are looking for cheaper funds. At the same time, depositors have the option of holding higher yield securities, so banks must compete for funds. Banks, meanwhile, have become increasingly concerned about the cost of maintaining large shareholding interests in certain customers.

Foreign banks could be among the beneficiaries of weakened *keiretsu* relationships. Three related factors could help increase the market share of foreign banks in Japan: as a group, *keiretsu* firms are no longer the largest commercial bank customers; corporate restructuring in Japan will likely involve cutting the costs of financial services and introduce greater competition; and the operational ties between Japanese banks and non-financial firms are slowly being reduced.

Nevertheless, and even though *keiretsu* are probably in decline, the long-standing tendency of Japanese firms to deal with familiar business contacts, including financial institutions, will continue to make it difficult for foreign firms to penetrate Japanese markets. Loyalty and long-term business relationships are highly valued in Japan, and will persist in overshadowing short-term price, or product quality, considerations. For foreign firms to be successful in Japan, they will require patience. They must display an interest in long-term inter-corporate relations that favour consistency over short-term profitability.

Foreign firms must adapt to the Japanese way in order to successfully compete in Japan, just as they would need to make adjustments in any foreign market. For example, a marginally better price available from a competitor should not induce a foreign firm operating in Japan to switch away from its current Japanese supplier. It appears that North American firms have already drawn some lessons from the Japanese system, and have begun, at least on a modest scale, to implement them in their domestic operations. In the drive to become internationally competitive, we expect that all firms will selectively adopt practices from the Japanese and North American styles of inter-corporate relations.

Summary of Recommendations

In conclusion, this Paper makes several specific recommendations aimed at increasing the transparency of inter-corporate relationships in Japan, and improving the access foreign financial institutions have to the Japanese markets:

- There is a need to press for a more effective, formal mechanism for ensuring that all financial sector regulations, formal and informal guidelines and other government directives are widely discussed and reviewed in advance of implementation, including by interested foreign investors in Japanese financial services markets, and are subsequently clearly written and made publicly available.

- A review should be conducted of the membership practices of private sector insurance and banking associations to ensure that there are no barriers to active participation by foreign insurance companies and banks established in Japan.

- A sunshine mechanism related to the activities of these associations and their relations with government regulators should be introduced, so that the membership lists of the associations are readily available publicly and there is fuller public disclosure of the inter-action between government and the associations with regard to the development of guidelines and proposed changes to regulations and framework laws governing the financial sector.

- There should be an acceleration of the approval process for new insurance products in Japan. Currently, it takes far too long, with the Ministry of Finance and the Life Insurance Association of Japan (with foreign under-representation) taking up to four years to review a product, during which time competing firms are free to develop similar products.

- We should support efforts to ensure that a comprehensive insurance system reform bill is passed in Japan, including provisions for liberalization of the life and non-life insurance markets (in addition to areas such as personal accident and disability insurance, which are not yet liberalized, but where foreign firms already have a significant market share). Reform should also include the lifting of restrictions that prevent life insurance companies from offering non-life policies, and vice-versa.

- Even though cross shareholding formalizes business relationships that already exist as opposed to creating new ones, we could explore tax incentives or other procedures to stimulate greater trading of shares of non-financial firms, since about 70% of shares in Japan are never traded. The *keiretsu* culture tends to narrow the prospective sphere of lending by foreign banks in Japan to "second-tier" companies not affiliated with an industrial group. More active share trading could permit foreign banks to buy more easily, although modestly and carefully in keeping with prudential concerns, into major Japanese firms, thus helping to underpin a longer term relationship, with enhanced potential for a fuller financing role with regard to "first-tier" companies.

Resumé

Au Japon, les relations entre les institutions financières et non financières sont beaucoup plus étroites qu'en Amérique du Nord. Ce document décrit ce type de relations spéciales sur le marché japonais, détermine si elles se limitent aux institutions japonaises et examine leurs répercussions sur le commerce, d'une part, et la façon dont la politique commerciale doit y répondre, d'autre part.

Les principales conclusions du document sont les suivantes :

- Au Japon, les relations entre les sociétés sont fondées sur les pratiques commerciales du pays et ne visent pas explicitement à exclure les sociétés étrangères ou à faire des distinctions à leur détriment.

- Néanmoins, il existe un certain nombre d'obstacles réels au commerce international ou, tout au moins, des conditions attribuables directement ou indirectement aux liens étroits inter-sociétés, qui font que l'accès au marché japonais est plus difficile que l'accès à d'autre marchés.

- La politique commerciale peut servir à opérer un changement au Japon. Il est essentiel que toutes les entreprises, étrangères et nationales, puissent bénéficier des relations étroites existant entre les sociétés ainsi qu'entre le gouvernement et l'industrie.

- Les initiatives relevant de la politique commerciale n'accroîtront pas à elles seules la participation étrangère au marché japonais. C'est surtout aux entreprises étrangères qu'il appartient de s'adapter aux pratiques japonaises et de nouer des relations d'affaires à long terme — si prisées par les Japonais.

Mentionnons, à titre d'exemple, le fait qu'au Japon, environ 20 % des actions en circulation est détenu par des banques commerciales, alors qu'aux États-Unis les banques détiennent moins de 1 % de l'ensemble du capital-actions des sociétés américaines. Ces liens étroits ne sont cependant pas limités aux banques commerciales, puisque les sociétés commerciales détiennent les deux tiers de l'ensemble du capital-actions des sociétés japonaises. Aux États-Unis, 38 % seulement du capital-actions sont détenus par les sociétés.

Bien que la loi contre les monopoles interdise aux institutions financières de détenir plus de 5 % des actions d'autres entreprises (10 % dans les cas des compagnies d'assurance), les liens inter-sociétés qui se sont noués depuis la Seconde

Guerre mondiale ressemblent à ceux qui unissaient les *zaibatsu*, groupes centrés sur la famille, que l'on retrouvait au Japon avant et pendant la guerre. Les autorités d'occupation ont tenté de dissoudre les *zaibatsu* qui étaient, selon elles, des concentrations dangereuses de pouvoirs, notamment des pouvoirs économiques. Tandis que les groupes commerciaux axés sur la famille succombaient rapidement aux nouveaux instruments de contrôle législatifs, d'autres groupes, appelés les *keiretsu*, voyaient le jour. Les *keiretsu* étaient fondés sur des liens étroits entre les banques et les institutions non bancaires.

L'établissement de liens étroits entre les banques et les institutions était inévitable dans le contexte de la reconstruction de l'économie japonaise. En effet, le Japon se retrouvait isolé du reste du monde sur le plan financier, avait un marché des valeurs mobilières peu développé et contrôlait rigoureusement les taux d'intérêt. La plupart des épargnants et des emprunteurs étaient contraints de faire affaire avec les banques commerciales.

En l'absence de choix, les sociétés emprunteuses dépendaient beaucoup des banques commerciales pour se maintenir à flot. Même si les banques ne pouvaient détenir que 5 % du capital-actions d'autres entreprises, et que d'ordinaire ce pourcentage était moindre, les rapports qu'elles entretenaient avec les entreprises auxquelles elles accordaient du financement par emprunt à long terme tenaient davantage du comportement d'actionnaires et non de créanciers. Alors qu'au sein d'un *keiretsu*, les entreprises ne détiennent qu'une petite part du capital-actions d'une société soeur, (habituellement de 2 à 5 % des actions en circulation), dans l'ensemble d'un réseau, de *keiretsu*, par contre, le pourcentage du capital-actions détenu peut être très élevé. Vu le grand nombre d'accords d'actionnariat croisés et « stables », de 60 à 80 % des actions d'un *keiretsu* ne sont jamais négociées en bourse.

La capacité des entreprises japonaises à emprunter des sommes importantes auprès des banques, surtout si elles font partie du même *keiretsu*, pose la question de savoir si elles ont accès à des capitaux plus patients, à meilleur marché, qui leur conféreraient un avantage concurrentiel. Selon les renseignements disponibles, nous savons que les entreprises japonaises ont accès à des capitaux plus patients, mais il est plus difficile de savoir s'il y a, ou même s'il y a jamais eu, des capitaux à bon marché au Japon.

Un certain nombre de facteurs portent à croire que l'importance des *keiretsu* diminue, même s'ils jouent encore un rôle prépondérant sur le plan économique. Maintenant que les entreprises japonaises ont facilement accès à d'autres sources de capital (y compris à des sources étrangères) la clientèle des banques évolue. Après avoir vu leurs bénéfices diminuer quatre années d'affilée, les entreprises japonaises sont à la recherche de fonds à bon marché. De leur côté, les déposants peuvent se procurer des titres portant intérêt à des taux plus élevés, de sorte que les banques doivent se battre pour garder leur clientèle. Entre temps, les banques s'inquiètent de plus en plus du coût de leur participation dans certaines entreprises clientes.

Les banques étrangères pourraient se trouver au nombre des bénéficiaires de l'affaiblissement des relations qui unissent les membres des *keiretsu*. Trois facteurs connexes pourraient aider les banques étrangères à accroître leur part du marché japonais : collectivement, les sociétés formant un *keiretsu* ne représentent plus la majorité de la clientèle des banques commerciales; la restructuration des sociétés japonaises comportera probablement une réduction du coût des services financiers et accroîtra la concurrence; les liens opérationnels entre les banques japonaises et les institutions non financières diminuent graduellement.

Néanmoins, et ce en dépit de la régression probable des *keiretsu*, la tendance de longue date qu'ont les entreprises japonaises de faire affaire avec des gens connus, y compris des institutions financières, continuera de faire obstacle aux entreprises étrangères souhaitant pénétrer les marchés japonais. La loyauté et les relations d'affaires à long terme sont très prisées des Japonais, qui continueront de reléguer au second plan les prix à court terme et la qualité du produit. Pour réussir au Japon, les entreprises étrangères devront faire preuve de patience et manifester un intérêt pour les relations à long terme, qui favorisent l'harmonie au détriment des profits à court terme.

Les entreprises étrangères doivent s'adapter à la façon de faire des Japonais pour les concurrencer sur les marchés intérieurs, tout comme elles le font pour d'autres marchés étrangers. Par exemple, l'entreprise ne devrait pas lâcher son fournisseur japonais pour la simple raison qu'un concurrent offre un prix légèrement inférieur. Il semble que les sociétés nord-américaines aient déjà appris certaines leçons, qu'elles ont commencé à mettre en pratique dans leurs opérations nationales, ne serait-ce qu'à petite échelle. Nous nous attendons à ce que toutes les entreprises souhaitant évoluer sur les marchés mondiaux adoptent certaines pratiques des entreprises japonaises et nord-américaines en matière de relations inter-sociétés.

Résumé des recommandations

En guise de conclusion, les auteurs du document formulent plusieurs recommandations visant à accroître la transparence des relations inter-sociétés au Japon et à ouvrir davantage les marchés japonais aux institutions financières étrangères :

- Insister sur l'adoption de mécanismes officiels efficaces pour que tout règlement visant le secteur financier, ainsi que toute ligne directrice, officielle ou officieuse, en particulier celles du gouvernement, fassent avant leur mise en oeuvre l'objet d'un examen et de pourparlers globaux auxquels participeront notamment les investisseurs étrangers intéressés par le marché japonais des services financiers, et pour que ces règlements et lignes directrices soient clairement rédigés et publiés.

- Examiner les conditions d'adhésion aux associations privées de compagnies d'assurance et de banques à l'égard de leurs membres afin d'éliminer tout obstacle à la participation active des compagnies d'assurance et des banques étrangères établies au Japon.

- Mettre en place un mécanisme visant à éliminer le secret entourant les activités de ces associations et leurs relations avec les organismes gouvernementaux de réglementation afin qu'elles ouvrent leurs listes de membres au public et qu'elles divulguent tous les aspects de leurs relations avec l'État à propos de l'élaboration de lignes directrices et des changements qu'il est proposé d'apporter aux règlements et aux lois-cadres régissant le secteur financier.

- Accélérer le processus d'approbation des nouveaux produits d'assurance au Japon. Le processus actuel est beaucoup trop long : l'examen d'un produit par le ministre des Finances et l'Association des compagnies d'assurance-vie du Japon (au sein de laquelle les intérêts étrangers sont sous-représentés) peut prendre jusqu'à quatre ans, période pendant laquelle les concurrents peuvent, à leur guise, mettre au point des produits semblables.

- Appuyer les efforts en vue de l'adoption d'un projet de loi sur la réforme complète du secteur des assurances au Japon, notamment la libéralisation des marchés de l'assurance-vie et de l'assurance I.A.R.D. (en plus de l'assurance individuelle contre les accidents et l'assurance-invalidité, secteurs qui ne sont pas encore libéralisés mais où les compagnies étrangères possèdent déjà une part importante du marché). Les réformes devraient aussi prévoir la levée des restrictions empêchant les compagnies d'assurance-vie de vendre de l'assurance I.A.R.D. et, à l'inverse, les compagnies d'I.A.R.D. de vendre de l'assurance-vie.

- Même si l'actionnariat croisé officialise des relations commerciales existantes au lieu d'en créer de nouvelles, il faut explorer les mesures d'encouragement, en particulier sur le plan fiscal, afin de stimuler la négociation des actions d'entreprises non financières, puisque, au Japon, environ 70 % des actions ne sont jamais négociées en bourse. La culture du *keiretsu* tend à restreindre les perspectives des institutions prêteuses souhaitant s'établir au Japon en limitant leurs activités à des sociétés de second rang qui n'ont aucune affiliation à un groupe industriel. Une plus grande activité boursière dans ce secteur permettrait aux banques étrangères de devenir actionnaires de grandes entreprises japonaises plus facilement, quoique modestement et avec précaution, conformément aux considérations de prudence. En étayant ainsi des relations à long terme, elles augmenteraient leur capacité virtuelle de jouer un rôle plus important quant au financement d'entreprises de « premier niveau ».

1. Introduction

There are fundamental differences in the North American and Japanese relationships between financial institutions and non-financial firms. Generally speaking, the relationships are much closer in Japan. There is much more interaction between financial institutions and the firms to which they lend, and there are stronger ownership linkages in both directions. Close Japanese inter-corporate linkages are not limited to relations between financial and non-financial firms. In Japan, companies tend to have shared interests with several firms, only some of which are engaged in related business activities.

A number of fundamental questions emerge with respect to inter-corporate relationships in Japan, particularly as they affect Japanese participation in foreign markets and foreign firms' participation in Japanese markets.

- What defines the special relationships between Japanese financial institutions and non-financial firms?
- Are the relationships strictly limited to Japanese financial institutions, or can foreign institutions develop similar relationships in Japan with Japanese firms?
- Do the relationships (between both financial and non-financial firms, and two or more non-financial firms) confer specific benefits to Japanese firms that enhance their international competitiveness? If so, what should be the appropriate responses of foreign firms and governments? Should Japanese business practices be copied, or should foreign government representatives press for change in Japan?

The questions surrounding Japanese inter-corporate linkages centre on the differences between accepted business practices in Japan and North America. It is critical to bear in mind, however, that "different" does not necessarily mean "unfair" in an international trading sense. Markets can work differently in different countries, and corporate cultures and practices that are not internationally transferable or shared can result in the effective exclusion of foreign firms. But this is not necessarily a question of "fairness".

An analysis of the relationships between firms in Japan, including financial institutions, must consider their formal governance as well as their informal development. The formal governance of inter-corporate relations is within the domain of the legal system. Informally developed relations include ownership and other ties that, while still formally governed by the legal system, have evolved based on generally accepted business practices.

The international response to the different ways in which Japanese firms operate and relate to each other has been led by the United States. The Structural Impediments Initiative talks in 1989-90 and the present Framework Talks are examples of the many bilateral government consultations that have taken place. At the same time, there has been pressure within the U.S. to review strict domestic limitations on ownership linkages between financial and non-financial firms so as to more closely resemble the Japanese system.[1] Clearly, there are roles for both trade policy and a mix of domestic policies. Neither can fully address the competitive implications of different corporate ownership structures and relations across countries. Only together can they bridge some of the differences, and foster an international exchange of the relative strengths of managing inter-corporate relations differently.

The remainder of this Paper is organized as follows. Section 2 provides the setting by outlining the corporate ownership structure in Japan and comparing it to the United States. In section 3, the legal structure presiding over corporate relations in Japan is examined. Section 4 considers the development of informal inter-corporate relations in Japan, focusing on *keiretsu*. The trade implications of *keiretsu* are also examined. Section 5 is an overview of the treatment of foreign financial institutions in Japan. The purpose is to determine whether foreign financial institutions share the capacities to develop close relations with non-financial firms. Trade implications for financial institutions are considered. Finally, section 6 contains conclusions, lessons from the Japanese experience and policy implications.

2. Corporate Ownership Structure in Japan

There are two distinct issues in the analysis of corporate ownership. First is the question of who owns whom. In the context of this Paper, inter-corporate shareholdings between financial and non-financial firms are of most interest. The second issue is the degree of ownership concentration. Again, this Paper will focus on whether there is a concentration of ownership within financial institutions.

[1] See, for example, U.S. Congress, Office of Technology Assessments, *Multinationals and the National Interest: Playing by Different Rules,* Washington, D.C., 1993, p. 135.

2.1 Who Owns Whom

A 1992 study by Prowse indicates that in 1984, corporations in Japan held nearly twice the percentage of total outstanding equity as U.S. corporations (see Table 1).[2] One of the most startling differences was in the common stock holdings of financial institutions, particularly commercial banks. More than 20 per cent of the outstanding stock of all firms in Japan was held by commercial banks, while in the U.S., commercial banks have been prohibited from directly holding any corporate stock on their own account.

The Banking Act of 1933 (known as the Glass-Steagall Act) only allows U.S. banks to hold debt securities of other companies. Under the Bank Holding Company Act of 1956, however, bank holding companies in the U.S. (but not banks) are each allowed to hold up to 5% of the common stock of any company.[3] Their holdings, along with those of investment banks and brokerage firms are included with "other financial" in Table 1.

Another notable difference between equity ownership in Japan and the U.S. is the holdings of insurance companies. In Japan, insurance companies held 17.7 % of all outstanding shares, while in the U.S. insurance companies held only 4.6%.

There have been a number of important financial developments in Japan since 1984, however, including the end of the bubble economy and new international capital adequacy standards, that might have altered Prowse's findings, especially the percentage of outstanding equity held by commercial banks.

[2] S. D. Prowse, "The Structure of Corporate Ownership in Japan", in *Journal of Finance*, Vol. 47, No. 3, New York, NY, July 1992, p. 1123.

[3] See E.L. Symons, Jr., "The United States Banking System", in *Brooklyn Journal of International Law*, Vol. XIX, No. 1, Brooklyn Law School, Brooklyn, NY, 1993, p. 25. Bank holding companies were originally used to circumvent branching and business restrictions faced by banks. In the early 1970s, small and medium sized banks began using the holding company structure, in which bank shareholders own stock in the holding company rather than directly in the bank. Holding companies have been used to consolidate bank management and operations, but not primarily as a means to acquire equity in non-bank businesses. The traditional separation between banking and non-banking business (based on concerns regarding the concentration of economic power) has been largely maintained in practice. See K. Spong, *Banking Regulation*, Third Edition, Federal Reserve Bank of Kansas City, Kansas City, MO, 1990, pp. 34-8. Note that in the U.S., 21.8% of outstanding equity is held by financial institutions other than banks or insurance companies (see Table 1). Of this share, only a "small" proportion is held by bank holding companies according to Prowse.

Table 1[4]
Percentage of Outstanding Equity Held by Various Sectors in the United States and Japan in 1984

	Japan	U.S.
All Corporations	67.3	37.7
Financial Institutions	43.3	26.6
Commercial Banks	20.5	0.2
Insurance Companies	17.7	4.6
Other Financial	5.1	21.8
Non-Financial Corporations	24.0	11.1
Households	26.7	58.1
Foreign	5.0	4.2
Other	1.0	0.0
Total	100.0	100.0

[4] Other studies have also focused on the ownership of Japanese corporations, with the following results:

	Common Equity Owned* (Manufacturing)	Equity Holdings**
Financial Institutions	34.4%	41.5%
Individuals	29.6	23.2
Domestic Corporations	25.7	24.5
Foreigners	7.0	5.4
Other	3.3	5.3

*See W.C. Kester, "Capital and Ownership Structure: A Comparison of United States and Japanese Manufacturing Corporations", in *Financial Management,* Vol. 15, No. 1, Financial Management Association, Hanover, NH, Spring 1986, p. 7.
**For year-end 1991. See C. Conner, *The Japanese Financial Services Industry in the 1990s,* The Conference Board of Canada Report 127-94, Ottawa, June 1994, p. 13. "Other" includes investment trusts and securities companies.

- The End of the Bubble Economy

The term "bubble economy" refers to the rapid rise in private demand and asset prices in Japan in the late 1980s, and their subsequent decline in the early 1990s.[5] In the midst of the bubble, land and stock prices climbed to new highs that were not sustainable by the economic fundamentals. A popular anecdote used to illustrate the extent to which Japanese land prices rose is that, in the late 1980s, the land under the Imperial Palace in Tokyo was worth as much as all the land in California, or all the land in Canada, or all the land, houses and factories in Australia.

Commercial real estate prices in Tokyo dropped 7% and 19% in 1991 and 1992, respectively.[6] Even though Japanese banks have engaged in significantly less real estate lending than North American banks, the decline in Japanese real estate prices has resulted in sharp increases in non-performing loans held by Japanese banks.[7] One option to cover the expenses of bad debts is for banks to sell assets, including their equity holdings.

In addition to the real estate decline, the Tokyo Stock Exchange index has fallen about 50% (as of June 1994) since its peak in December 1989. In and of itself, a fall in the index need not reduce the share of outstanding stock held by commercial banks. If bank portfolios are fully diversified, and changes in their values mirror those of the market, banks' shares of outstanding stock will remain unchanged.

[5] For a discussion of the Japanese bubble economy, including factors that led to its demise, see C.F. Bergsten and M. Noland, *Reconcilable Differences? United States - Japan Economic Conflict,* Institute for International Economics, Washington, D.C., June 1993, pp. 43-53.

[6] See Bank for International Settlements, *63rd Annual Report,* Bank for International Settlements, Basle, 1993, p. 159. By comparison, commercial real estate prices fell by 18% and 13% in the U.S. North-East, and by 9% and 13% in Toronto, over the same period. There have been suggestions that land prices in Tokyo and Osaka need to fall by as much as 60% from their 1990 peak to reach a level that is sustainable by the growth of the economy. See R.W. Wright, *Japanese Finance in Transformation: Implications for Canada,* The Canada-Japan Trade Council, Ottawa, 1994, p.16.

[7] In 1992, 19% of Japanese commercial bank loans to the private sector were considered real estate loans, compared to 43% in the U.S. and 51% in Canada. See Bank for International Settlements, *op. cit.,* p. 168. The non-performing loans of Japanese banks are estimated (as of September 1993) to be close to 30 trillion yen. See "The Banks Feel the Pain", in *The Banker,* Financial Times Magazines, London, January 1994, p. 49, and "Tough on the Taxpayer", in *The Economist,* London, February 26, 1994, p. 79.

Prior to the decline in the stock market, Japanese banks had used capital gains on their shareholdings in order to boost profits. With the fall in equity prices, the banks' latent gains declined, reducing the incentive to sell (and in some cases probably eliminating the possibility of selling) stocks for capital gains.[8] Falling equity prices suggest a reduction in equity sales, at least to the extent they were used to boost bank profits.

- New International Capital Adequacy Standards

In 1988, the Basle Supervisors' Committee (the Committee on Banking Regulations and Supervisory Practices of the Group of Ten Countries and Luxembourg) concluded an agreement on risk-weighted capital adequacy standards that required a minimum 8% ratio of capital to risk-weighted credit exposure by the end of 1992.[9] The agreement made an important distinction between "core capital" (also known as Tier 1 capital) and "supplementary capital" (also known as Tier 2 capital). Core capital, which consists of shareholders' equity and disclosed reserves, must account for at least half of a bank's total recognized capital. Supplementary capital is regarded as lower quality capital and, of particular importance to Japanese banks, can include 45% of the unrealized capital gains on bank equity holdings, as well as general loan-loss provisions, hybrid capital instruments and subordinated debt.

Based on the strength of the Tokyo stock market at the time the agreement was announced, it appeared that Japanese banks would have no problem acquiring the additional core capital of about 6,000 to 8,000 billion yen required to meet the 8% ratio.[10] Concerning supplementary capital, there was no indication that the unrealized capital gains would decline so much that banks would need to issue subordinated debt.

[8] At the end of 1989, the largest banks held 55.4 trillion yen in unrealized capital gains. By the end of March 1993, holdings were down to 17.3 trillion yen. See R.W. Wright, *op. cit.*, p. 18, and International Monetary Fund, *International Capital Markets Part II*, Washington, D.C., August 1993, p.15.

[9] For a full discussion of the new standards, see D.E. Alford, "Basle Committee International Capital Adequacy Standards: Analysis and Implications for the Banking Industry", in *Dickinson Journal of International Law*, Vol. 10, No. 2, Dickinson School of Law, Carlisle, PA, Winter 1992, pp. 189-222.

[10] See Bank for International Settlements, *59th Annual Report*, Bank for International Settlements, Basle, 1989, p. 91.

Although abiding by the new capital adequacy standards proved more difficult for Japanese banks than first anticipated, it did not cause any reduction in the banks' share of outstanding corporate equity. In fact, given the reduced value of unrealized capital gains, selling equities would have only made matters worse by further reducing supplementary capital needed to achieve the 8% ratio referred to above.

The Japanese government took two steps in August 1992 to indirectly stabilize equity prices by reducing bank incentives to realize capital gains.[11] First, banks were allowed to omit reporting in their interim accounts (September) the losses on equities whose market value had fallen below book value.[12] Typically, banks would have sold other equities to cover the losses, putting further downward pressure on stock prices. Second, the Ministry of Finance relaxed the limit on dividend-payout ratios for banks.[13] In the past, some banks had avoided cutting dividends by realizing capital gains on their equity holdings to boost profits.

In summary, the two main motives that Japanese banks have had to sell equity holdings in the past few years -- to make up for real estate losses and to boost profits generally -- have likely been at least offset by the contribution of latent profits to supplementary capital (even though that contribution declines along with stock prices) and the government initiatives outlined above. The present share of outstanding equity held by commercial banks is estimated at about 18%.[14]

2.2 Degree of Ownership Concentration

The fact that financial institutions hold over 40% of outstanding equity in Japan does not reveal anything about the concentration of ownership. With 11 city banks, 3 long-term credit banks, 7 trust banks, almost 130 regional banks and hundreds of credit associations and cooperatives, it is conceivable that the collective equity held by financial institutions could be quite widely distributed. In terms of management control and business influence over a particular corporation, there is a big difference

[11] See International Monetary Fund, *op. cit.*, p. 13.

[12] The book value of shares is calculated by dividing common equity (reported in balance sheets as the difference between assets and liabilities) by the number of shares outstanding. The market value is simply the share price in the market.

[13] The dividend-payout ratio is the ratio of dividends to corporate earnings.

[14] See R.W. Wright, "Japanese Financial Flows to Canada", in *Japanese Finance in Transition: Implications for Canada,* The Canada-Japan Trade Council, Ottawa, May 1993, p. 36.

between equity held by only a few financial institutions and equity held by a large number of financial institutions.

In addition to comparing the percentage of equity held by various sectors in Japan and the U.S., Prowse also compared ownership concentration in the two countries. He found that, for an average firm, the top five shareholders in Japan held 33.1% of outstanding shares, while the top five shareholders in the U.S. held an average of 25.4%. The median levels of ownership concentration were 29.7% in Japan and 20.9% in the U.S..

Financial institutions ranking among the top five Japanese shareholders held 25% of an average firm's total shares. They are by far the most important of the large shareholders, with top five non-financial corporations holding 4.9%, individuals 3% and "others" 0.2% of total shares. The remaining shares are typically widely held.

The Prowse results indicate that ownership concentration is somewhat higher in Japan than in the U.S.. However, financial institutions in Japan are collectively larger and, judging by their level of ownership concentration, much more powerful shareholders than is the case in the U.S..

3. Formal Governance of Relationships

Modern relationships between firms in Japan are easily traced to the family-based holding companies, known as *zaibatsu*, that existed prior to and during the Second World War.[15] It has been alleged that these organizations had important roles in leading Japan into the War.[16] During the post-War Occupation, economic reform

---

[15] For historical discussions of the economic implications of Japan's social framework, and the importance of loyalty and personal obligation, see R. L. Carson, *Comparative Economic Systems*, M. E. Sharpe Inc., New York, 1990, pp. 447-52; and A. Hazera and H. Hayashida, "The Influence of Japanese and American Stockholders on Corporate Planning: A Cross-Cultural Examination", in *Business and The Contemporary World*, Vol. IV, No. 1, Bentley College, Waltham, MA, Autumn 1991, pp. 102-11. For a discussion of the role of *zaibatsu* in the economic development of Japan, see P. Duus, *The Cambridge History of Japan: Volume 6: The Twentieth Century*, Cambridge University Press, Cambridge, U.K., 1988, pp. 448-9.

[16] See E. Razin, "Are the *Keiretsu* Anticompetitive? Look at the Law", in *North Carolina Journal of International Law and Regulation*, Vol. 18, No. 2, University of North Carolina School of Law, Chapel Hill, N.C., Winter, 1993, p. 369.

was based on "democratizing" Japan, and included land reform, labour reform and the dissolution of *zaibatsu*.

It was the intention of the American Occupation to remove *zaibatsu* so as to eliminate the concentration of economic power. In an immediate sense, the Occupation was successful. Large companies were broken down into several smaller ones, *zaibatsu* head offices were closed, and a number of legal barriers were erected to prevent the reemergence of conglomerates. The present legal structure governing Japanese corporate relations differs little from that which the American Occupation introduced.

3.1. The Anti-Monopoly Law

In April 1947, the Anti-Monopoly Law (AML), which was based on U.S. antitrust laws, was enacted.[17] In December 1947, the Elimination of Excessive Concentration of Economic Power Act was enacted, allowing the Holding Company Liquidation Commission to identify and eliminate any company deemed a monopoly.[18] The Japan Fair Trade Commission (FTC) was established to monitor and enforce the AML.

- Shareholding Offenses[19]

In addition to sections that prohibit mergers and asset sales when they would result in a reduction in competition, the AML has several restrictions on shareholding. As a direct consequence of *zaibatsu*, the existence of holding companies is strictly forbidden under Section 9 of Chapter IV. Any company whose primary purpose is to control other companies through equity stakes would be considered in violation of this Section.

Section 10 of the AML restricts the acquisition of shares when it would result in a reduction of competition, regardless of the lack of existence of holding companies or any intent to engage in concerted activity. There are no pre-determined structural

[17] Law Relating to Prohibition of Private Monopoly and Methods Preserving Fair Trade (Law No. 54 of 1947).

[18] The Elimination of Excessive Concentration of Economic Power Act is Act Number 207 of 1947. Imperial Ordinance Number 233 of 1946 created The Holding Company Liquidation Commission.

[19] This section is drawn from E. Razin, *op. cit.*, pp. 383-5.

tests to determine if competition has been reduced; each case is analyzed independently.

Inter-corporate shareholdings are limited by Section 9.2, as amended in 1977. Large non-financial companies -- with capital in excess of ten billion yen or net assets in excess of thirty billion yen -- are prohibited from acquiring or holding stock of other companies in excess of their capital or their net assets, whichever is larger. Section 11 limits inter-corporate shareholdings of a given financial company to 5% of the outstanding shares of the target company. An insurance company is allowed to hold 10% of other companies. There is no limit to the equity of a non-financial company that several financial companies might hold collectively.

- Directorate Offenses[20]

In order to prevent an anticompetitive concentration of economic power through the interchange of directors, the AML prohibits officers or employees from one company from holding an officer position in another company at the same time. However, the FTC has determined that a reduction in competition can occur only if the two companies are involved in the same type of business.

In order to determine whether directorate offenses have taken place, and there is a reduction in competition, the FTC looks at the market share held by the company involved in the alleged violation.

- Unfair Business Practices[21]

Although companies are free to contractually engage with other companies in any way they see fit, the arrangements must be consistent with the AML provisions related to unfair business practices. To be covered by the provisions, the actions must be consistent with the AML's legal definition of unfair business practices, be an impediment to "fair competition" and be designated by the FTC as unfair.[22]

[20] This section is drawn from E. Razin, *op. cit.*, pp. 385-6.

[21] This section is drawn from E. Razin, *op. cit.*, pp. 386-97.

[22] Section 19 of the AML prohibits unfair business practices. Article 2(9) broadly defines acts that may constitute unfair business practices, and determines the coverage of Section 19.

Unfair business practice offenses include the following.[23]

- Resale price maintenance involves fixing prices at artificial levels. Although the Japanese courts have condemned unequivocally this practice, there is a lack of recent litigation.[24] It is unclear whether the rigid standard still prevails.

- Exclusive dealing can take the form of a downstream firm requiring an upstream firm to sell it all of its output, or an upstream firm requiring a downstream firm to buy only its output.[25] Firms often use rebates to ensure exclusive dealing. Japanese courts presume illegality when the rebates are large or increasingly large or when their method of calculation is unclear.

- Abuse of dominant position occurs if upstream or downstream firms exert coercive influence over other firms regarding the non-price terms of a transaction.[26]

- Refusal to deal is an unfair business practice only if it is the result of two or more firms in collusion or actions taken by a market-dominating firm.[27] It is generally accompanied by other anticompetitive acts.

The Anti-Monopoly Law is obviously not limited to the relationships between financial institutions and non-financial firms. Those relations are subject to the same constraints as any other inter-corporate relations in Japan. The unique restriction on Japanese financial institutions concerns their right to each hold only 5% of the equity (10% in the case of insurance companies) of other firms.

[23] For a more complete discussion of unfair business practices in Japan and how they influence trade, see I.P. Sharma and P. Thomson, *Competition and Trade Policy Interface: Some Issues in Vertical Restraints*, Policy Staff Paper No. 94/11, Department of Foreign Affairs and International Trade Canada, Ottawa, forthcoming.

[24] For a list of cases and FTC decisions dating from 1966 to 1975, see E. Razin, *op. cit.*, p. 392. There have been no major court findings since 1975.

[25] FTC Notification Number 15 describes the illegal forms of exclusive dealing.

[26] FTC Notification Number 15 describes abuses of dominant position.

[27] FTC Notification Number 15 defines refusal to deal.

4. The Development of Informal Relationships

At first glance, the laws and regulations outlined in Section 3 seem to indicate that there is little opportunity for, or tolerance of, collusive behaviour by Japanese corporations. Yet, there are a number of popular complaints about Japan, citing various anti-competitive and/or collusive practices that effectively exclude foreign firms.[28] The complaints against Japan could be a misguided result of its large trade surplus -- a case of "sour grapes" -- or they could be based on different economic or business practices, or government initiatives, in which case they merit closer attention.

4.1 A Historical Context

For a more complete understanding of the relationships between banks and non-financial firms, it is necessary to consult their economic history.[29] In the 1920s and 1930s, the Japanese government greatly increased its financial regulations until, during World War II, the government had controls over the entire financial system. Despite reforms introduced by Occupation forces, wartime financial controls formed the basis of the government's post-war regulatory regime over the economy. The Ministry of Finance became the primary regulatory authority in Japan.

---

[28] Complaints against Japan include: the yen was kept artificially low until 1985; there are numerous import and investment barriers; the patent application process is complex and lengthy, allowing domestic firms to develop similar technologies before foreign firms' patents have been approved; patent coverage is defined too narrowly; the government uses subsidies and legal concessions to encourage certain domestic firms to merge, form cartels, or engage in other cooperative arrangements; the existence of *keiretsu* makes it difficult for foreign investors to acquire, or compete with, *keiretsu* firms; the government grants low-interest loans to enable firms to win foreign contracts; Japanese businesses pay bribes to win foreign contracts; and industries have been selected to drive out non-Japanese competitors to establish Japanese dominance. See B. Sarachek, "Japan Bashing and the American Malaise", in *Business and the Contemporary World,* Vol. 4, No. 3, Walter de Gruyter & Company, Berlin, Summer 1992, p. 41. Complaints about specific trade barriers are contained in D.K. Nanto, *Japan's Official Import Barriers,* Congressional Research Service Report for Congress 93-657 E, Washington, D.C., July 11, 1993.

[29] For historical discussions on Japanese finance and the roles of commercial banks, see T.F. Cargill and G.F.W. Todd, "Japan's Financial System Reform Law: Progress Towards Financial Liberalization?", in *Brooklyn Journal of International Law,* Vol. 19, No. 1, Brooklyn Law School, Brooklyn, NY, 1993, p. 51-7; and T.F.M. Adams and I. Hoshii, *A Financial History of The New Japan,* Kodansha International Limited, Palo Alto, CA, 1972.

The three most important features of the Japanese financial system with respect to the evolution of the banks' relationships with non-financial firms were its international isolation, the lack of well developed securities markets and strict interest rate controls.[30] Savers and borrowers had no options other than placing their money with, or borrowing money from, the domestic banks. Immediately following the War, firms had to look to the banks for reconstruction finance, since funds available in the capital markets were not nearly sufficient. In the 1950s, however, 30% of new industrial equipment funds were sourced from government-directed industrial credits, programs in which the commercial banks played a small and secondary role.[31]

Leaving aside government credits, the dependence on bank loans rather than equity markets created strong bonds between banks and other enterprises. The *zaibatsu*, which were supposed to have been dismantled by the Occupation, effectively re-emerged, with new, central roles for banks. One of the primary means by which banks monitored the activities and financial health of the firms with which they were associated was to hold equity.[32] The equity ties, together with the high debt loads firms carried, created very close affiliations between banks and other commercial enterprises that have developed into the relationships that are presently known as *keiretsu*.

[30] Controls on interest rates were at least partly responsible for the lack of capital market developments.

[31] See D. Vittas and Y.J. Cho, "The Role of Credit Policies in Japan and Korea", in *Finance and Development,* Vol. 31, No. 1, International Monetary Fund and World Bank, Washington, D.C., March 1994, p. 11.

[32] This is, in fact, the main reason why banks hold equity. Holdings are seldom, if ever, traded since they are not regarded as investments for profit. See H.A. Garten, "Universal Banking and Financial Stability", in *Brooklyn Journal of International Law,* Vol. 19, No. 1, Brooklyn Law School, Brooklyn, NY, 1993, p. 177.

4.2 *Keiretsu*

"The sundry ways in which keiretsu operate ... make generalization rather treacherous."[33]

"Definitions of keiretsu do vary so widely that it is often difficult to say who is in and who is out."[34]

"Although defining the elements of these corporate groups is possible, identifying the existence of actual keiretsu is less easily accomplished."[35]

"It is important to keep in mind that group 'membership' is not clearly defined; there are no membership dues or cards."[36]

Given the importance attached -- especially by foreigners -- to the special relationships between *keiretsu* firms, there is a surprising lack of agreement regarding their identity, their role in the Japanese economy and the impact they have on domestic competition. There is much more agreement -- although still little empirical proof -- regarding their deleterious effects on the ability of international firms to compete in the Japanese market.[37]

---

[33] R.L. Lawrence, "Efficient or Exclusionist? The Import Behaviour of Japanese Corporate Groups", in *Brookings Papers on Economic Activity 1,* W.C. Brainard & G.L. Perry, eds. Brookings Institution, Washington, D.C., 1991, p. 313.

[34] G.R. Saxonhouse, "Comments and Discussion", in *Brookings Papers on Economic Activity, 1,* W.C. Brainard & G.L. Perry, eds. Brookings Institution, Washington, D.C., 1991, p. 333.

[35] E. Razin, *op. cit.,* p. 367.

[36] T. Hoshi, A. Kashyap and D. Scharfstein, "Corporate Structure, Liquidity, and Investment: Evidence From Japanese Industrial Groups", in *Quarterly Journal of Economics,* Vol. CVI, No. 1, MIT Press, Cambridge, MA, February 1991, p. 41.

[37] Although there is much more agreement, there is still no consensus, and the "proof" offered is generally anecdotal. See, for example, M.E. Kreinin, "How Closed is Japan's Market? Additional Evidence", in *The World Economy,* Vol. 11, No. 4, Basil Blackwell Publisher Ltd., Oxford, U.K., December 1988, pp. 529-42. Exceptions are derived estimates of the trade effects of *keiretsu* by R.L. Lawrence. See R.L. Lawrence, *op. cit.,* pp. 311-41; and R.L. Lawrence, "Imports in Japan: Closed Markets or Minds?", in *Brookings Papers on Economic Activity 2,* W.C. Brainard & G.L Perry, eds. Brookings Institution, Washington, D.C., 1987, pp. 517-48.

4.2.1 Vertical *Keiretsu*[38]

Vertical *keiretsu* are groups of companies engaged in activities that generate revenues from a principal product. The firms involved are usually suppliers of various component parts, such as in the automotive and electronics sectors. Both the central manufacturer and sub-contractor or distributor firms benefit from the stability of the relationships. The central manufacturer receives inputs of a certain quality and quantity, and its output is promoted and distributed in a consistent manner. Smaller sub-contractors and distributors benefit from managerial, financial and technological support from the larger firms and are guaranteed a reasonable long-term profit.

Banks are not directly related to vertical *keiretsu*. The dominant position is held by the principal manufacturer which also provides intra-*keiretsu* financing. The principal companies hold shares in their affiliates, but affiliates typically hold no shares in the central manufacturing companies.

4.2.2 Horizontal *Keiretsu*

Horizontal *keiretsu* are groups of companies engaged in a wide variety of seemingly unrelated business activities. Four of the six largest horizontal *keiretsu* are based on earlier *zaibatsu* (Mitsubishi, Sumitomo, Mitsui and Fuyo) and the other two (Dai-Ichi Kangyo and Sanwa) are centred around banks.[39] While companies in these six *keiretsu* make up only 10% of companies on the Tokyo Stock Exchange, more than half of the country's largest corporations are group members.[40] In the late 1980s, they collectively earned 18% of Japan's total net profits, made 17% of total sales, and employed about 5% of the labour force.[41]

---

[38] See E. Razin, *op. cit.*, pp. 373-9; and D. E. Westney, "Japanese Multinationals in North America", in *Multinationals in North America,* L. Eden, ed. The Industry Canada Research Series, University of Calgary Press, Calgary, 1994, pp. 263-7.

[39] In fact, all horizontal *keiretsu*, including those which evolved from *zaibatsu* relationships, are centred around banks.

[40] See M. Anchordoguy, "A Brief History of *Keiretsu*", in *Harvard Business Review,* Vol. 68, No. 4, Boston, MA., July-August 1990, p. 58.

[41] See M. Anchordoguy, *op, cit.*, p. 58. Their dominance of certain sectors of the economy is greater than of others. They account for 40% to 55% of total sales in the natural resources, primary metal, industrial machinery, chemical and cement industries. See T. Hoshi, A Kashyap and D. Scharfstein, *op. cit.*, p. 37.

There are financial, managerial and operational links between horizontal *keiretsu* firms. In addition, presidents of the major member firms meet regularly, although the importance of such meetings, as measured by the amount of business conducted at them, is subject to some debate.[42]

- Financial Links

Financial links within horizontal *keiretsu* include both debt and equity financing. Banks provide most of the debt financing in the form of loans, while manufacturing and international trading firms provide trade credits to other *keiretsu* firms. From the point of view of the firm providing the financing (usually a commercial bank), such arrangements provide it with extensive input into the operations of the financed firms. From the point of view of the financed firm, there is a tax advantage associated with borrowing, since interest expenses are deductible from gross revenue, and thus reduce the amount of tax payable. Dividends on equity issues are paid out of after-tax income.[43]

In addition to the tax advantage, a number of other incentives have favoured debt over equity financing in Japan. The incentives have been based on corporate ownership structures and institutional financial arrangements, and include the reduced cost of financial distress and reduced agency costs.[44] As a result, Japanese firms typically have been more highly leveraged than U.S. firms.[45] Moreover, the borrowing of Japanese firms has been more concentrated, especially for *keiretsu* members.[46]

---

[42] See E. Razin, *op. cit.* pp. 371-2. The meetings are generally held in secret, and are regarded by some participants as little more than social gatherings.

[43] The tax system also favours debt over equity in North America.

[44] See W.C. Kester, *op. cit.*, pp. 5-9; and A.B. Frankel and J.D. Montgomery, "Financial Structure: An International Perspective", in *Brookings Papers on Economic Activity, 1*, W.C. Brainard & G.L. Perry, eds. Brookings Institution, Washington, D.C., 1991, pp. 287-91.

[45] For summary statistics on debt/equity ratios for a sample of 344 Japanese firms and 452 U.S. firms, see W.C. Kester, *op. cit.*, p. 11. Using book value equity, the average Japanese debt/equity ratio was 1.91, and the average U.S. debt/equity ratio was 0.58. Using market value equity, the average Japanese debt/equity ratio was 0.98, and the average U.S. debt/equity ratio was 0.69.

[46] See S.B. Kim, "The Use of Equity Positions by Banks: The Japanese Evidence", in *Economic Review*, No. 4, Federal Reserve Bank of San Francisco, San Francisco, CA, Fall 1991. p. 44. Kim claims one of the objectives of Japanese authorities in the 1970s was to make industrial financing the almost exclusive preserve of Japan's financial institutions, and to limit their number by strict entry

Over the course of the 1980s, however, there was a shift from Japanese firms relying almost exclusively on financial institutions to more market-based, North American style financing. In the late 1980s, for example, convertible bonds appeared to be a particularly attractive, and low-cost, mechanism for raising funds in Japan.[47] In 1988 and 1989, Japanese companies raised nearly 15 trillion yen through domestic convertible bonds.[48] From the issuer's point of view, convertible bonds allow access to cheap capital since they normally offer a lower yield to compensate for the conversion privilege. They appealed to buyers because the Japanese stock market was continuously appreciating, and the options to convert usually became profitable.

It has been suggested that, since the banks provide long-term debt financing in order to ensure the commercial viability of *keiretsu* affiliates over extended periods of time, their relationships more closely resemble those of equity holders than creditors.[49] To some degree, this would account for the control Japanese banks seem to enjoy in excess of that which would normally be associated with their level of shareholdings, which are limited to 5% (any given bank in any given non-financial firm).

The close relationship *keiretsu* firms have with creditors is cemented by the equity that creditors hold.[50] Prowse found that in his sample of 85 *keiretsu* firms, the largest creditor was also the largest shareholder in 55 cases.[51] They held an average of 21.9% of the firm's debt and 6% of the firm's equity.

---

control.

[47] See K. Otaki, "The Changing Role of Japanese Banks", in *Japanese Finance in Transition: Implications for Canada,* The Canada-Japan Trade Council, Ottawa, May 1993, p. 21. A convertible bond provides the holder with an option to exchange the bond for a specific number of shares of common stock of the firm.

[48] See "Corporate Japan Reins In Its Costs", in *AsiaMoney and Finance,* Euromoney Publications, London, February 1993, p. 53.

[49] See E. Razin, *op. cit.*, p. 371. Actually, the debt issued by Japanese banks is typically short term, in the form of promissory notes with maturities of 90 to 120 days. The notes are continually rolled over for years. See W.C. Kester, *op. cit.*, p. 7.

[50] For a discussion of the efficiency gains from issuing debt and equity to a single investor, see S.B. Kim, *op. cit.*, pp. 41-9.

[51] S.D. Prowse, *op. cit.*, p. 1128.

For commercial banks, their direct equity holdings in particular firms are typically quite small. There is no evidence to suggest that banks are breaking the 5% rule. The relationships banks have with other *keiretsu* firms are based on high debt/equity ratios, interlocking directorates and close inter-corporate operational links.

In *keiretsu*, it is unusual for more than 10% of any firm's outstanding shares to be owned by another single firm.[52] Normally, member firms purchase between 2% and 5% of each other's shares.[53] In total, cross shareholding (also known as mutual shareholding, or inter-corporate shareholding) accounts for 15% to 30% of member companies' stock.[54] In addition to cross shareholding, companies enter into "stable shareholding" agreements with other large institutions. The result is that 60% to 80% of *keiretsu* company shares are never traded.[55]

In the theory of the firm, whenever there is a separation between ownership and management, there is a potential "principal-agent problem" in which the interests of the principals (shareholders) and agents (managers) differ. Owners are interested in profitability, whereas managers can get sidetracked, focusing instead on such concerns as maximizing market share or enlarging the firm. It has been argued that the close relationships between Japanese banks and non-financial firms, which are characterized by cross shareholdings that are rarely traded and high levels of corporate debt, can reduce the incidence of the principal-agent problem.[56] Banks, acting as principals, closely monitor the activities of related firms and, by extending loans to

[52] See E. Razin, *op. cit.*, p. 370.

[53] See M. Anchordoguy, *op. cit.*, p. 58.

[54] See M. Anchordoguy, *op. cit.*, p. 59; R.L. Carson, *op. cit.*, p. 453; and R.L. Lawrence, "Efficient or Exclusionist? The Import Behaviour of Japanese Corporate Groups", in *Brookings Papers on Economic Activity 1,* W.C. Brainard & G.L. Perry, eds. Brookings Institution, Washington, D.C., 1991, p. 312.

[55] See M. Anchordoguy, *op. cit.*, p. 59. A Canadian study indicates that only 5% of the stocks traded on the Toronto Stock Exchange could be characterized as widely traded, 35% are moderately traded and 60% are infrequently or thinly traded. See R.J. Daniels and J.G. MacIntosh, "Toward a Distinctive Canadian Corporate Law Regime", in *Osgoode Hall Law Journal,* Vol. 29, No. 4, Osgoode Hall Law School of York University, Downsview, Ontario, Winter 1991, p. 877.

[56] By holding both debt and equity, Japanese banks are well placed to monitor affiliated firms and ensure that their own interests, as owners, are served. See S. Prowse, *op. cit.*, pp. 1128-9.

them, implicitly approve of their management techniques and decisions. This signals to other principals that their agents are operating in the owners' best interests.[57]

- Patient Capital

The financial relationships between *keiretsu* firms, and the central roles of commercial banks within *keiretsu*, beg the question as to whether Japanese firms have access to cheaper, longer-term capital, known as patient capital, and, if so, whether that access confers an international trading advantage. The absence of concern about corporate take-overs due to the lack of available shares, the long-term relationships between banks and other members of *keiretsu*, and the reliance of Japanese firms on banks for financing have led some analysts to conclude that capital is indeed cheaper, and easier to access for longer time periods, in Japan.[58]

There is little debate as to whether Japanese firms have access to long-term capital. It is thought that the availability of long-term bank debt financing allows Japanese corporations a longer planning horizon.[59] This is due to the certainty of interest payments, and less pressure from shareholders to maximize profits -- and ultimately shareholders' returns -- in the short term.

One advantage of the longer planning horizon associated with the reliance on bank debt and stable shareholders is that Japanese firms are able to distribute less income as dividends and retain more for reinvestment.[60] In addition, there is a tax benefit to retaining earnings, since capital gains from the eventual sale of securities

[57] The belief that cross shareholding is related to making managers more accountable to owners is not universally held. Some analysts feel that cross shareholding is only a means to cement mutually beneficial long term business relationships. See "Corporate Governance Survey", in *The Economist,* London, January 29, 1994, p.11.

[58] For a review of five separate studies that suggest the cost of capital in Japan is cheaper than in the U.S. (by anywhere from 1.6% to 6.7%), see W.C. Kester and T.A. Luehrman, "The Myth of Japan's Low-Cost Capital", in *Harvard Business Review,* Vol. 70, No. 3, Boston, MA, May-June 1992, p. 133.

[59] See E. Razin, *op. cit.*, p. 366. See also M. Porter "Capital Disadvantage: America's Failing Capital Investment System", in *Harvard Business Review,* Vol. 70, No. 5, Boston, MA., September-October 1992, pp. 65-82.

[60] See E. Razin, *op. cit.*, p. 360. Dividend yields in Japan averaged 18.2% between 1970 and 1991, and 24.5% in North America over the same period. See R. W. Wright, *Japanese Finance in Transformation: Implications for Canada,* The Canada-Japan Trade Council, Ottawa, 1994, p. 9.

are tax free. By retaining earnings, the value of a company's shares should rise. In effect, retained earnings delay shareholder income and provide it in a tax-free form.

Although it is generally agreed that Japanese firms have had access to long-term capital, there is much more debate on whether they have had access to relatively cheap capital.[61] A study by Kester and Luehrman casts considerable doubt on the conventional wisdom that Japan's high domestic savings rate and activist government policies have ensured a low corporate cost of capital.[62]

Kester and Luehrman point out a number of flaws in other cost of capital studies. These include: problems in matching data sources, as AA rated debt in the U.S. and AA rated debt in Japan are quite different; the general failure to control for different risk; and the failure to recognize different accounting practices in Japan and the U.S.. Kester and Luehrman cite studies that adjust their findings to account for each of the flaws. In every study, the cost of capital advantage that Japan was thought to enjoy disappears. Kester and Luehrman then correct for all the other studies' oversights and determine that: "We can find no compelling statistical evidence that, on average, the United States and Japan currently have different costs of capital."[63]

4.2.3 Is the Horizontal *Keiretsu* Fading?

Several developments in the Japanese and international economies over the past decade or so have led to a weakening in the degree to which *keiretsu* firms are linked, particularly with commercial banks. The developments in Japan include regulatory changes as well as attitudinal changes within business management circles. The international developments centre on the integration of capital markets and the movement of Japanese firms to seek cheaper capital abroad.

One measure of the linkages between banks and other *keiretsu* members is the composition of bank lending. Throughout the 1970s, and even more so in the 1980s, the proportion of bank lending to manufacturing declined and lending to real estate,

---

[61] Most studies compare Japan's cost of capital relative to that of the U.S..

[62] W.C. Kester and T.A. Luehrman, "The Myth of Japan's Low-Cost Capital", in *Harvard Business Review,* Vol. 70, No. 3, Boston, MA, May-June 1992, pp. 130-8.

[63] W.C. Kester and T.A. Luehrman, *op. cit.*, p. 134.

construction and the other services rose.[64] Small and medium-sized enterprises displaced large firms (normally fellow *keiretsu* members with the banks) as the primary customers for bank loans.

One of the factors contributing to the decline of large manufacturing enterprises' share of bank lending was the increased supply of government bonds in the 1970s, and the pressure that caused within Japan to liberalize interest rates on deposits. Depositors had the option of holding higher yielding government securities, so banks had to compete for funds. The banks experienced a decline in net interest margins and shifted lending away from larger customers towards smaller ones, where margins are usually higher.

Since the long-term banking relationships that existed in *keiretsu* were partially due to a lack of efficient alternatives for firms seeking capital, the maturing of domestic capital markets and the fact that many larger Japanese companies have become more global in their operations, have caused firms to rely more on domestic securities markets and international capital markets for funds.[65] Large manufacturing firms relied on banks for 38.4% of their financing in 1975; by 1989, that was down to 25.2%.[66]

[64] In 1980, 32.6% of bank lending went to manufacturing and 32.5% went to small business. By 1992, 13.2% went to manufacturing and 50.4% went to small business. See International Monetary Fund, *op. cit.*, p. 10. Lending to the non-traditional sectors has grown along with their overall importance to the economy. The share that the six largest *keiretsu* command of Japan's total assets and net income has fallen in recent years, partly because *keiretsu* firms have less impact on new service-oriented industries. See E. Razin, *op. cit.*, p. 369.

[65] An indication of the move away from bank debt is the fall in average Japanese debt/equity ratios in the late 1980s. See W.C. Kester and T.A. Luehman, *op. cit.*, p. 132. They quote one study that estimates debt/equity ratios fell by 50% between 1985 and 1989. A similar process has also been underway in the U.S., where commercial banks' share of the assets of all financial institutions has been steadily declining for the last 40 years. See G.G. Kaufman and L.R. Mote, "Is Banking a Declining Industry? A Historical Perspective", in *Economic Perspectives*, Federal Reserve Bank of Chicago, Chicago, IL, May/June 1994, pp. 2-19; and "International Banking Survey", in *The Economist*, London, April 30, 1994, p. 11.

[66] See R.W. Wright, *op. cit.*, p. 11.

In the 1980s, Japanese borrowers turned increasingly to the Euromarkets for long-term funding.[67] Once the Foreign Exchange Control Law was relaxed in 1980, the total funds raised by Japanese firms in overseas markets rose from an average of 560 billion yen per year between 1975 and 1979 to 1.4 trillion yen in 1981. Overseas securities represented less than 20% of all securities issued by Japanese firms prior to 1980, and nearly 50% of new issues by 1985. Most of the funds raised abroad were used to repay domestic borrowings, indicating cheaper capital was available outside Japan to some Japanese borrowers.

Aside from the interest rate regulation changes and the emergence of alternative sources of funds, it appears that Japanese manufacturing enterprises are moving away from traditional banking relationships as a means of reducing bank control over their operations.[68] Japanese managers are avoiding debt financing in order to escape the close scrutiny of lenders, the direct involvement of lenders in enterprise decisions and the insertion of bank officers in enterprise management. Some companies in high technology industries such as electronics, pharmaceuticals and communications equipment have gone so far as to refuse bank nominees for their boards of directors.

Banks, meanwhile, are becoming increasingly concerned about the cost of maintaining large shareholding interests in certain customers. Some firms are thought to spend several hundred million dollars annually in order to preserve their current shareholding levels.[69]

It is not only the relationships between banks and other *keiretsu* members that are changing. According to Merrill Lynch, a U.S. investment bank, the cross shareholding ratio of all stocks listed on the Tokyo exchange has fallen to 54.6%, down from its peak of near 57% in 1990.[70]

---

[67] See T.F. Cargill and G.F.W. Todd, *op. cit.*, p. 48; and W.C. Kester and T.A. Luehrman *op. cit.*, p. 132.

[68] See W.C. Kester, *op. cit.*, pp. 13-5.

[69] See T. Myerson, "Barriers to Trade in Japan: The *Keiretsu* System -- Problems and Prospects", in *New York University Journal of International Law and Politics*, Vol. 24, No. 3, New York University School of Law, New York, NY, Spring 1992, p. 1110.

[70] See "Asian Equity Guide", supplement to *AsiaMoney and Finance*, Euromoney Publications, London, March 1994, p. 27.

4.3 Trade Implications for Foreign Firms

Despite the recent changes that appear to have weakened traditional *keiretsu* links, they still exist and must be considered when analyzing the ability of foreign firms to compete in Japanese markets. The relationships that *keiretsu* foster are long-term alliances that foreign firms must deal with when conducting business in Japan, or competing with Japanese firms in third countries. Such long-term thinking and planning is often quite different from what foreign firms are used to, and has a number of competitive implications.

- Probably the most widespread complaint against Japan is that the long-term, well established relationships that exist between domestic firms leave little opportunity for foreign firms to penetrate the market.[71] Supplying a similar product at a lower price, or a better quality product at a similar price, will not ensure market access in an environment where steady, familiar business relationships are so highly valued.

- "*One of the tenets of the theory of the international flow of capital is that if an entrepreneur cannot sell his merchandise in a particular country, then he can purchase a company there. However, in the case of Japan not only is it difficult to sell foreign merchandise, it is impossible to buy out a corporation.*"[72] With 60% to 80% of keiretsu company shares never traded, it is unrealistic for foreign firms to consider "buying into" the Japanese intra-corporate network as a means of circumventing its exclusionary practices.

- The ability of Japanese firms to focus more on long term stability and less on quarterly or annual profit figures is a luxury most North American firms do not have.[73] Patient capital, in the form of long-term bank debt and cross shareholding, allows Japanese firms to make decisions that will (presumably) be profitable in the long term, even if it means lower profits in the short term. While there are clearly some advantages to being able to invest for the long term, one must be careful not to overstate them. To consider access to patient

[71] See, for example, O. Hiroshi, "Corporate Capitalism: Cracks in the System", in *Japan Quarterly*, Vol. XXXIX, No. 1, Asahi Shimbun Publishing, Tokyo, January-March 1992, p. 58.

[72] O. Hiroshi, *op. cit.*, p. 58.

[73] Indeed, many Japanese firms might no longer have that luxury either. After four years of declining profits, many Japanese companies will need to restructure, cut costs and emphasize profits over market share to ensure survival. See R.W. Wright, *op. cit.*, p. 26.

capital a competitive advantage, we must accept that long term planning is eventually more profitable than summing up quarterly or annual profits that are maximized continuously. There is some evidence that indicates *keiretsu* firms are in fact less profitable than non-*keiretsu* firms in Japan.[74]

- Extensive cross shareholding may limit the speed at which Japanese firms can adapt to changing market conditions, since there are many stakeholders that can potentially influence corporate decision making. Shifting consumer tastes, for example, might not be satisfied as quickly in Japan as in other countries. To the extent that foreign firms are accustomed to acting more quickly than Japanese firms, foreigners have an advantage.[75]

- The argument that the close relationship between financial institutions and non-financial firms has resulted in Japanese firms having access to cheaper capital than those in North America is yet to be settled. If Japanese firms did have an advantage at one time, the internationalization of capital markets and liberalization within Japanese markets have reduced that advantage.

- While the average cost of capital might not be much different in Japan and North America, some analysts suggest that *keiretsu* firms have a lower cost of capital due to unofficial guarantees of financial stability provided by member banks. The guarantees can influence the purchasing patterns of member firms, and effectively exclude non-member, and foreign, firms.[76]

In summary, the extensive linkages between financial institutions and non-financial firms do not explicitly exclude foreign firms from specific Japanese markets. Further, it is not even clear whether the two most often cited advantages of the linkages -- access to cheaper capital and the ability to plan and invest for the long term -- are in fact true in the first case and an advantage in the second case, and thus

[74] See M. Anchordoguy, *op. cit.*, p. 59; and D. Beason, "Are *Keiretsu* Economically Relevant?", in *Business and the Contemporary World*, Vol. IV, No. 2, Bentley College, Waltham, MA, Winter 1992, p. 36.

[75] This is consistent with the view that the Japanese economy is producer-oriented and the North American economies are consumer-oriented. See U.S. Congress, Office of Technology Assessments, *op. cit.*, pp. 139-40.

[76] See U.S. Department of the Treasury, *National Treatment Study*, Washington, D.C., 1990, p. 220.

imply anything very revolutionary about the international competitiveness of Japanese firms.

That is not to suggest, however, that the relationships between financial institutions and non-financial firms have no impact on international trade. The underlying bias that favours dealing with (or owning, or being owned by) familiar (or related, in the *keiretsu* sense) business contacts, including financial institutions, can effectively exclude foreign firms. Although this bias is likely found, at least to some degree, in all countries, attention focuses on Japan because of the extent of the close-knit relationships, and the value placed on them by the domestic business community.

It has been pointed out that the influence of *keiretsu* relationships is probably in decline. If that is in fact the case, it is likely to be a long, slow process whereby some Japanese firms only reluctantly turn to international markets and suppliers. As such, any positive effects that the decline of *keiretsu* might have on trade, particularly in industries such as traditional manufacturing which have been dominated by *keiretsu*, will be small, but slowly growing.

5. The Treatment of Foreign Financial Institutions in Japan

Given that there are special relationships between financial institutions and non-financial firms in Japan, it is important to determine whether those relationships are restricted, tacitly or otherwise, to include only domestic financial institutions. In determining whether the relationships are restricted, one must look at the treatment of foreign financial institutions in Japan. To the extent that foreign financial institutions are treated differently, there might be a role for trade policy in identifying and reducing or eliminating any barriers that prevent them from fully participating as equal entities in the Japanese financial system.

The financial reform process in Japan dates back to the 1970s. In response to developments in both the Japanese and international markets, interest rate regulations covering deposits have been slowly eliminated, the allowed business activities of financial institutions have been broadened and a number of other regulations have either evolved or disappeared.[77]

[77] The reform process is termed "financial liberalization" in Japan and "deregulation" in the U.S.. For a discussion of Japanese financial liberalization, see Y. Suzuki, "Financial Restructuring: The Japanese Experience", in *Restructuring the Financial System,* A Symposium Sponsored by the Federal Reserve Bank of Kansas City, Jackson Hole, Wyoming, August 20-22, 1987, pp. 105-14; and J.R. Brown, "Japanese Banking Reform and the Occupation Legacy: Decompartmentalization, Deregulation,

Despite the reforms to date, foreign institutions have raised a number of concerns regarding their ability to compete in the Japanese market, including:

- reciprocal entry requirements;
- a general lack of transparency;
- delays in the regulatory approval of new financial products;
- disproportionally high tax rates placed on new financial products that discourage their introduction;
- government protection of incumbents in specific market segments, blocking entry of other domestic and foreign firms;
- tightly compartmentalized markets, blocking entry of firms whose specialty is outside particular market segments;
- conditional entry requirements to ensure foreign firms are not able to service the market or compete effectively in it; and
- the application of regulation is often on a case-by-case basis with authorities.[78]

While there are a number of foreign financial institutions in Japan -- including commercial banks, trust banks, securities companies, insurance companies, investment trusts, investment advisory firms and pension fund managers -- this Paper will focus on commercial banks and insurance companies.

---

and Decentralization", in *Denver Journal of International Law and Policy*, Vol. 21, No. 2, University of Denver, Denver, CO, Winter 1993, pp. 361-99.

[78] See T. Papailiadis, *The Canadian and Japanese Financial Services Industries*, The Conference Board of Canada, Report 46-89-DF, Ottawa, October 1989, p. 1; B.W. Semkow, "Foreign Financial Institutions in Japan", in *Law Policy in International Business*, Vol. 23, No. 2, Georgetown University Law Center, Washington, D.C., 1991-92, p. 334; and C.F. Bergsten and M. Noland, *op. cit.*, p. 169.

5.1 Commercial Banks

Domestic and foreign commercial banks in Japan are regulated by the Ministry of Finance under the "New" Banking Law of 1981 (NBL).[79] The core business of banking is defined to include the acceptance of deposits, the making of loans and the performance of exchange transactions. In addition, the NBL lists a number of ancillary businesses that banks may engage in, including: buying and selling securities, although this is limited to transactions made on the bank's own account and those upon customers' written orders; lending securities; underwriting government bonds and government guaranteed debentures; acting as an agent for other banks and for those engaging in financial business; and foreign exchange.[80]

The entry of foreign banks into Japan is subject to reciprocal treatment of Japanese banks in foreign markets.[81] Once foreign banks are granted a licence, the NBL (Article 4) grants them formal parity with domestic banks under a national treatment standard. Foreign banks are allowed to engage in the same businesses as domestic banks, and the NBL makes no distinction with respect to branch expansions, bank acquisitions or funding.

When the NBL was implemented, there were some instances in which the treatment of foreign banks was better than national treatment. The national treatment plus included: a five-year exemption from new prudential lending limits applied to domestic banks; more generous certificate of deposit issuance limits; no strict capital/asset limits; and continued exemption from government bond underwriting requirements.[82]

As is typical in most markets, foreign banks in Japan have focused on wholesale banking, investment banking such as money market activities, other types of corporate financing and foreign exchange. Usually, foreign banks are unable to compete with domestic retail networks, and generally refrain from attempting to do

[79] Law Number 59 of 1981.

[80] Banks can engage in a number of other business activities as well. See B.W. Semkow, *op. cit.*, p. 340.

[81] See H. Moudi, "The State of U.S. Banking in the Global Arena", in *Boston University International Law Journal,* Vol. 10, No. 2, Boston University School of Law, Boston, MA, Fall 1992, p. 283.

[82] See B.W. Semkow, *op. cit.*, p. 347.

so except through some limited mergers or acquisitions in which already existing retail networks are taken over.[83] There has been no interest on the part of foreign banks in establishing retail banking networks in Japan.[84] As of March 1989, Japan's city and regional banks together had over 15,000 branches.[85]

Until the financial reform law was passed by the Diet in June 1992, Japanese commercial banks had limited securities powers beyond underwriting and trading in government securities.[86] Foreign banks, which had pushed for reciprocal access rather than national treatment, had more extensive business powers with respect to securities. Licences were granted for foreign firms to underwrite, distribute, trade and broker debt and equity securities, as long as they conducted similar business in their home countries or elsewhere. Article 65 of the Securities and Exchange Law, which prohibits Japanese commercial banks from becoming engaged in investment banking, was only partially dismantled in the 1992 reform. There remain a number of barriers between banking and securities activities, and the impact of the changes will be staggered over several years.[87]

In addition to the written laws that govern Japan's banking sector, the Ministry of Finance has other means to oversee the business of banking, including cabinet orders (*seirei*), ministerial orders (*shorei*), subsidiary regulations (*kisoku*), circulars (*tsutatsu*) and directives (*kunrei*).[88] There are also important oral directives, known as "administrative guidance" (*gyosei-shido*), issued during consultations between

[83] See OECD, *Banks Under Stress*, Paris, 1992, p. 118. An example of international bank expansion by the acquisition of an already existing retail network is the Bank of Montreal purchase of Harris Bankcorp. Bank of Montreal plans to aggressively expand Harris' retail banking and small-business banking operations in Chicago and throughout the Midwest.

[84] See B.W. Semkow, *op. cit.*, p. 355.

[85] By comparison, Royal Bank of Canada, the country's largest, has about 1,700 branches.

[86] The 1992 reform law is known as the Law Concerning the Realignment of Relevant Laws for the Reform of the Financial System and the Securities Trading System, Law Number 87 of 1992.

[87] See T.F. Cargill and G.F.W. Todd, *op. cit.*, p. 49.

[88] See B.W. Semkow, *op. cit.*, p. 340.

regulatory authorities and the banks.[89] Administrative guidance is a form of moral suasion that carries no official penalties for non-compliance, but can result in the withholding of regulators' permission for a certain application, for example, in order to encourage a bank's compliance.[90] This practice allows the banking authorities "...significant flexibility to mold regulations to changing circumstances and to develop ad hoc solutions as problems arise, without giving particular concern for the precedential implications of the action."[91]

5.1.1 The Canadian Experience

Prior to the 1981 revision of Canada's Bank Act, Canadian banks only had representative offices in Japan. The 1981 revisions allowed foreign banks direct entry into Canada, and Japanese authorities subsequently allowed Canadian banks direct entry into Japan.[92] By 1987, the six largest Canadian banks had received branch status in Japan.[93]

Unfortunately, the collective experience of Canadian banks in Japan has not been good in terms of profitability.[94] They have faced two problems in generating spread-based business.[95] First, they have been unable to compete with Japanese

---

[89] See T.F. Cargill and G.F.W. Todd, *op. cit.*, p. 54; U.S. Department of Treasury, *op. cit.*, pp. 221-2; H. Moudi, *op. cit.*, p. 286; and General Accounting Office, *Deposit Insurance, Overview of Six Foreign Systems,* NSIAD-91-104, Washington D.C., February 1991, p. 27.

[90] Administrative guidance is not restricted to the banking sector. It has also been cited as an informal barrier to trade in petroleum products (by the Korean government) and textiles. See B. Balassa and M. Noland, *Japan in the World Economy*, Institute for International Economics, Washington, D.C., 1988, pp. 216-7; and E.J. Lincoln, *Japan's Unequal Trade*, The Brookings Institution, Washington, D.C., 1990, p. 15.

[91] T.F. Cargill and G.F.W. Todd, *op. cit.*, p. 54.

[92] See R.W. Wright and S. Huggett, *A Yen For Profit: Canadian Financial Institutions In Japan,* The Institute for Research on Public Policy, Halifax, Nova Scotia, 1987, p. 13.

[93] See T. Papailiadis, *op. cit.*, p. 1.

[94] The following discussion is based on R.W. Wright and S. Huggett, *op. cit.*, pp. 14-8.

[95] Spread-based business refers to the income banks receive from borrowing money at one interest rate (retail deposits, for example) and lending money at another, higher interest rate.

banks that have had access to large pools of low-cost deposit funds.[96] Canadian banks must turn to the money markets to acquire funds, at substantially higher cost. Second, the largest Japanese companies -- the ones Canadian banks would most like to lend to, given their stability -- have either not required much bank funding or have traditionally turned to their *keiretsu* banks.[97] Canadian banks have developed some Japanese corporate clients, but they are "second-tier" companies, not affiliated with an industrial group. The risk attached to such loans is somewhat higher.

Much of the Canadian bank lending has been by referral from major Japanese banks. Typically, the spreads on such loans are low, and the Japanese bank providing the referral expects the favour returned by the Canadian bank for business in Canada or elsewhere.

5.2 Insurance Companies

Foreign life and non-life insurance companies command very small shares of the Japanese market.[98] While the Insurance Business Law of 1939 and the Law Concerning Foreign Insurers of 1949 present no discriminatory barriers (beyond a requirement that foreign insurers only sell products already sold elsewhere) to foreign insurance companies, there are a number other obstacles that impede their growth.[99]

According to Semkow, the cartel-like structure of the Japanese insurance market has eliminated price competition, with both insurance premiums and dividends subject to agreements between firms.[100] With little price or quality competition,

---

[96] The deregulation of interest rates in Japan has alleviated this problem somewhat. As deposit interest rates have risen, the implicit subsidy to Japanese banks (in the form of cheap sources of funds) has disappeared.

[97] An argument could be made that any bank entering a new foreign market, including the Canadian market, would face this problem of not having access to the most preferred corporate clients. Indeed, there are relationships between Canadian firms and Canadian banks, but they are not nearly as strong in practice as those in Japan.

[98] In 1990, foreign life insurance companies received 2.0% of premium income. Non-life insurance companies received 3.6% of premium income. See B.W. Semkow, *op. cit.*, p. 384.

[99] The Insurance Business Law of 1939 is Law Number 41 of 1939. The Law Concerning Foreign Insurers of 1949 is Law Number 184 of 1949.

[100] See B.W. Semkow, *op. cit.*, p. 387.

insurers compete with large, aggressive sales forces. The inability of foreign firms to market and distribute their products as effectively as the well staffed Japanese firms has caused foreign firms to improvise, sometimes selling products in department stores or with other services.

The approval process for new insurance products is an area of concern to foreign firms. The Ministry of Finance and the Life Insurance Association of Japan take up to four years to review a new product, during which time competing firms are free to develop similar products. Once a new product is finally introduced to the market, the competitive advantage of the firm that originally developed it is gone. A concern of U.S. insurers is the considerable influence insurance councils and industry associations have over what new products are introduced. There has been little foreign participation in the councils and associations.

A comprehensive insurance system reform bill is to be submitted to the Diet in 1995. Bilateral talks on insurance have been going on between the U.S. and Japan since last year, with the U.S. hoping to influence the Japanese regulatory review. Issues the U.S. has pressed for include: liberalization of the life and non-life insurance markets in addition to the "third area" liberalization proposed by Japan, which includes personal accident and disability insurance already penetrated by U.S. firms; commitments from the Japanese government to increase procurement of foreign insurance; a lifting of the restrictions that prevent life insurance companies from offering non-life policies, and vice-versa; and a more transparent Ministry of Finance procedure for reviewing licence applications.[101]

Early indications are that at least some of the concerns raised by foreign insurance companies will be addressed by the new regulations. A "developer's benefit" will be granted in order to encourage the development of new products, licencing procedures are to be shortened and made more transparent, and the government will consult foreign firms regarding the reform process.

---

[101] See *Inside U.S. Trade,* Inside Washington Publications, Washington, D.C., April 23, 1993, pp. 17-8, July 23, 1993, p. 8; and U.S. International Trade Commission, "U.S.-Japan Relations After the Summit", in *International Economic Review,* U.S. International Trade Commission, Washington, D.C., April 1994, p. 21.

5.3 Trade Implications for Foreign Financial Institutions

For banking and insurance, along with a number of other services such as advertising, engineering and legal services, it is difficult, and sometimes impossible, to deliver the service through cross-border trade. It is usually necessary to provide the service directly to the customer. Thus, such services tend to be delivered by direct investment enterprises (following the national laws and customs of their country of location), rather than by cross-border transactions.[102]

The necessity of establishing a foreign presence to facilitate the trade of commercial banking and insurance services raises three issues related to the effects on trade of Japanese commercial bank and insurance regulations. First is the right of foreign firms to establish enterprises in Japan; second is the domestic regulatory treatment of foreign firms; and third is the local customs of business enterprises.

- Right of Establishment

As mentioned above, foreign banks are able to establish branches, subsidiaries or representative offices in Japan based on reciprocal treatment of Japanese banks in the foreign banks' home countries. Beyond the requirement of reciprocity, there is no formal means to block the entry of foreign banks, but there is a licencing procedure to establish each new branch that has been cited as time consuming.[103] According to the U.S. Department of Treasury, Japanese authorities have made efforts to expedite this process.

Foreign life insurance companies face no discriminatory treatment under Japanese insurance laws concerning their right to establish a local presence.

- The Domestic Regulatory Environment

There are no regulations that specifically limit the operations of foreign banks in Japan. In fact, as was outlined above, there are several areas in which foreign banks receive better than national treatment, and operate outside the regulatory

[102] See J.S. Landefeld, O.G. Whichard, and J.H. Lowe, "Alternative Frameworks for U.S. International Transactions", in *Survey of Current Business,* Vol. 73, No. 12, U.S. Department of Commerce, Bureau of Economic Analysis, Washington, D.C., December 1993, p. 52.

[103] See U.S. Department of the Treasury, *op. cit.*, p. 217.

constraints faced by domestic banks. Even though there is no regulatory discrimination against foreign banks, there are still a few practical difficulties.

One of the main problems foreign banks face with the Japanese regulatory environment is its lack of transparency. The use of administrative guidance as opposed to relying solely on clearly established, well written banking laws leaves foreign banks at a distinct disadvantage. As the U.S. Treasury points out: "...foreign firms...are both less familiar with the unique Japanese environment and more used to dealing with a clear set of written regulations."[104] The "unique Japanese environment" refers to how widespread both the use and acceptance of administrative guidance is as a regulatory tool. Its ad hoc nature implies that potentially unpredictable changes in regulations or their interpretation can occur at any time.

Another problem foreign banks face is a lack of equal access to Bank of Japan credit facilities.[105] Although this was to have been resolved with an announced increase in the Bank's lending quotas to foreign banks in 1990, there are still complaints that the system favours domestic banks. Equal access to Bank of Japan credit is important since its loans are made at the discount rate, which is below the market rate.

The extent to which the 1995 reform bill will remove some of the regulatory obstacles that foreign insurance companies face remains unclear. So far, the cartel-like structure of the market has made it very difficult for foreign firms to gain market share in Japan.

- Local Customs

Banks and insurance companies face the same problem in Japan that other foreign enterprises do. Close inter-corporate links, especially between *keiretsu* firms, make it difficult to develop client bases, particularly with large, internationally active Japanese firms.[106]

---

[104] U.S. Department of Treasury, *op. cit.*, p. 221.

[105] See B.W. Semkow, *op. cit.*, p. 359; and U.S. Department of Treasury, *op. cit.*, p. 219.

[106] For an example of how one foreign bank provided new product information to a Japanese firm which then explained the product to its *keiretsu* bank and dismissed the foreign bank, see S. Haruo, "Japanese Capitalism: The Irony of Success", in *Japan Echo,* Vol. XIX, No. 2, Japan Echo Incorporated, Tokyo, Summer 1992, p. 20.

The same factors, however, that were mentioned earlier as contributing to the weakening of the *keiretsu*, could help foreign banks increase their market share.

- The emergence of small- and medium-sized firms and households as the primary bank customers puts foreign banks on a more equal footing with their domestic counterparts. With *keiretsu* firms no longer collectively the most important bank customers, foreign banks are no longer (informally) excluded from the largest segment of the market. Although foreign banks will face the usual international banking problems associated with attracting small business and retail clients -- namely, the lack of familiarity on both sides -- they are still in a better position now to compete with local banks.

- If, after four years of declining profits, part of the corporate Japanese restructuring exercises involves cutting costs associated with banking and finance, there will be an increase in the degree of competition in the banking market. Firms seeking better prices, better service, or both, will look beyond traditional *keiretsu* ties, perhaps to the benefit of foreign banks.

- The movement of Japanese firms to reduce the operational control banks once enjoyed implies that some firms will be seeking new relationships with new banks. One way for a Japanese firm to ensure that its new banking relationship does not evolve into one that is bank dominated, would be to develop ties with a bank that had never participated in the old-style practices. Again, this could present opportunities for foreign banks.

It is less clear whether weakened *keiretsu* relationships can solve one of the problems unique to foreign insurance companies. Not only do *keiretsu* corporations tend to buy their insurance from member firms, but so do their employees.[107] It is uncertain whether such purchases are based on a premium discount extended to *keiretsu* employees or employee loyalty to firms in the same *keiretsu*.

---

[107] See B.W. Semkow, *op. cit.*, p. 389.

6. Conclusions and Policy Implications

The tight relationships between financial institutions and non-financial firms in Japan are in keeping with the country's history of close inter-corporate linkages, formerly known as *zaibatsu*. The lack of domestic financial market development following World War II, along with certain government initiatives, solidified the relationships by fostering a corporate dependence on domestic financial institutions for capital.

There are generally two possible responses to a situation in which domestic firms interact with a foreign economy and encounter difficulties competing or capturing significant market share due to structural economic differences or differences in economic values or practices. Domestic firms can copy some of the practices of foreign firms, hoping to duplicate their success, or foreign firms can be pressed to adopt domestic practices. In both cases, there are potential policy implications.

6.1 *Keiretsu*

Presently, *keiretsu* relationships are a concern to virtually all foreign firms trying to participate in Japanese markets, except suppliers of certain primary commodities. The sectors of the economy that *keiretsu* have dominated, and continue to dominate, such as manufacturing, roughly coincide with those that encompass tradeable goods. Yet, as discussed earlier, *keiretsu* can also affect foreign firms in other sectors, including financial services.

6.1.1 Financial Versus Non-financial Industries

If, as certain evidence indicates, the role of *keiretsu* is slowly declining, the implications for foreign firms, and foreign trade policy makers, are changing. Since commercial banks are at the heart of horizontal *keiretsu*, and financial relationships seem to be the new weak link, the most immediate opportunities for foreign firms could be in financial services. Japanese firms are looking for cheaper financing alternatives and less corporate direction from creditors.

Given the changes that have already taken place, trade policy makers concerned about the effects of *keiretsu* should not be focused on "opening" the Japanese market further through formal financial sector regulatory reform for commercial banking. There are no regulations restricting the entry of foreign firms, no foreign firms have shown an interest in establishing a large-scale branching network, and the financial ties that bind *keiretsu* are loosening themselves. It remains to be seen, however, whether loosened *keiretsu* ties will result in Canadian banks being able to service "first-tier" as opposed to "second-tier" companies. To the extent that our banks are relegated to dealing with smaller and/or riskier firms, they face an implicit *keiretsu*-based trade barrier that effectively restricts their market access.

Despite the changes underway, it is likely that policy makers will still be strongly encouraged by some bankers to press for certain changes in Japan. At a conference on U.S.-Japan financial markets last year, William Rhodes, Vice Chairman, Citicorp-Citibank, spoke critically of the contrast in market shares held by U.S. banks in Japan and Japanese banks in the U.S.[108] Policy makers must be careful not to be too sympathetic to simple market share comparison arguments. Firms command different market shares in different countries for a multitude of reasons, only a limited number of which can, or should, be addressed by trade policy.[109]

With the move to loosen *keiretsu* being motivated by financial considerations, the relationships between other *keiretsu* members that are not based directly on financial interactions are likely to change more slowly. The tendency of *keiretsu* firms to purchase from, and sell to, other members will continue to affect foreign firms trying to enter the market.

Instead of financial service industries, the focus of trade policy with respect to *keiretsu* should be squarely and primarily on non-financial industries, although there is considerable debate on the best policy approach.[110] In the past, exchange rate

[108] Rhodes' remarks were captured in the conference summary, *Pressing Issues in U.S.- Japan Financial Markets*, Japan Society, New York, NY, October 21, 1993. He said that, as of March 1993, U.S. banks held less than 1% of Japanese banking assets, and Japanese banks held 12% of U.S. banking assets.

[109] In the banking industry, there can be indirect links between trade policy and market share, since the international expansion of domestic banks generally follows the pattern of outward foreign direct investment flows. It appears that Japanese banks in the U.S., however, have expanded their customer base beyond the affiliates of Japanese firms that are based in the U.S.. See R. Seth and A. Quijano, "Japanese Banks' Customers in the United States", in *Quarterly Review,* Vol. 16, No. 1, Federal Reserve Bank of New York, New York, NY, Spring 1991, pp. 79-82; and R. Seth and A. Quijano, *Growth in Japanese Lending and Direct Investment in the United States: Are They Related?* Federal Reserve Bank of New York Research Paper No. 9101, New York, NY, January 1991.

[110] While we suggest focusing trade policy with respect to *keiretsu* on non-financial industries, we recognize that financial institutions will probably also benefit from any changes that loosen inter-corporate ties in Japan. See, for example, the discussion above on Canadian banks' access to "first tier" versus "second tier" clients.

management has been tried, as have Japan-U.S. discussions on structural issues, sector-specific initiatives and quantitative indicators. Bergsten and Noland suggest a two-track structural and sectoral approach, with joint or parallel enforcement of national antitrust statutes concerning restrictive business practices, including *keiretsu*.[111] Others suggest that there is likely little to be gained from negotiating with Japan, and the U.S. should act unilaterally to restrict Japanese access to U.S. markets.[112] That way, the U.S. would have some leverage in calling for change in the functioning of the Japanese market.

6.1.2 Cross Shareholding Lessons

> *"Ironically, the achilles heel of the Japanese financial system has been the extensive cross-shareholding so often held up as the foundation of Japan's competitive edge."*[113]

The key to extracting appropriate lessons from a foreign economic system is to consider its entire experience, good and bad. When observing the Japanese experience, it is easy to be overwhelmed by impressive macroeconomic statistics. The mid to late 1980s was a period marked by strong economic growth, very little change in unit labour costs, low inflation, low unemployment, fiscal surpluses and low interest rates.[114] One must be careful, however, not to confuse correlation -- between a well performing economy and an economic system that allows extensive cross shareholding -- with causation. There are a number of problems with cross shareholding, particularly as it affects commercial banks. Some of the problems have only come to the fore with the end, or bursting, of the bubble economy.

One of the main concerns with respect to commercial banks in Japan holding equity in non-financial corporations is the variation those equity holdings can cause

---

[111] See C.F. Bergsten and M. Noland, *op. cit.*, pp. 210-3.

[112] See, for example, D. Salvatore, "How to Solve the U.S.-Japan Trade Problem", in *Challenge*, M.E. Sharpe Inc., New York, NY, January-February 1991, pp. 40-6.

[113] See R.W. Wright, *op. cit.*, p. 16.

[114] See OECD, *Economic Outlook* 54, Paris, December 1993, various tables.

in bank capital and the supply of loanable funds.[115] Rising stock markets increase the capital base of Japanese banks, and hence their supply of loanable funds. Similarly, falling stock markets decrease the supply of loanable funds. While the issue of bank ownership of commercial firms, and vice-versa, arises periodically, especially in the U.S., where the Japanese system is held up as a model by those who favour direct linkages between banking and commerce, the relationship between stock prices and bank capital tends to be ignored.[116] Anyone prescribing a closer banking-commerce link must carefully consider the effects on bank capital and loanable funds of movements in the stock market.

In addition, allowing banks to hold equity increases the risk that they bear, especially if their holdings are not well diversified.[117] The increased risk of bank failure is enhanced by the presence of a deposit insurance system. Even though Japan has never had a bank failure, bank equity links in other countries could lead to excessive risk taking, depending on the banks' abilities to manage their portfolios.[118]

A benefit attached to the corporate ownership structure and banking relationships in Japan is the reduced costs of financial distress.[119] For a firm experiencing financial difficulty, other companies within the *keiretsu* often assist

---

[115] See R.W. Wright, "Japanese Financial Flows to Canada", in *Japanese Finance in Transition: Implications for Canada,* The Canada-Japan Trade Council, Ottawa, 1993, pp. 36-7; Bank for International Settlements, *op. cit.*, p. 91; and S.B. Kim and R. Moreno, "Stock Prices and Bank Lending Behaviour in Japan", in *Economic Review,* No. 1, Federal Reserve Bank of San Francisco, San Francisco, CA, 1994, pp. 31-42.

[116] See, for example, R.J. Pozdena, "Why Banks Need Commercial Powers", in *Economic Review,* No. 3, Federal Reserve Bank of San Francisco, San Francisco CA, 1991, pp. 18-31; and L.J. Mester, "Banking and Commerce: A Dangerous Liaison?", in *Business Review,* Federal Reserve Bank of Philadelphia, Philadelphia, PA, May-June 1992, pp. 17-29.

[117] For a full discussion, see A.B. Frankel and J.D. Montgomery, *op. cit.*, pp. 293-4.

[118] Although Japan has never had a bank failure, bank regulators have overseen the transfer of deposits, including those exceeding the maximum coverage limit of deposit insurance, from failing banks to other banks. See H.S. Scott and S. Iwahara, *In Search of a Level Playing Field: The Implementation of the Basle Capital Accord in Japan and the United States,* Occasional Paper No. 46, Group of Thirty, Washington, D.C., 1994, p. 8.

[119] See, for example, W.C. Kester, *op. cit.*, p. 7; A.B. Frankel and J.D. Montgomery, *op. cit.*, p. 287; and J.B. Treece and K.L. Miller, "If the Japanese Were Running G.M.", in *Business Week,* McGraw-Hill Inc., New York, NY, January 27, 1992, p. 32.

through discriminatory pricing, stretching receivables and/or prompt cash payment of payables. A bank can facilitate a merger, arrange loans from other banks, or, in the case of bankruptcy, absorb all losses itself to avoid protracted negotiations among claimants.

There are at least two points of interest in relation to the appeal of the financial distress argument.

- The efficiency of the market is side-stepped by the continued support of firms whose operations should be terminated. Investing resources in unprofitable enterprises without questioning whether those resources could be better applied elsewhere inevitably leads to certain inefficiencies.
- The ability of foreign firms to compete in Japan is reduced by the support of inefficient Japanese firms. If unprofitable *keiretsu* members are carried financially by other members, there is little chance that foreign firms will be able to enter Japanese markets, since it is the weak firms that should be most prone to (international) competition.

The final problem with cross shareholding is the resulting increase in stock market volatility. It might seem that, with such a large percentage of Japanese shares held for the long term, stock prices would be relatively stable. That is not the case. With only about 30% of outstanding shares traded, small buying or selling pressures can result in large price variations.[120]

6.2 Setting the Agenda

In setting the agenda for future trade policy initiatives with Japan, one must keep in mind that there are formal trade barriers caused by legal or regulatory differences in the treatment of foreign and domestic firms, and informal trade barriers caused, for example, by established and accepted business practices that favour dealing with local enterprises. This Paper has identified several formal trade barriers -- such as the development and application of new regulations or the approval process for introducing new products -- that hinder foreign financial institutions' and non-financial firms' abilities to compete in Japan. The primary focus of the Paper, however, has been on the established relationships between Japanese financial

[120] See R.W. Wright, *Japanese Finance in Transformation: Implications for Canada,* The Canada-Japan Trade Council, Ottawa, 1994, p. 13.

institutions and non-financial firms, and their effects on international trade, which are based entirely on locally accepted business practices.

If, in addressing only the trade effects of inter-corporate relations, the goal of trade policy is to increase exports to Japan, it can either press for changes so that Japanese business practices more closely resemble our own, or encourage domestic firms to adapt to the Japanese way.

- Pressing the Japanese

The current U.S. approach to correcting its trade deficit with Japan, and to managing Japan-U.S. trade relations in general, is one that emphasizes the "measurability" of progress.[121] The U.S. wants to use a variety of quantitative indicators to determine whether Japanese markets are sufficiently open, or become sufficiently open over a predetermined period of time, to international competition. It is a sector-specific approach, the professed goal of which is to increase trading opportunities for all exporters to Japan.

From a Canadian (or any other third country) perspective, the primary concern with the U.S. proposal is that it could divert trade.[122] Bhagwati claims that it is nothing more than "export protectionism", working to guarantee U.S. firms a specific share of the Japanese market. In such an environment, Japan will have a powerful incentive to divert imports from other countries to the U.S. in order to meet U.S. market share goals. If the U.S. insists on such a quantitative strategy, and Japan concedes, the Canadian response should be to urge both sides to consider the market share held by all foreign firms as the appropriate measure of Japan's openness. That way, Japanese imports will not be diverted to the U.S..

A more fundamental problem with the U.S. approach is that it does not address the real issue -- that of different business practices and inter-corporate relations in Japan. The changes trade policy makers could press for in Japan so as to further loosen the current relationships between financial institutions and non-financial firms are only limited by the imagination, and could include: limiting the amount of debt

---

[121] The views of the Clinton administration are articulated in a recent article by Roger C. Altman, Deputy Secretary of the Treasury, in *Foreign Affairs*. See R.C. Altman, "Why Pressure Tokyo?", in *Foreign Affairs*, Vol. 73, No. 3, Council on Foreign Relations, New York, NY, May-June 1994, pp. 1-6. See also U.S. International Trade Commission, *op. cit.*, pp. 16-22.

[122] See J. Bhagwati, "Samurais No More", in *Foreign Affairs*, Vol. 73, No. 3, Council on Foreign Relations, New York, NY, May/June 1994, pp. 7-12.

financing Japanese firms can receive from local banks; stimulating stock market activity via some type of trading incentives; and/or raising the level of shares foreign banks can hold in non-financial firms.

While such changes might increase the equity shares foreign firms hold in Japanese firms, and thus create (at least on paper) relationships between foreign and Japanese firms that resemble the inter-corporate links already in place in Japan, they will not alter *keiretsu* practices or the tendencies of Japanese firms to deal with familiar business contacts. Holding equity in Japanese firms is not sufficient. Cross shareholding formalizes relationships that already exist, it does not create them. The suggestion that foreign firms can "buy into" closer inter-corporate relations with Japanese firms is mistaken.[123] The Japanese way is not to buy shares and then develop close business ties; rather, close business ties are cemented by cross shareholdings. Pressing Japan either to allow foreign participation in inter-corporate relationships through equity ties or to dismantle existing relationships will not, in and of itself, result in an increase in the market share held by foreign firms. The key for foreign firms is to develop their own mutually beneficial long-term business relationships with Japanese firms (with or without equity ties). Only in this context might new mechanisms to cement relationships (by encouraging, for example, greater equity trading) likely have an impact on trade flows over the medium or long term.

Where Japan can, and should, be immediately pressed with respect to inter-corporate relations is in the area of business associations. It is essential that foreign firms are as well informed about Japanese market developments and industry strategies as their domestic counterparts. The immediate Japanese response to such pressure would likely be that the associations are already open to both domestic and foreign firms. While that is largely correct, this Paper reports that foreign insurance companies are not well represented in the insurance associations, and the associations' power and influence are considerable. In terms of commercial banks, with the widespread use of administrative guidance, regulators' views, as well as bankers' responses, might be more clearly communicated to, and discussed within, the banking associations.

[123] One might reasonably argue, however, that the case of foreign commercial banks is a special one in which they should acquire an equity stake in potential business customers as an indication of their commitment to the customers and the Japanese market. At the same time, the equity holdings would allow foreign banks to closely monitor their debtors just as Japanese banks have done. The problems are that shares might not be available, or only be available at a high price, and it would need to be determined whether the original equity investment would generate enough business for this approach to be profitable.

If foreign firms are not entirely accepted in Japanese business associations, or are regarded as less than equal members, then the activities of the associations should be made public. Trade officials should insist on full public disclosure of the relationships between industry associations and government, including any formal or informal discussions or agreements, as well as association lobbying efforts. Membership lists need to be made public, and perhaps periodic reports should be made available detailing association activities. Opening up the associations, or at least publicizing their activities, will extend to foreign firms a clearer understanding of the issues affecting their industry in Japan, and general industry strategies.

From a trade policy perspective, unravelling the Japanese relationships between industry and government is critical. Even though close inter-corporate relationships can, and do, tangentially exclude foreign firms, all firms still operate in an open market. There remains a chance that if foreign firms are competitive enough, they can pry apart inter-corporate alliances and capture part of the market. There is no way, however, for foreign firms to pry apart close industry-government relationships. It is up to trade policy officials to pursue these types of changes in Japan.

The use of administrative guidance as a tool to regulate banks in Japan is an excellent example of the industry-government ties that can effectively exclude foreign firms. The very nature of its application, which is ad hoc, unwritten and communicated within a familiar community, leaves foreign firms trying to enter and adapt to a new market with a different set of rules at a distinct disadvantage. To reduce the uncertainty foreign financial firms face, any future trade discussions with Japan should include the transparency of the financial regulatory system in general, and the use of administrative guidance in particular. Just as with industry associations, it is in the interest of foreign financial institutions to have all industry-government interactions publicized. Japanese authorities must be urged to ensure that all regulations, guidelines and other government directives are widely discussed and reviewed in advance of implementation, including by interested foreign participants in Japanese markets, and are subsequently clearly written and made publicly available.

- Adapting to the Japanese Way

In order to develop relationships with Japanese firms, foreign firms, including financial institutions, must, to a certain degree, conduct business (or at least be well versed in) the Japanese way. That might include cross shareholding between foreign firms and Japanese firms, but not necessarily. More important approaches would include, for example, not switching Japanese suppliers for a marginally better price.

Patience and perseverance are essential in the early stages of fostering business relationships with Japanese firms, particularly those that are *keiretsu* members.

It appears that the appropriate lessons for firms to draw from the Japanese economic system, including *keiretsu*, are already being imported into North America, albeit on a modest scale. U.S. companies are now incorporating cross shareholding practices to develop patient capital, just-in-time delivery systems and design-in techniques with suppliers.[124] Clearly, there are advantages to both the Japanese and North American styles of inter-corporate relations. In the drive to become internationally competitive, or maintain competitive positions, firms will adopt practices from both systems, with or without specific government initiatives.

- Government Leadership

There is at least one element not related to trade policy that should be a part of the government strategy with respect to promoting Canadian trade with Japan. The first step for any Canadian firm attempting to establish a presence in Japan in order to foster the inter-corporate relationships necessary to be successful, is to develop a customer base from which to operate. At the same time, it is essential that government lead by example in its own dealings with Japanese firms. According to Wright and Huggett, provincial governments, in particular, have tended to bypass Canadian financial institutions in their financing dealings with Japan.[125] Instead, they have used Japanese institutions. Encouraging Canadian firms to aggressively pursue international trading opportunities has a distinctly hollow ring to it if governments themselves are not actively promoting Canadian firms abroad. Anything less than the full support of competitive Canadian firms is an abrogation of government leadership responsibilities.

[124] See C.F. Bergsten, "New Rules for International Investment", in *Multinationals in North America,* L. Eden, ed. The Industry Canada Research Series, University of Calgary Press, Calgary, 1994, p. 393. For company-specific examples of how U.S. firms have adopted Japanese corporate practices, see "Learning From Japan", in *Business Week*, McGraw-Hill Inc., New York, NY, January 27, 1992, pp. 52-60.

[125] See R.W. Wright and S. Huggett, *op. cit.*, p. 40.

ANNEX 1

Relations Between Commercial Banks and Non-Financial Firms in North America

- Canada

In Canada, a commercial bank cannot own more than 10% of the voting shares in any Canadian company, with a number of exceptions.[126] Banks that are widely held, called Schedule I banks, are allowed to own any number of shares in a foreign-owned corporation provided that such shareholdings do not lead to a violation of the 10% limit on shareholdings of Canadian firms. Closely held banks, called Schedule II banks, are also prohibited from owning more than 10% of the voting shares of any foreign-owned corporation.

No single shareholder, or group of associated shareholders, can own more than 10% of any Schedule I bank's voting shares. In addition, non-U.S. residents in aggregate cannot hold more than 25% of any class of shares of a bank. Pursuant to the FTA/NAFTA, Mexican and U.S. residents are exempt from the 25% limitation, but not the 10% limit.

If a Schedule II bank is domestically owned, it must become widely held within ten years of its creation. A bank is widely held if no more than 10% of its voting shares are held by one shareholder or associated group. Domestically owned Schedule II banks are subject to the 25% limit on non-resident holdings of its shares. If a Schedule II bank is a foreign subsidiary, it must remain closely held.

- United States

In the United States, banks are not permitted to own stock of other companies, except those engaged in activities that the banks themselves may also conduct, such as mortgaging, leasing, and securities and brokerage companies. Bank holding companies are allowed to hold up to 5% of the shares of any company, financial or non-financial. Acquiring 5% or more of voting shares of companies specializing in bank-related activities requires permission of the appropriate control agencies.

---

[126] The exceptions include: corporations which service or maintain property owned or leased by the bank; corporations with the sole objective of promoting exports; securities dealers; mortgage loan, venture capital, factoring, leasing and data processing corporations; corporations that operate real estate investment trusts or mortgage investment companies; and foreign corporations. See OECD, *Financial Market Trends*, No. 49, Paris, June 1991, p. 33.

Industrial and commercial companies may acquire up to 25% of shares in a bank as a passive investment, with the permission of appropriate control agencies. Changes in bank ownership involving more than 10% of the voting stock of a bank require prior authorization by the appropriate control agencies.

ANNEX 2

The Treatment of Foreign Commercial Banks in North America

- Canada

The Bank Act restricts foreign banks from carrying on business in Canada except through a representative office or a Canadian chartered bank subsidiary.[127] Foreign banks are prohibited from establishing and operating branches. Setting up a representative office or subsidiary is subject to reciprocal treatment of Canadian banks in the foreign bank's home country.

Under the FTA, U.S. banks were exempted from limitations on the right of subsidiary establishment, restrictions on the ability of a U.S. bank's Canadian subsidiary to establish additional branches were lifted and restrictions were eased on the transfer of capital from U.S. parent banks to their Canadian subsidiaries. U.S. banks are still not allowed to open directly a branch in Canada.

The NAFTA did not modify any previous restrictions placed on U.S. banks, but based market access of all financial institutions in the three member countries on a set of general rules enshrining national treatment, MFN treatment, the right of consumers to purchase cross-border financial services and the right to market access through the establishment of a commercial presence.

- United States

The International Banking Act of 1978 covers the activities of foreign banks in the United States. The Act provides the following: restrictions on inter-state deposit taking; applications of Federal Reserve requirements; requirement of deposit insurance for branches engaged in retail business; application of the non-bank restrictions of the Bank Holding Company Act; and availability of the Federal Reserve discount window. According to Symons, the Act generally provides foreign banks national treatment with respect to their U.S. operations.[128] There are no federal prohibitions on foreign

[127] See H. Moudi, *op. cit.*, pp. 287-9.

[128] See E.L. Symons, *op. cit.*, p. 14.

acquisitions of U.S. banks and, as of 1990, foreign control of U.S. banking assets was 22.9%.[129]

Under the FTA, domestic and foreign banks operating in the U.S. are allowed to underwrite and purchase Canadian government-backed securities. The U.S. promised that Canadian banks would receive the same treatment as U.S. banks in any future amendment of the Glass-Steagall Act, which prohibits commercial banks from engaging in investment banking.

[129] See H. Moudi, *op. cit.*, p. 265.

Bibliography

Adams, T.F.M and I. Hoshii. *A Financial History of The New Japan,* Kodansha International Limited, Palo Alto, CA, 1972.

Alford, D.E. "Basle Committee International Capital Adequacy Standards: Analysis and Implications for the Banking Industry", in *Dickinson Journal of International Law,* Vol. 10, No. 2, Dickinson School of Law, Carlisle, PA, Winter 1992.

Altman, R.C. "Why Pressure Tokyo?", in *Foreign Affairs*, Vol. 73, No. 3, Council on Foreign Relations, New York, NY, May-June 1994.

Anchordoguy, M. "A Brief History of *Keiretsu*", in *Harvard Business Review,* Vol. 68, No. 4, Boston, MA., July-August 1990.

"Asian Equity Guide", supplement to *AsiaMoney and Finance,* Euromoney Publications, London, March 1994.

AsiaMoney and Finance. "Corporate Japan Reins In Its Costs", Euromoney Publications, London, February 1993.

Balassa, B. and M. Noland. *Japan in the World Economy,* Institute for International Economics, Washington, D.C., 1988.

Bank for International Settlements. *59th Annual Report,* Bank for International Settlements, Basle, 1989.

_________. *63rd Annual Report,* Bank for International Settlements, Basle, 1993.

The Banker. "The Banks Feel the Pain", Financial Times Magazines, London, January 1994.

Beason, D. "Are *Keiretsu* Economically Relevant?", in *Business and the Contemporary World,* Vol. IV, No. 2, Bentley College, Waltham, MA, Winter 1992.

Bergsten, C.F. "New Rules for International Investment", in *Multinationals in North America,* L. Eden (ed), The Industry Canada Research Series, University of Calgary Press, Calgary, 1994.

Bergsten, C.F., and M. Noland. *Reconcilable Differences? United States - Japan Economic Conflict,* Institute for International Economics, Washington, D.C., June 1993.

Bhagwati, J. "Samurais No More", in *Foreign Affairs,* Vol. 73, No. 3, Council on Foreign Relations, New York, NY, May/June 1994.

Brown, J.R. "Japanese Banking Reform and the Occupation Legacy: Decompartmentalization, Deregulation, and Decentralization", in *Denver Journal of International Law and Policy,* Vol. 21, No. 2, University of Denver, Denver, CO, Winter 1993.

Business Week. "Learning From Japan", McGraw-Hill Inc., New York, NY, January 27, 1992.

Cargill T.F. and G.F.W. Todd. "Japan's Financial System Reform Law: Progress Towards Financial Liberalization?", in *Brooklyn Journal of International Law,* Vol. 19, No. 1, Brooklyn Law School, Brooklyn, NY, 1993.

Carson, *R.L. Comparative Economic Systems*, M. E. Sharpe Inc., New York, NY, 1990.

Conner, C. *The Japanese Financial Services Industry in the 1990s,* The Conference Board of Canada Report 127-94, Ottawa, June 1994.

Daniels, R.J. and J.G. MacIntosh. "Toward a Distinctive Canadian Corporate Law Regime", in *Osgoode Hall Law Journal,* Vol. 29, No. 4, Osgoode Hall Law School of York University, Downsview, Ontario, Winter 1991.

Duus, P. *The Cambridge History of Japan: Volume 6: The Twentieth Century,* Cambridge University Press, Cambridge, U.K., 1988.

The Economist. "International Banking Survey", London, April 30, 1994.

_________. "Tough on the Taxpayer", London, February 26, 1994.

_________. "Corporate Governance Survey", London, January 29, 1994.

Frankel, A.B. and J.D. Montgomery. "Financial Structure: An International Perspective", in *Brookings Papers on Economic Activity, 1,* W.C. Brainard & G.L. Perry, eds. Brookings Institution, Washington, D.C., 1991.

Garten, H.A. "Universal Banking and Financial Stability", in *Brooklyn Journal of International Law,* Vol. 19, No. 1, Brooklyn Law School, Brooklyn, NY, 1993.

General Accounting Office. *Deposit Insurance, Overview of Six Foreign Systems,* NSIAD-91-104, Washington D.C., February 1991.

Haruo, S. "Japanese Capitalism: The Irony of Success", in *Japan Echo,* Vol. XIX, No. 2, Japan Echo Incorporated, Tokyo, Summer 1992.

Hazera, A. and H. Hayashida. "The Influence of Japanese and American Stockholders on Corporate Planning: A Cross-Cultural Examination", in *Business and The Contemporary World,* Vol. IV, No. 1, Bentley College, Waltham, MA, Autumn 1991.

Hiroshi, O. "Corporate Capitalism: Cracks in the System", in *Japan Quarterly,* Vol. XXXIX, No. 1, Asahi Shimbun Publishing, Tokyo, January-March 1992.

Hoshi, T., A. Kashyap and D. Scharfstein. "Corporate Structure, Liquidity, and Investment: Evidence From Japanese Industrial Groups", in *Quarterly Journal of Economics,* Vol. CVI, No. 1, MIT Press, Cambridge, MA, February 1991.

Inside U.S. Trade. Inside Washington Publications, Washington, D.C., April 23, 1993, July 23, 1993.

International Monetary Fund. *International Capital Markets Part II,* Washington, D.C., August 1993.

Kaufman, G.G. and L.R. Mote. "Is Banking a Declining Industry? A Historical Perspective", in *Economic Perspectives,* Federal Reserve Bank of Chicago, Chicago, IL, May/June 1994.

Kester, W.C. "Capital and Ownership Structure: A Comparison of United States and Japanese Manufacturing Corporations", in *Financial Management,* Vol. 15, No. 1, Financial Management Association, Hanover, N.H., Spring 1986.

Kester, W.C. and T.A. Luehrman. "The Myth of Japan's Low-Cost Capital", in *Harvard Business Review,* Vol. 70, No. 3, Boston, MA, May-June 1992.

Kim, S.B. "The Use of Equity Positions by Banks: The Japanese Evidence", in *Economic Review,* No. 4, Federal Reserve Bank of San Francisco, San Francisco, CA, Fall 1991.

Kim, S.B. and R. Moreno. "Stock Prices and Bank Lending Behaviour in Japan", in *Economic Review,* No. 1, Federal Reserve Bank of San Francisco, San Francisco, CA, 1994.

Landefeld, J.S., O.G. Whichard, and J.H. Lowe. "Alternative Frameworks for U.S. International Transactions", in *Survey of Current Business,* Vol. 73, No. 12, U.S. Department of Commerce, Bureau of Economic Analysis, Washington, D.C., December 1993.

Lawrence, R.L. "Efficient or Exclusionist? The Import Behaviour of Japanese Corporate Groups", in *Brookings Papers on Economic Activity 1,* W.C. Brainard & G.L. Perry, eds. Brookings Institution, Washington, D.C., 1991.

_________. "Imports in Japan: Closed Markets or Minds?", in *Brookings Papers on Economic Activity 2,* W.C. Brainard & G.L Perry, eds. Brookings Institution, Washington, D.C., 1987.

Lincoln, E.J. *Japan's Unequal Trade,* The Brookings Institution, Washington, D.C.,1990.

Mester, L.J. "Banking and Commerce: A Dangerous Liaison?", in *Business Review,* Federal Reserve Bank of Philadelphia, Philadelphia, PA, May-June 1992.

Moudi, H. "The State of U.S. Banking in the Global Arena", in *Boston University International Law Journal,* Vol. 10, No. 2, Boston University School of Law, Boston, MA, Fall 1992.

Myerson, T. "Barriers to Trade in Japan: The *Keiretsu* System -- Problems and Prospects", in *New York University Journal of International Law and Politics,* Vol. 24, No. 3, New York University School of Law, New York, NY, Spring 1992.

Nanto, D.K. *Japan's Official Import Barriers,* Congressional Research Service Report for Congress 93-657 E, Washington, D.C., July 11, 1993.

Organization for Economic Cooperation and Development. *Economic Outlook* 54, OECD, Paris, December 1993.

_________. *Banks Under Stress,* OECD, Paris, 1992.

_________. *Financial Market Trends,* No. 49, OECD, Paris, June 1991.

Otaki, K. "The Changing Role of Japanese Banks", in *Japanese Finance in Transition: Implications for Canada,* The Canada-Japan Trade Council, Ottawa, May 1993.

Papailiadis, T. *The Canadian and Japanese Financial Services Industries,* The Conference Board of Canada, Report 46-89-DF, Ottawa, October 1989.

Porter, M. "Capital Disadvantage: America's Failing Capital Investment System", in *Harvard Business Review,* Vol. 70, No. 5, Boston, MA., September-October 1992.

Pozdena, R.J. "Why Banks Need Commercial Powers", in *Economic Review,* No. 3, Federal Reserve Bank of San Francisco, San Francisco, CA, 1991.

Prowse, S.D. "The Structure of Corporate Ownership in Japan", in *Journal of Finance,* Vol. 47, No. 3, New York, NY, July 1992.

Razin, E. "Are the *Keiretsu* Anticompetitive? Look at the Law", in *North Carolina Journal of International Law and Regulation,* Vol. 18 No. 2, University of North Carolina School of Law, Chapel Hill, N.C., Winter, 1993.

Rhodes, W. *Pressing Issues in U.S.- Japan Financial Markets,* Japan Society, New York, NY, October 21, 1993.

Salvatore, D. "How to Solve the U.S.-Japan Trade Problem", in *Challenge,* M.E. Sharpe Inc., New York, NY, January-February 1991.

Sarachek, B. "Japan Bashing and the American Malaise", in *Business and the Contemporary World,* Vol. 4, No. 3, Walter de Gruyter & Company, Berlin, Summer 1992.

Saxonhouse, G.R. "Comments and Discussion." In *Brookings Papers on Economic Activity, 1,* W.C. Brainard & G.L. Perry, eds. Brookings Institution, Washington, D.C., 1991.

Scott, H.S. and S. Iwahara. *In Search of a Level Playing Field: The Implementation of the Basle Capital Accord in Japan and the United States,* Occasional Paper No. 46, Group of Thirty, Washington, D.C., 1994.

Semkow, B.W. "Foreign Financial Institutions in Japan", in *Law Policy in International Business,* Vol. 23, No. 2, Georgetown University Law Center, Washington, D.C., 1991-92.

Seth, R. and A. Quijano. "Japanese Banks' Customers in the United States", in *Quarterly Review,* Vol. 16, No. 1, Federal Reserve Bank of New York, New York, NY, Spring 1991.

________. *Growth in Japanese Lending and Direct Investment in the United States: Are They Related?* Federal Reserve Bank of New York Research Paper No. 9101, New York, NY, January 1991.

Sharma, I.P. and P. Thomson. *Competition and Trade Policy Interface: Some Issues in Vertical Restraints,* Policy Staff Paper No. 94/11, Department of Foreign Affairs and International Trade Canada, Ottawa, forthcoming.

Spong, K. *Banking Regulation,* Third Edition, Federal Reserve Bank of Kansas City, Kansas City, MO, 1990.

Suzuki, Y. "Financial Restructuring: The Japanese Experience", in *Restructuring the Financial System,* A Symposium Sponsored by the Federal Reserve Bank of Kansas City, Jackson Hole, Wyoming, August 20-22, 1987.

Symons, E.L. "The United States Banking System", in *Brooklyn Journal of International Law,* Vol. XIX, No. 1, Brooklyn Law School, Brooklyn, NY, 1993.

Treece, J.B. and K.L. Miller. "If the Japanese Were Running G.M.", in *Business Week,* McGraw-Hill Inc., New York, NY, January 27, 1992.

U.S. Congress, Office of Technology Assessments. *Multinationals and the National Interest: Playing by Different Rules,* Washington, D.C., 1993.

U.S. Department of the Treasury. *National Treatment Study,* Washington, D.C., 1990.

U.S. International Trade Commission. "U.S.-Japan Relations After the Summit", in *International Economic Review,* U.S. International Trade Commission, Washington, D.C., April 1994.

Vittas, D. and Y.J. Cho. "The Role of Credit Policies in Japan and Korea." In *Finance and Development,* Vol. 31, No. 1, International Monetary Fund and World Bank, Washington, D.C., March 1994.

Westney, D.E. "Japanese Multinationals in North America", in *Multinationals in North America,* L. Eden (ed), The Industry Canada Research Series, University of Calgary Press, Calgary, 1994.

Wright, R.W. *Japanese Finance in Transformation: Implications for Canada,* The Canada-Japan Trade Council, Ottawa, 1994.

__________. "Japanese Financial Flows to Canada", in *Japanese Finance in Transition: Implications for Canada,* The Canada-Japan Trade Council, Ottawa, May 1993.

Wright, R.W. and S. Huggett, *A Yen For Profit: Canadian Financial Institutions In Japan,* The Institute for Research on Public Policy, Halifax, Nova Scotia, 1987.

16. Le libre-echange nord-américain, les subventions et les droits compensateurs: la problématique et les options, par Gilbert Gagné. 94/13 (Juillet 1994). SP47

17. Dangerous Liaisons: The World Trade Organization and the Environmental Agenda, by Anne McCaskill. 94/14 (June 1994) SP48

18. Damned If We Don't: Some Reflections On Antidumping and Competition Policy, by Keith H. Christie. 94/15 (July 1994) SP49

B) TRADE DEVELOPMENT SERIES

1. From a Trading Nation to a Nation of Traders: Towards a Second Century of Trade Development, by Andrew Griffith. 92/05 (March 1992) SP12

2. Exports and Job Creation, by Morley Martin. 93/06 (June 1993) * SP24

C) REGIONAL TRADE AND ECONOMIC SERIES

1. Different Strokes: Regionalism and Canada's Economic Diplomacy, by Keith H. Christie. 93/08 (May 1993) * SP26

2. Japan Trading Corp.: Getting the Fundamentals Right by I. Prakash Sharma. 93/16 (December 1993) * SP34

3. Canada in the Americas: New Opportunities and Challenges, by Conrad Sheck, Colin Robertson, Jamal Khokhar, Nicolas Dimic, and Keith Christie. 94/06 (April 1994) * SP40

4. China 2000: The Nature of Growth and Canada's Economic Interests, by Steve Lavergne. 94/10 (May 1994) SP44

5. The Japanese Way: The Relationship Between Financial Institutions and Non-Financial Firms, by James McCormack. 94/16 (July 1994) SP50

D) OTHER ECONOMIC PAPERS

1. World Population Growth and Population Movements: Policy Implications for Canada, by Michael Shenstone. 92/07 (April 1992) SP14

2. Pour des sanctions efficaces et appropriées, par Jean Prévost. 93/04 (mars 1993) * SP22

3. Black Gold: Developments in the World Oil Market and the Implications for Canada, by Sushma Gera. 93/05 (February 1993) * SP23

4. Determinants of Economic Growth in Developing Countries: Evidence and Canadian Policy Implications, by Rick Mueller. 94/08 (April 1994) * SP42

5. Still an Albatross? The LDC Debt Crisis Revisited, by Rick Mueller. 94/09 (May 1994) SP43

6. Pro-Active Sanctions: A New/Old Approach to Non-Violent Measures, by Dr. Nicholas Tracy. 94/17 (June 1994) SP51A

* available in English/disponible en français