

BOJ's Campaign for Deregulation

By Sakamoto Sakae

Deregulation is an important policy assignment for the Hata administration, and recently Bank of Japan (BOJ) Governor Mieno Yasushi has been actively vocalizing the need for deregulation in the financial fields. As the BOJ shares the role of regulating these fields with the Ministry of Finance (MOF), the BOJ governor's statements have been critical of both the BOJ and the MOF's administration in the banking sector. According to an internal source, the MOF is not as indifferent as it purports to be to Mieno's words.

In late March, Governor Mieno delivered a speech in Tokyo entitled "The Situation of the Domestic Economy and Finance and the Need to Strengthen the Financial System," in which he called for the introduction of market principles into Japan's bank management. Despite his careful wording, the speech could be interpreted as a criticism of the MOF's administration of banks, and so caused a sensation among those concerned. Here, I will relate the essence of his speech from my notes.

Mieno singled out "encouraging competition," "stronger risk control," "market control," and "sufficient infrastructure for financial transactions" as the measures needed to reform Japan's financial system.

Market control is the key point to consider among these measures. Mieno said, "I believe the strongest principle determining the managerial behavior of Japanese financial institutions has been a concern for maintaining 'the industry average' and staying 'in line' with other banks. In a situation where such thinking prevails, once an action lacking sufficient risk consideration spreads to one corner of the market, the risk will likely diffuse further, in line, throughout the financial system."

What Governor Mieno meant specifically by "further diffusion" of risks is the current suffering of banks under a huge amount of bad assets accrued from the land and asset investment drive of

the past bubble economy. Mieno is saying that behind this same-direction oriented management was the desire to maintain the industry average and stay in line as the behaving principle. I would like to point out here that the "line up" mentality of bank managers has been bred by the MOF's financial administration based on the "convoy" system. (Of course, Mieno did not speak out to this extent.)

Supervision and regulation limits

After criticizing this mentality, Mieno's tone rose further:

"[Risk management requires measures set within the financial system to prevent demoralization of managers.] In this regard, the role of administrative regulation and supervision is also important. However, checking by means of supervision and regulation always runs the risk of excess: This type of approach tends to underestimate returns from risk-taking by financial institutions, only focusing on losses by failed risk-taking, resulting in excessive regulation and supervision."

Here, Mieno indicates the negative side of regulation and supervision by the BOJ and MOF. This is a strikingly brave statement being made by the head of the financial authority. How then, can the morale of bankers best be checked? The governor's answer is, "by the market mechanism."

"[Contrary to authoritative supervision and regulations] checking by the market is always conscious of the balance between risk and return. This is typically seen in shareholder control. Shareholders demand higher-than-fixed-income yields through dividends and share price appreciation in return for their taking risks. Shareholder equity supplied in this way works as an ultimate buffer in various risk-taking activities by the financial institution. At the same time, the stock market also functions to control managerial behavior

through changes in share prices and new issues."

Here, Mieno was merely talking about the basics of the market economy that are considered common sense in the West, especially in the U.S. This sounded like something new to the audience because, it seems, the Japanese financial system has yet to catch up with Western standards. Perhaps aware of this, Mieno stated, "Although the current checking mechanism of the stock market is not working ideally, it has been steadily strengthening in recent years as evidenced by the widening gaps among share prices of different financial institutions."

Emphasis on market mechanisms

Mieno has been consistent in stressing the market mechanism. In another lecture showing the BOJ's stance on liquidization of bad assets (December 1993), he said, "The essential point is how to carry out the adjustment of balance sheets of corporations and banks smoothly; in particular, how to deal with bad assets. As witnessed in the U.S., there seems to be room for financial and capital markets to play some role in tackling the bad asset problem."

One BOJ observer analyzes the background of the governor's series of statements emphasizing the market mechanism as below:

"Taking the authority to inspect banks for instance, the MOF is overwhelmingly more powerful than the BOJ as a financial authority. However, with the current trend of deregulation, the MOF's power (i.e., financial administration) is set to weaken in the future. This will strengthen the BOJ's power in relative terms, and the BOJ's emphasis on the market mechanism should be viewed within the context of deregulatory trends. As governor of the central bank, Mieno expressed his opinion too clearly. It seems to me that speech writers (middle rank executives in the BOJ)



Photo: Kyodo News Service

Bank of Japan Governor Mieno Yasushi, seen here offering remarks at a meeting of branch managers.

had decided to express their views unreservedly with consideration to the governor's term of office."

Mieno's term of office needs to be explained. The BOJ governor's term is five years and Governor Mieno (the 26th governor and a career BOJ official), who fought against the bubble economy and the recession following the bursting of the bubble, will retire his

seat in mid-December of this year. There is an unusual custom concerning the BOJ governor's seat: it has been filled alternately by career BOJ officials and ex-vice ministers of finance since the 22nd governor, Sasaki (a career BOJ official), with the 23rd governor, Morinaga, from the MOF; the 24th governor, Maekawa, from the BOJ; and the 25th governor, Sumita, from the MOF.

The practice is likely to be repeated for the next governor—that is, the 27th governor will be from the MOF.

According to the same BOJ observer, "The middle rank BOJ executives are planning to stir up public opinion regarding the importance of the market mechanism through Mieno who is easier to handle." However, some intellectuals insist, "The very way of choosing the BOJ governor and the president of the Tokyo Stock Exchange (chosen from ex-vice ministers of finance) is a symbol of the supremacy of the financial administration. Both heads should be chosen from the market (i.e. private sector) before any discussion on deregulation."

Stimulating financial and capital markets

The deregulation strategy authorized by the former Hosokawa administration was detailed in the Hiraiwa Report drawn up last December by the Advisory Group for Economic Restructuring headed by Hiraiwa Gaishi, chairman of Keidanren (Japan Federation of Economic Organizations). Regarding stimulating the financial and capital market, the report says: "... as financial and capital globalization proceeds, mutual dependency of domestic and overseas markets has intensified. As a result, it has become important to encourage efficiency and stimulate the domestic financial and capital markets, as well as to create a free, highly transparent and internationally acceptable market."

To be sure, this is only a general argument and each case has not yet been discussed by the MOF. The series of campaigns by the BOJ governor to emphasize the market mechanisms should be taken as aiming to pave the way for the upcoming process. To what extent the MOF's power can be dismantled is receiving attention from those concerned.

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