BOJ Autonomy and MOF Dissolution

By Sakamoto Sakae

A year ago, the Japanese financial world was shaken by bad credit scandals at financial institutions, but this year's hot issues are the revision of the Bank of Japan (BOJ) Law and reform of the Ministry of Finance (MOF). The former consists of a movement to remove the Bank of Japan from the jurisdiction of the Ministry of Finance and make it an independent institution with functions similar to those of central banks found in Europe and the United States. The latter issue is a movement to break up the Ministry of Finance, which has become too powerful, and restructure its administrative functions based on a market economy model. The dispersion of the power of the "almighty" MOF and the strengthening of the authority of the BOJ, now known sarcastically as "MOF's Hongoku–cho Branch," are the tasks at hand. Although they may appear different on the surface, they are both part of the fundamental reorganization needed to move Japan's economic and financial policies from the centralized, bureaucrat–controlled model to the market–driven model.

The current Bank of Japan Law dates to the early part of World War II, when Japan was preparing for an all–out war against Britain and the U.S. Consequently, the goal of the law was the "appropriate use of the nation's total economic strength." Today, 51 years after the end of the war, this goal is completely at odds with the times. The overall meaning of reform measures is to change this outdated goal to the central bank's true goal, which is the stability of the currency value and the financial system. But when it comes down to details, the most important issue is how to eliminate MOF authority to intervene in BOJ financial policies and appointment of its governor and other top–level staff. Under the current Bank of Japan Law, any change in financial policies, such as the raising or lowering of interest rates, virtually requires the approval of the Ministry of Finance. The appointment and replacement of the Bank governor and directors is also under the de facto control of the Ministry of Finance. This MOF power over BOJ business is the source of the Bank of Japan's nicknames "MOF Hongoku–cho Branch" and "MOF Banking Bureau, Bank of Japan Division."

Photo: Japan National Press Club

Bank of Japan Governor Matsushita stresses importance of central bank's independence. (Lecture at Japan National Press Club)

BOJ Governor Matsushita's campaign

During a speech to the Japan National Press Club in June, BOJ Governor Matsushita Yasuo outlined the reasons why the central bank should stand independent of the government and politics. The speech marked the beginning of a campaign for BOJ independence from the MOF.

Matsushita began by saying, "In various countries in the past, governments have frequently increased the money supply or dropped interest rates too low as a means of cheaply acquiring revenue or forcibly regulating currency exchange rates. The result in many cases was unstable commodity prices and large economic fluctuations or the loss of moderation in management of financial affairs; in the end, the citizens paid the price."

Speaking for the economic merits of an independent BOJ, Matsushita went on to say, "These experiences have instilled the idea of leaving the stability of the currency value to a central bank that distances itself from the short–term interests of bureaucrats and politicians, and the idea of respecting the neutrality and professional judgment of a central bank." Clearly, Matsushita's emphasis on exchange rates was a reference to the bubble economy brought on by the super–low interest rate policy in the wake of the Plaza Accord, an instance where the BOJ feels it was pressured by the U.S. Treasury Department and the Japanese government.

Matsushita also pointed out the necessity of an independent BOJ from the standpoint of democracy. "One basis for giving autonomy to the central bank," he said, "is the nature of the goal of stability in currency values. Namely, this goal originates in a demand for [a central bank] that is distanced from short–term interests in order to improve the foundation on which the people's lives and economic activity are built. Looking at it from the standpoint of the current national structure, an independent central bank could also be a tool for preserving the system of checks and balances on power."

"Modern nations are built within the basic framework of democracy and the separation of powers. Giving independence to the central bank follows this principle and can be said to be a practical application of it."

This line of reasoning breaks away from an economic argument and seems to be some roundabout logic dreamed up by Matsushita's speech writer.

While the MOF recognizes the need to revise the Bank of Japan Law, when it comes to a reduction in its authority by an independent BOJ, it takes a negative stance. The debate over the independence of the BOJ will move forward as the Central Bank Research Council, an advisory organ to the prime minister (chaired by Torii Yasuhiko, president of Keio University), studies the fundamental points of revising the law and the Financial System Research Council, an advisory board to the finance minister, looks into the details of such a revision. A conclusion is expected before the beginning of 1997. The points of interest include how much MOF power will be shaved in the three areas of domestic financial policy, international currency matters and financial institution inspections (and how these powers are transferred to the BOJ), and how the independence of the BOJ will increase in areas including the right to appoint key bank officers.

In his speech to the Japan National Press Club, BOJ Governor Matsushita recognized the MOF's right to table motions and make proposals relating to financial policy (in a system like Germany's), and also the need for openness of financial policy management (like the U.S. Federal Reserve Board's financial reports to Congress and the Federal Reserve Board chairman's testimony before Congress). His conciliatory statements seem to suggest a strategy of gaining BOJ independence by offering some concessions to the MOF.

Separating financial departments from the MOF

The issue of reform of the Ministry of Finance is colored much more deeply by politics than is the issue of revision of the Bank of Japan Law. The three government parties strongly intend to reform the MOF as an extension of the administrative reform that has been the focus of the pledge of "good government" over the past several years. Representative of these intentions is "Prime Minister Hashimoto's Administrative Reform Vision," which *The Nihon Keizai Shimbun* reported in late August. According to the article, Hashimoto, in preparation for general elections that could be called as early as the autumn, will announce a policy concept whereby "the current 22 central government ministries and agencies will be reorganized into 14 ministries consisting of, for example, a Financial Affairs Ministry, a Service Industry Ministry and a Production and Distribution Ministry. As part of the reorganization, major government offices will be broken up, separating for example, the functions of the Finance Ministry's Budget Bureau and Banking Bureau."

The "Vision" strategy is meant to allay public criticism of "big government" and the "bloated" Ministry of Finance, and to increase the number of Diet seats held by the Liberal Democratic Party.

Based on the Hashimoto Vision, the present Ministry of Finance would be carved up and realigned in three new entities. The big three bureaus of the present ministry—the Budget Bureau (budget organization), Tax Bureau (creation of tax system) and Financial Bureau (management of national property and government bonds)—would be reassembled as the new Financial Affairs Ministry. Secondly, the Banking Bureau, which drew attention for its failure to handle the illegal trading of U.S. bonds at Daiwa Bank's New York branch and the *jusen* housing loan fiasco, and the Securities Bureau, which has been severely criticized for its over–zealous intervention in the securities business, will be reconstituted as the Service Industry Ministry. (This new ministry will have control over a wide range of financial departments such as the leasing business, which is now under the control of the Ministry of International Trade and Industry.) Finally, the International Finance Bureau, in charge of currency policy, and macroeconomic policy departments will be transferred to the Economic Planning Agency, which will be reborn as the Economic Ministry. (MITI's international trade policy departments will also be absorbed into this new ministry.)

It is doubtful that an administrative reform plan as drastic as this one can be smoothly carried out considering the strong instinct for self–preservation held by government agencies. However, as a theoretical plan, it clearly identifies the problems within the current bureaucracy. With the inclusion of the Ministry of Finance Reform Plan proposed by the chairman of the government parties' Ministry of Finance Reform Issue Project, Ito Shigeru (vice–chairman of the Social Democratic Party), other ministries and agencies (especially industrial administration government offices such as the Ministry of Posts and Telecommunications, the Ministry of Transport, the Ministry of Construction and the Ministry of Agriculture, Forestry and Fisheries) are also slated for restructuring. Under the Ministry of Finance Reform Plan, the Banking Bureau, Securities Bureau and International Finance Bureau are cut away from the MOF to form the new Financial Bureau, while a committee (based on the Securities and Exchange Commission in the United States) covering the inspection and surveillance of the financial world and securities business world will be set up independently of the Ministry of Finance.

From bureaucratic leadership to a market–controlled model

Naturally, the Ministry of Finance is strongly resisting the amputation of its finance–related bureaus. The MOF's own structural reform concept, which the ministry is promoting as an alternative to the Hashimoto Vision, allows for the combination of the Banking, Securities and International Finance bureaus into one bureau and the separation of the banking and securities inspection departments from these bureaus. Both the new bureau and the inspection departments, however, would remain within the MOF. In other words, the MOF is completely opposed to its own dissolution.

As a famous 19th century philosopher said, "Power tends to corrupt and absolute power corrupts absolutely." Considering the scandals surrounding MOF bureaucrats which have been surfacing since last year, this aphorism seems to apply to the MOF. When one also considers the drop in the share of the Japanese economy held by finance and the shift from a bureaucrat–led economy (the developing country model) to a market–driven economy (the developed country model), the break–up of the MOF seems to be an absolute necessity. JJTI

Sakamoto Sakae is an economic news editor at Jiji Press news agency. He specializes in such fields as finance and international economic affairs.