

## Japan-U.S. Relations In the Information Age

By Shoichi Akazawa

In the nearly 20 years since people first began to speak of the information age and the information society, the advances in information transmission and processing technology have surpassed all expectations and we are now firmly ensconced in this information age.

It is information that has erased the national borders in the global economy over the past decade. Likewise, it is information that has forced Gorbachev to adopt his dual policies of *perestroika* (restructuring) and *glasnost* (openness). Indeed, it is no exaggeration to say that a free and unfettered flow of information is a prerequisite for any society to prosper on the basis of freedom and democracy.

Japan and the United States are such free and democratic societies, and they joined hands for prosperity and stability in the wake of World War II. Yet this relationship began to sour as trade friction arose in the mid-1970s, and many observers have speculated that the information gap was a major contributing cause of this discord. Because this information gap stems from such factors as the differences in the two countries' structures, populations and global presences, I doubt if it will ever be possible to completely close it.

While Japan is naturally very interested in what happens in the United States, given that the United States has a major impact on events both in Japan and worldwide, America is content to relegate Japan to the sidelines of consciousness unless something happens that has a direct impact on U.S. fortunes.

As a result, it is only natural that there should be less information going from Japan to the United States than the other way around. Yet even within this lesser flow, it is crucial that there be a constant flow of accurate information available to those Americans who are concerned about Japan and who have a direct business or other interest in Japan. It is this mission that has sustained the *Journal of Japanese Trade & Industry* over the past 10 years.

Just as important—if not even more important—is the need for Japanese who live in the United States for business or other reasons to make a constant effort to keep their friends and neighbors fully informed about developments in Japan. This effort by “grass roots ambassadors” is, I believe, all the more important in light of the rapid increase in Japanese investment in the United States over the last few years.

### COMING UP

With the bursting of the so-called bubble economy the prevailing concern in Japan today is the prospects for the economy of tomorrow. The turn of the year provides a good opportunity to review the past year and preview likely developments in the months ahead. Forecasting the course of the economy is not an easy task. Neither optimism nor pessimism are likely to satisfy the reader, and the accuracy of any prediction can only be judged by the turn of events.

Nevertheless, in the January/February issue of the *Journal of Japanese Trade & Industry*, we will attempt to analyze the past and predict the future course of the Japanese economy. Hisao Kanamori, chairman of the Japan Center for Economic Research, and Josen Takahashi, senior fellow of Mitsubishi Research Institute, Inc., have taken on the main burden of this onerous task. Their analyses in the Cover Story item will provide a valuable perspective on the Japanese economy at least in the coming months of 1992. In addition to their contributions, there will be separate analyses of 22 sectors of Japanese industry.

The *Journal* welcomes letters of opinion or comment from its readers. Letters, including the writer's name and address, should be sent to: the Editor, Japan Economic Foundation, 11th Floor, Fukoku Seimei Bldg., 2-2 Uchisaiwai-cho 2-chome, Chiyoda-ku, Tokyo, 100 Japan. Letters may be edited for reasons of space and clarity.

## Educating Executives

I read with great interest K. Kobayashi's article in the September/October issue of the *Journal* on Corporate In-house Education. It is clear that the “challenge of globalization” and “business ethics” will be two areas of primary importance in the future. Within the last category, having established business ethics as an area of focus, it is crucial to define the parameters of the ethical code. Ethical rules will be culturally relative and the rules which apply to any given operation will be dependent on the culture and community in which that particular operation takes place.

There is no simple rule book to give the executive operating in a foreign country, nor is there a magic set of guidelines to define a “socially responsible decision.” Defining social responsibility is one of the most difficult tasks for the education of corporate citizens of the future.

One area which clearly stands out in comparing the American education system and the Japanese is that of the importance of extracurricular activities. Not simply sports, but also involvement in community affairs, local politics, and local education. The same interests and involvements continue from university right through work in corporate America. It is completely accepted and expected of the good corporate citizen. This involvement in the community is what brings about the understanding of the community that allows one to make decisions that have a level of social responsibility.

It is this attitude of selfless involvement and participation in the local community (not isolation, and devoted focus on business interests alone) which most Japanese working abroad are lacking, and this represents the largest stumbling block to their “globalization” and development of business ethics. It is very encouraging to see in Japan the recent strengthening of grass roots groups like womens' consumer interest associations and youth for a greener environment. It is my hope that Japanese corporate culture will as soon as possible incorporate some of these values to develop more human and socially responsible organizations.

Barbarine Rich  
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## Securities Scandals Rock Japan's Establishment

Japanese society has been inundated with wave after wave of securities scandals, including the spectacle of big, medium-sized and small securities companies compensating favored clients for their trading losses and even getting involved in money-laundering schemes. Far from isolated cases, these scandals are seen as clear-cut evidence of mutual backscratching during a prolonged period of easy money and easier morals. As such, they have sparked new international dissatisfaction with the workings of what is seen as an unfair market.

In response, the Japanese government has sought to strengthen its regulatory oversight of the securities market. On September 13, the Provisional Council for the Promotion of Administrative Reform proposed that the government establish a Securities and Finance Inspection Board (working name) attached to the Ministry of Finance and give it subpoena and investigative powers equal to those of the National Tax Administration Agency.

The government says it intends to enact the necessary legislation and to impanel this board next July, but there is still considerable doubt about whether or not this will ensure transparency and fairness in Japan's securities market.

### Falling stock and bond prices

The first inkling that the securities companies had been compensating clients for their trading losses came on June 20, when it was revealed that Nomura Securities, Japan's largest securities company, had recorded a trading loss of approximately ¥16 billion in its report for the term ended March 31, 1990, but had later said instead on its tax filing that these were not trading losses but taxable expenses for entertaining clients.

This ¥16 billion, it turned out, was money that Nomura had used to compensate its major corporate clients for trading losses when the bottom fell out of the stock and bond markets. The way the compensation scheme worked, Nomura purchased stocks and bonds from the clients at higher-than-market prices to enable select clients to earn a profit even

as other clients were taking a loss on the same portfolios.

Following this, it was revealed in quick succession that the other three of Japan's Big Four (Daiwa, Nikko and Yamaichi), 13 second-tier securities companies, and even four third-tier companies were also involved in similar schemes to compensate select clients for their trading losses.

The Japanese Securities Exchange Law prohibits any securities company from giving a written promise to indemnify clients against trading losses, and providing such indemnification after the fact in the absence of a written agreement is prohibited by Ministry of Finance directives.

Accepting responsibility, the chairman of Nomura Securities, Setsuya Tabuchi (considered the dean of the Japanese securities industry), and its president, Yoshihisa Tabuchi (no relation) and the president of Nikko Securities, Takuya Iwasaki, all resigned. At the same time, Setsuya Tabuchi resigned his post as Keidanren vice chairman.

### ¥172.8 billion in payments

These securities scandals were also hotly debated in the Diet, and there was considerable pressure for publishing the names of the companies that were compensated. On July 29, the Big Four released their lists. Albeit with some overlap, these lists included a total of 228 institutional investors and three individuals, and the total amount paid came to ¥128,316 million (\$916.5 million at the rate of ¥140/\$).

Within this, it was shown that Nomura paid a total of ¥27,479 million (\$196.3 million) to 48 institutional investors and one individual, Daiwa ¥22,116 million (\$158 million) to 57 institutional investors, Nikko ¥33,100 million (\$236.4 million) to 59 institutional investors, and Yamaichi ¥45,621 million (\$325.9 million) to 64 institutional investors and two individuals.

Not only does the list of compensated institutional investors read like an honor roll of Japanese business, it also boasts a number of public-interest organizations such as the Pension Welfare Service Public Corporation and the Public School Personnel Mutual Aid Association.

On July 31, 13 second-tier securities companies (including such names as

Kokusai and Wako) followed suit by releasing their own lists showing a total of ¥43,696 million to a cumulative total of 380 institutional investors and six individuals. Then on August 16, four third-tier companies unveiled a list of compensation amounting to ¥874 million to a total of 92 institutional investors and individuals.

### Different stories

Almost as soon as these lists were made public, the investors that had received the indemnifications went to the press with statements that they did not really think of this money as compensation at all, or that it was something the securities firm thought up and did entirely on its own initiative. While some of this may have been self-serving, it is quite possible that the recipients had not explicitly asked for compensation and were not aware that this was an extraordinary transaction—which itself just goes to show how much for granted everyone took this collusion between the big securities companies and the big investors. It was a vivid reminder of the moral paralysis afflicting so many Japanese companies and of the very lax state of internal controls.

On the other side of the deal, the securities companies explained that they had paid the compensation in order to keep the investors' business. As the president of Taiheiyō Securities, Masao Komatsu, put it, "These were basically payoffs to hold onto our client list in a very competitive market." Clearly the securities companies felt they were pushed into making the payments.

According to one industry expert, given Japan's system of fixed-rate commissions, the securities companies raked in massive commissions so long as the big institutional investors were making money on their stock trading and other transactions, and it was tacitly understood that they would be there with a little help if the investors ever had to swallow a loss. For the companies, this had the advantage that they were making can't-lose investments. As a result, this was a very comfortable relationship for both sides, and it was easy to slip into the habit of ignoring the little investor's interests.

This cozy relationship between the securities companies and their major in-

stitutional investors was consolidated when interest rates were super-low. As excess liquidity pushed stock prices to dizzying heights, Japan's major non-financial companies raised a total of ¥70 trillion in equity financing in the four years from 1987 to 1990. Much of this money was raised not for capital investment or other specific needs but for *tokkin* and other investment instruments. *Tokkin* are high-risk, high-return products, and it is unthinkable that the companies' chief financial officers would have put so much money into such speculation without help from the securities companies and an assumption that there would be a fixed, guaranteed rate of return.

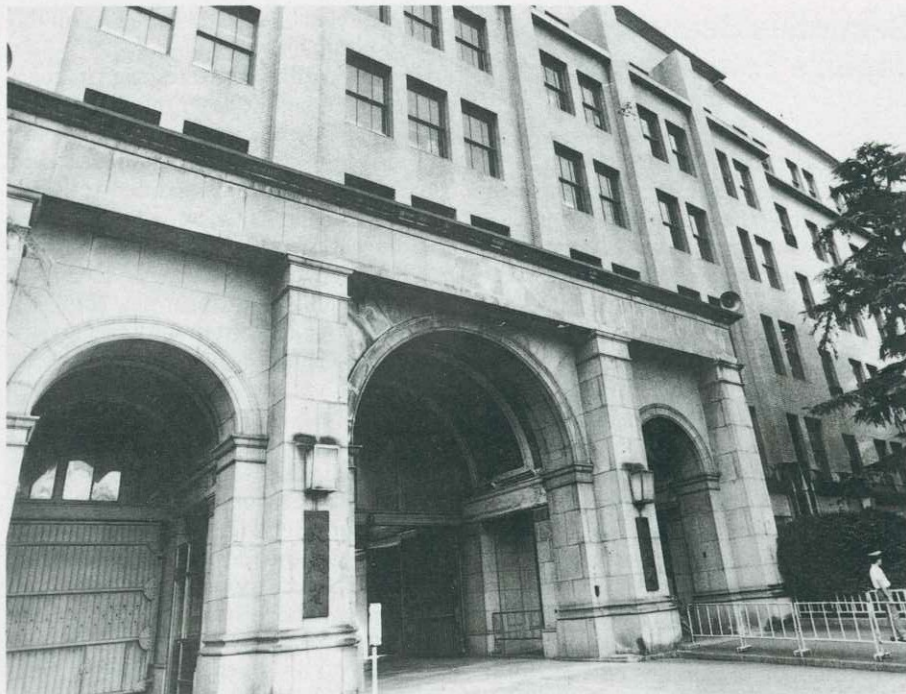
With the amendment of the Securities Exchange Law and the Law Concerning Foreign Securities Firms in October, after-the-fact compensation has been prohibited and penalties have been provided to give the prohibition teeth. Yet some observers have suggested that the problem will not go away until Japan deregulates trading commissions as recommended by the Provisional Council for the Promotion of Administrative Reform.

### Deferring a Japanese SEC

Seeking to prevent similar scandals in the future, the government proposed that a Securities and Finance Inspection Board be established with quasi-judicial powers. In order to ensure that this board is independent of the bureaucracy, it was suggested that the board's members be distinguished people with judicial or other experience appointed by the Minister of Finance and confirmed by the Diet.

In addition, it was also hoped that (i) the oligopolistic state of the securities market could be broken up by making the licensing requirements explicit and thereby facilitating new entries, (ii) stock trading commissions could be gradually deregulated, (iii) the administrative guidance directives could be codified into law, (iv) the securities industry's self-regulatory mechanisms could be beefed up, and (v) a greater sense of personal responsibility could be instituted.

However, the recommendations of the Provisional Council for the Promotion of Administrative Reform say nothing about giving this board an independent power of administrative disposition, and the



Officials at the Ministry of Finance, pictured here, argue that a Japanese version of the SEC would not be compatible with the nation's social structures.

council's original idea of creating a strong and independent Japanese board akin to the SEC was quietly dropped.

From 1947 through 1952, Japan had an independent Securities Transaction Committee. This committee was established on July 23, 1947, but it was not so much a government agency as a forum to discuss the more important issues in securities administration. With the amendment of the Securities Transaction Law in 1948, this was given administrative authority, assigned its own secretariat, and put under the jurisdiction of the Ministry of Finance.

This administrative authority included (i) authority relating to administrative disposition, including the power to revoke the registrations of securities companies, the Securities Dealers' Association and the securities exchanges, (ii) authority over the establishment, amendment and abolition of Securities Transaction Committee regulations, and (iii) authority to mediate disputes regarding securities trading, to investigate rulings by the Securities Dealers' Association, and to file for restraint or cease-and-desist orders from the courts.

This committee differed from the U.S. SEC in a number of ways that made it

distinctly Japanese. For one, it was not an independent body but an adjunct to the Ministry of Finance. For another, it was staffed by people from the Ministry of Finance and not by outside legal experts. And finally, it was not given strong investigative powers. When the Occupation ended in 1952, there was a major review and reorganization of Japan's administrative structures and the committee was abolished.

One of the reasons that no Japanese-style SEC is likely to be established in the wake of the current scandals is that Japanese securities regulations are based not on registrations—as they are in the United States—but rather on licensing, which makes after-the-fact regulation difficult. It was also suggested that splitting the inspection and oversight functions would make securities administration less efficient.

Finally, the Ministry of Finance argued strenuously that an SEC-like organization would not be compatible with Japanese social structures, an attitude that says less about such a proposed panel's compatibility with society than about its obvious incompatibility with today's entrenched administrative and governmental structures. ■