**The Japanese Version of the "Big Bang"**
**—Background and Outlook—**

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## Background

As in the case of numerous other countries, Japan is a nation with a variety of different faces. As can be said also of many other countries, however, the perception of Japan among people around the world is limited to an extremely small number of things and natural features. In the past, these amounted to Mount Fujiyama and geisha. During the postwar period, people around the world gazed with astonishment at the increase in the quality of Japanese industrial products, and the accompanying rise in their status and expansion of market share, and such products as the Sony Walkman and Toyota cars, became new national symbols. Still today the image of Japan as an industrial nation is a strong one. In other words, with the changing of the times, the national symbols have been supplemented by new ones.

During the 1980s what amazed people around the world about Japan was the inflation of the value of its financial assets. Experiencing persistent current-account surpluses, a strong yen, and rising asset values (land and stocks), Japan during that period became the world's largest creditor nation, and Japanese funds poured out across the world. It was the time when Ezra Vogel's book *Japan as Number One* sold well, the presence of Japanese banks and securities companies grew worldwide, and Japanese banks monopolized the upper end of the world rankings in terms of assets. Stock trading and other financial business became very active, banks and securities companies from other countries flocked to set up operations in Japan, and Tokyo indisputably became the biggest financial center in Asia. Tokyo was expected to become one of the world's three major financial centers, together with New York and London.

During the 1990s Japan has retained its leading world status with respect to material "things," such as manufactured goods, and also some areas of computer software, such as game software. This is clear from a look at the country’s trade surplus. But financial strength, which was regarded as constituting another pillar of the Japanese economy, has suffered a serious slump. Although Japan’s status as the world’s largest creditor nation has not changed, the inflation of asset values collapsed after reaching a peak at the end of the 1980s, and since then asset values have declined consistently, manifested in low stock and land prices. This created a mountain of nonperforming loans which burdened Japanese financial institutions with massive bad loans, and brought about a steep decline in the international competitiveness that had been dominant in the 1980s.

The Tokyo market, which Japanese people in the 1980s had expected to rank alongside New York and London, and to be the central market in Asia, is becoming lifeless (see Figure 1). What is more, the credit ratings of many financial institutions are being substantially downgraded, and market activity has declined. At the end of 1997, after the decision had already been made (at the end of 1996), on the basic policy for the Japanese version of London’s “Big Bang” Yamaichi Securities, Japan’s fourth-largest securities house, failed and was compelled to wind up its operations voluntarily. Hokkaido Takushoku Bank also went into liquidation, and several other small and medium-scale banks and securities companies failed. This depression in the financial sector is generating a mood of unease about the entire Japanese economy, which is hobbling the economy.

The following are some of the inherent factors in Japan’s financial markets—including the foreign exchange, stock, bond, futures, and derivatives markets—that have been behind the Tokyo market’s rapid decline since the beginning of the 1990s:

(1) Legal regulations are more numerous than in London and New York, and banks are segregated into a complex range of categories—for example, commercial banks, trust banks, and long-term credit banks.

(2) Consequently, obstacles to the conduct of new financial business arise frequently, thereby impairing the ability of the Tokyo market to create original new products.

(3) Although not in the form of official regulations, there are many unwritten rules, such as administrative guidance by the authorities, and throughout the market there have been areas lacking in transparency.

(4) Costs are extremely high relative not only to European and North American markets, but also to Hong Kong and Singapore, in such forms as various transaction taxes (securities transaction tax), office rentals, staff remuneration, and charges for public utilities.

(5) There are relatively few people able to use English and computers, whereas these two attributes have been pillars of the expansion of the London and New York markets, and Tokyo has lagged behind while Hong Kong and Singapore have expanded.

A number of figures illustrate this. At present a third of transactions in Nikkei 225 futures are in fact conducted not in Tokyo but in Singapore. In addition, the number of foreign companies listed totals 290 in New York, 533 in London, 560 in Frankfurt, and 187 in Paris, but only 67 in Tokyo. This is an outstanding example of the poor conditions in the Tokyo market and its parochiality as a market.

In light of the fact that the Japanese economy holds personal savings of ¥1,200 trillion—savings equivalent to approximately one-third of the worldwide total—the weakness of the Tokyo market is clear for all to see.

**Recent History**

From the 1980s there was a debate over the necessity to make the Japanese financial system competitive by implementing reforms of the type carried out in the United States in the 1970s (the deregulation of stock brokerage commissions in 1975) and in Britain during the 1980s (London's "Big Bang" in 1986). This was because it had become clear that, compared with its size, the Japanese financial industry was inferior in terms of efficiency and competitiveness.

By the beginning of the 1990s the decline of Japan's financial markets and financial industry relative to the strength of Japanese manufacturing industry, which had retained its leading global standing, had become universally clear. This was because, be it the stock market or the foreign exchange market, trading volume had not risen compared with the vigorous activity in London and New York, and Tokyo's impact on the levels of market prices worldwide had declined markedly.

What has come as a shock to the Japanese is that despite the fact that the local economies are incomparably small in scale, the Hong Kong and Singapore financial markets, which benefit from such factors as relatively little regulation, low costs (public utilities charges, taxes, office rentals, costs of running back offices), and ready availability of English-speaking staff, have grown rapidly in strength while the Tokyo market has been hollowed out, so much so that these other two markets threaten to ultimately usurp Tokyo’s status as the financial center of Asia.

During the 1990s there has been a marked tendency for foreign banks and securities companies, which previously had scrambled to set up operations in Tokyo, to shift their Asian bases to Singapore or Hong Kong. Given this, the view has emerged that among the world’s leading markets the Tokyo market will become a local market. Furthermore, owing to such factors as regulations and the time required to gain official approvals, new financial products have ceased to emerge from Japan. In consequence, the Tokyo financial market has been described in some quarters as a “low-technology market.” Compared with Japanese manufacturing industry, which is indisputably a world-class high-technology industry, the weakness of the financial market has become very marked.

A widely held opinion that arose was that the loss of financial business and the decline of the financial markets (stock, bond, foreign exchange, commodity markets, etc.) would lead to falls in tax revenues and employment, causing the economy to contract and the country to decline. Consequently, the view that emerged was that Japan must not simply be a country that makes products; it had to become Asia’s financial center.

On November 11, 1996, Prime Minister Ryutaro Hashimoto laid out a basic policy of reforming Japanese financial markets and placing the Tokyo market on a par with the New York and London markets by the year 2001. This was the Japanese version of the “メ Big Bang モ,” under the catchwords “free, ” “fair, ” and “global. ”

“Free” means a free market based on market principles. By this Hashimoto was advocating the elimination of the troublesome regulations that had existed hitherto to ensure that the Tokyo market becomes a market embodying the realization of market principles. “Fair” means being a transparent and fair market, bringing refereeing based on transparent and equitable rules to the fore. This would sweep away the lack of transparency that has been said to characterize the Tokyo market. “Global” means aiming to be an international and ultramodern market. That is, there would be a constant devotion to global standards, not a focus on domestic logic.

Specifics of these three catchwords are set out below:

1. Free: A free market based on market principles

(1) Removal of limitations on entry into banking, securities, and insurance business and incorporation of the principle of free competition

(2) Abolition of the separation of banking business into short and long-term business and expansion of the securities business handled by banks (to satisfy customer needs)

(3) Liberalization of various fees and commissions (particularly stock brokerage commissions)

(4) Efficient management of personal financial assets through domestic and overseas transactions (the revision of asset-management regulations and improvement of disclosure)

2. Fair: A transparent and fair market

(1) Thorough disclosure at all levels, from corporate accounting to government administration (provision of adequate information)

(2) Establishment of the principle of self-responsibility (principle of self-responsibility upon clarification of the rules)

(3) Severe punishment (upon clarification of the rules, severe punishment for violations of the rules)

3. Global: An international and ultramodern market

(1) International standardization of the accounting system and improvement of the legal system pertaining to the development of derivatives

(2) Establishment of a cooperative system for global supervision

(3) Rationalization of taxation to attune it to internationalization

Today, the documentation compiled by the Ministry of Finance (MOF) relating to the revision of laws alone totals 2,129 pages and weighs 4.4 kilograms.

**Objectives**

The objectives of the Japanese “Big Bang” are as follows:

(1) To blow a new wind of fair competition into Japan’s rapidly declining financial industry and, by infusing the markets with vigor, to give the Japanese economy the strength to revive itself. To this end, the regulations that have hitherto been squeezing the market are to be eliminated as far as possible, so as to create competitive conditions similar to those in other markets such as London and New York.

(2) To prepare for a process of the survival of the fittest that will result from the competition generated in this way, through which strength will be retained in the market and weakness removed, infusing the Japanese financial markets and financial industry with vigor. In this way, the financial sector will develop to become a pillar of the Japanese economy in tandem with the manufacturing sector.

(3) By reviving the financial services industry in this way, to ensure that it becomes a fitting support for the strong manufacturing sector and is nurtured as an industry that supports the Japanese economy amid the ongoing aging of Japanese society.

(4) To brake the decline in foreign exchange business and outflows from Japan, for example of stock trading business and branches of foreign banks, and restore the status of the Tokyo market as Asia’s leading financial market ahead of Singapore and Hong Kong.

These are the macroeconomic objectives of the “Big Bang.” Among the more specific purposes, the most important is that of increasing opportunities for individual investors to invest their assets. This is the realization of consumer sovereignty in finance. Assets held by Japanese individual investors are generally believed to total ¥1,200 trillion, the equivalent of one-third of aggregate savings worldwide. What is important is that more than half of this ¥1,200 trillion remains deposited with banks and post offices.

In spite of the fact that interest rates on large-denomination time deposits with terms of three or four years are low, at only around 1%, the current state of Japan’s securities and other financial markets is such that there is a paucity of other attractive products in which to invest, though the Japanese “Big Bang” will bring about an enforced transformation of this environment.

As well as being flung from their present protected environment into a world of competition, Japanese financial institutions will be able to engage in diverse product development that regulations previously prevented them from undertaking. The financial institutions that succeed in this environment will be the victors, and the door is also being thrown open wide to foreign financial institutions. Indeed, recently the activity of foreign financial institutions in the Tokyo market has been showing an abrupt increase (see Figure 2).

**Schedule**

The Japanese “Big Bang” will not be a one-off massive explosion as suggested by its name, but rather a series of explosions of various sizes. The following are among the measures implemented up to March 1998:

—Lifting of the ban on options transactions in specific stocks by securities companies (1997)

—Lifting of the ban on the sale of investment trusts by banks (1997)

—Deregulation pertaining to the regulations governing pensions management (1997)

In practical terms, the start of the Japanese “Big Bang” was proclaimed by the revision of the foreign exchange law on April 1, 1998. With that, institutions other than authorized foreign exchange banks have become able to engage in foreign exchange business (reducing costs to companies), and netting has become possible. This point will be explained in greater detail below. Also going into effect on April 1 were the following:

—Extension of the liberalization of securities companies’ brokerage commissions (transaction value lowered from more than ¥1 billion to more than ¥50 million)

—Lifting of the ban on the establishment of financial holding companies (Financial holding companies are holding companies owning suchi institutions as banks, securities companies, and trust banks as subsidiaries, and are an important target of deregulation through the “Big

Bang.” The establishment of these financial holding companies makes it possible for financial institutions to provide comprehensive and diverse integrated financial services, which should be beneficial for both consumers and investors.)

The following measures are planned (as of April 1998):

July 1998

—Establishment of the Financial Supervisory Agency

—Liberalization of nonlife-insurance premium rates

During fiscal 1998 (April 1998–March 1999)

—Transfer of securities business to a registration system

—Disembargo of investment advisory and other asset-management services

—Disembargo of sale of insurance by securities companies

—Disembargo of sale of investment trusts by banks as principals

—Introduction of corporate-type investment trusts and private-placement investment trusts

—Disembargo of over-the-counter derivatives trading by banks and securities companies

Fiscal 1999

—Complete liberalization of the business areas of subsidiaries in separate business categories (the issue of stocks and secondary trading business by banks’ securities subsidiaries; pension trust business by securities companies’ trust subsidiaries)

—Complete liberalization of stock brokerage commissions

January 2001

—Complete liberalization of participation in third-sector fields by domestic life and nonlife insurance companies (Third-sector fields for insurance companies include sickness/medical insurance. Major life insurance companies are currently prohibited from entering this field, but the sector will be completely liberalized from this date.)

2001 and beyond

—Disembargo of sale of insurance at bank counters

**Impact of "Big Bang"**

The financial reform in New York during the 1970s, and the original "Big Bang" in the City of London in the 1980s both brought about great change to their respective markets. A look at how these two markets fared following the reforms may enable some kind of prognosis to be made as to the eventual outcome of the Japanese "Big Bang."

In New York, stock brokerage commissions were liberalized on May Day 1975, sparking fierce competition among securities brokers. The large-scale securities houses whose business was concentrated on wholesale business (securities business not with individual investors as clients, but with large-scale investors such as companies and institutional investors) shifted the core of their earnings from brokerage commissions to mergers and acquisitions and profits from trading, while the small and medium-scale brokers sought to break away from their structural dependence upon stock brokerage commissions by deriving their earnings from handling investment trusts and asset-backed securities. Prior to the implementation of the financial reform, the nature of the business operations of securities brokers in New York was far more uniform than it is today.

As a result of liberalization, however, progress was made in the United States in such forms as the development of derivatives markets, mergers and acquisitions, the emergence of asset-backed securities, the expansion of the NASDAQ market, and the proliferation of investment trusts, and in the 1980s the U.S. securities markets eventually broke out of the depression of the 1970s. A comparison of 1975—the year of total liberalization—with 1995 shows that the net income of securities companies after deduction of financial expenses grew from $28.6 billion to $58.1 billion. Firms fell by the wayside, but the industry as a whole achieved substantial development, and its prosperity continues today (see Figure 3).

What is more, the securities industry is continuing to change day by day, including the diversification of types of commission (for example, wrap accounts and annual-commission systems); the growth of discounters, the appearance of deep discounters through Internet trading, and the forging of tie-ups between financial planners and securities companies, all of which respond to diverse investor needs.

The main aspects of London's "Big Bang" included (1) the complete liberalization of trading commissions, (2) the abolition of the single-capacity system (to increase the size of and strengthen the earnings base of securities companies to enable them to cope with the complete liberalization of trading commissions, firms were permitted to act as both jobbers and brokers—two categories that had previously been strictly segregated), (3) the opening-up of membership of the stock exchange (City reorganization was accelerated by foreign capital), and (4) the lowering of the 1% tax on share transactions—the equivalent of Japan's securities transaction tax—to 0.5%.

The financial markets were invigorated by this series of measures and buoyed by the simultaneous worldwide rise in stock prices in 1986. Trading volume and trading value both rose, and the City reinforced its status as an international financial center. However, this was assisted by the progress of institutionalization, while a proportion of private investors were lost. The income of securities companies declined, and many small and medium-scale firms withdrew from market making and affiliated themselves with large firms. In business areas in which institutional investors were the clients, investment banks from continental Europe launched into London, and other developments such as the influx of large U.S. securities firms, led to more frenzied acquisition activity.

Some examples of mergers between merchant banks in Britain are given below:

| Acquired company | Acquiring company |
|---|---|
| Morgan Grenfell | Deutsche Bank |
| S.G. Warburg | Swiss Banking Corp. |
| Barings | ING (Netherlands) |
| Smith Newcourt | Merrill Lynch (U.S.) |
| Kleinwort Benson | Dresdner Bank (Germany) |

This phenomenon of acquisitions of British financial institutions sparked by the "Big

Bang” is known as the “Wimbledon phenomenon,” derived from the fact that although Britain provides the world’s foremost arena for tennis at Wimbledon, the winners of the Wimbledon tournament tend to be German or American players.

As a result of the “Big Bang,” however, London regained the status as one of the world’s leading financial markets that it had almost lost, leading to increased employment for British people, creating prosperity for the British economy, and increasing the range of choices for investors. Despite the extinction of the names of some of Britain’s traditional financial institutions, there is near-unanimous agreement that the British “Big Bang” was a success.

If the Japanese version of the “Big Bang” proceeds according to plan, it is expected to bring about changes greater than those that occurred in the London and New York markets. The Japanese financial markets are much more severely regulated than financial institutions in New York and the City, and Japanese financial institutions have conducted their business under “convoy system” supervision. This differs substantially from the London and New York markets, where deregulation had made considerable progress, and firms previously were able to display some degree of individuality in their management.

Japanese financial institutions will be leaping into a totally new world. The intensification of competition will make it essential for every individual financial institution to develop a more individual character, since commission structures will move markedly lower, with the result that institutions will be unable to develop business if they do not acquire more individuality and differentiate their products and services. Triggered by the “Big Bang,” Japanese financial institutions will plunge into a completely new paradigm.

It is uncertain whether the same kind of “Wimbledon phenomenon” that occurred in the London market will occur in the Tokyo market. The capital bases of Japanese financial institutions are much larger and more solid that those of the London merchant banks at that time, and if the yen does not weaken substantially, it will not be easy for foreign financial institutions to acquire them. Nevertheless, instead of going as far as the acquisition stage, there may be frequent instances in which Japanese financial institutions form business tie-ups with foreign financial institutions and establish joint-venture companies. In fact tie-ups and joint ventures of this type are already occurring, and piecemeal acquisitions—in the form of the partial acquisition of the defunct Yamaichi Securities by Merrill Lynch—are also beginning.

There is a strong likelihood that Japan’s financial markets will undergo substantial change through greater individuality and differentiation in this way, through tie-ups and joint ventures with foreign financial institutions, through increasingly fierce competition, and through changes in relationships with corporations and individual investors. If changes in London and New York are any guide, it is highly probable that once changes get under way, they will continue relentlessly. Thus if the reforms proceed smoothly, in 5 or 10 years’ time Japan’s financial markets most probably will have changed to an unimaginable extent from what they are today. Also, even if the number of firms participating in the financial markets declines, the lineup will be diverse in character, the number of people working in the markets will not decline, business will become more active, foreign financial institutions will join the fray and compete, and the markets will likely become a pillar supporting a vibrant Japanese economy.

**Problems**

A number of problems with the Japanese “Big Bang” are being pointed out, however: the fact that more than 20 years have elapsed since the reform in New York and more than 10 years since the reform in London, the economic conditions currently facing Japan, and the fact that the systems and structures that served Japan well in leading the country’s postwar economic development will be compelled to change by the vortex of the “Big Bang.”

The first problem is that of the strength of financial institutions. The aftereffects of the bubble period of the 1980s constitute a major headache for Japanese financial institutions. The biggest problem is the massive amount of bad loans that remain. Given that the decline in land values in Japan shows no sign of ceasing, the burden of charging these off will not be alleviated. Viewed overall, it is no exaggeration to say that the strength of Japanese financial institutions is at its weakest ever point in the postwar era.

What is being debated within the country is that, given the state of this strength, the impact of a major reform like the “Big Bang” will be to destabilize the operations even of financial institutions that would otherwise survive, which in turn may hobble the Japanese economy itself. The argument runs like this: The state of the Japanese economy is that of a patient sipping rice gruel in a hospital bed, and what the "Big Bang" will do is to bring a fatty steak and stuff it forcibly down the patient's throat. Unskillful treatment will likely lead to the patient's contracting more than simply diarrhea and being admitted once again to the intensive-care ward. One view expressed is that, in view of this, what is needed urgently is to rapidly build up bodily strength (establish the prospect of a resolution of the bad-loan problem) so as to at least enable the sick person to get out of bed and go for a stroll in the garden. If this argument gains strength, the present schedule may be changed.

The second problem is the clash with Japan's postwar system. Once the Japan-U.S. security arrangements had been put in place after Japan's defeat in World War II, Japan hastened to pursue economic success as its principal goal. Japan was fortunate insofar as it was able to use new industrial plant and equipment in fields of previous industrial strength, such as silk production, armaments industries, and shipbuilding, to make a new start amid the postwar ruins, and was provided with a major market in the form of the United States. In the aftermath of the war there was huge global demand, and the key to economic growth lay in how to concentrate capital, build industries, and export manufactured goods. Amid this process, the job of the industries in the Japanese financial sector was to acquire low-cost capital funds from the people and provide them to the industrial sector.

The borrowers were there, if only the funds could be raised, and these industrial and financial structures continued in a stable manner for nearly 30 years. Against this backdrop, stable industrial structures came into being in the forms of lifetime employment, a structure of administrative guidance by government agencies and cooperation by the private sector, and a predisposition on the part of industries not to compete. Even today this remains very strong in the Japanese financial industry, which has adhered to regulations to the last and has not faced global competition directly.

The Japanese "Big Bang" will change the order and culture that have persisted for decades in the postwar era in the Japanese financial sector. And to change that order and culture, there needs to be considerable resolution on the part of the government and organizations, and also of the work force and investors. Opinions ranged against this are that the Japanese people are not yet prepared for this, that Japanese people have traditionally placed a higher value on *wa* (harmony) than competition, and that if the "Big Bang" is enforced rapidly, it will give rise to social instability.

The third problem is the problem of the people's awareness. The problem here is that as financial business has been conducted amid a climate of regulations and excessive guidance and supervision, it appears that in Japan the principle of assuming self-responsibility in investment has not been established. When some kind of problem arises in the course of financial transactions between ordinary people in Japan, normally the mass media address the matter with such questions as "What's the matter with the authorities?" or "Why did the MOF not supervise this?" For people with normal ability to make judgments, however, the principle guiding investment decisions is that of self-responsibility, while the authorities are only the final adjudicators.

The Japanese "Big Bang" will demand greater self-responsibility on the part of Japanese investors, and financial institutions will have to sell products with an exposure to risk by explaining to investors that there is a risk. But for their part, investors require profitable and safe financial products. We can see that it will be some time before the awareness that financial products of all kinds carry inherent risks takes firm root among Japanese investors.

**Japan's "Big Bang" Under Way**

Even though such arguments and doubts remain, however, Japan's "Big Bang" took its first major step with the enforcement of the revised foreign exchange law on April 1, 1998. In spite of the arguments and doubts, the financial sector will certainly be thrust into the same world of international competition that Japan's manufacturing industry has already experienced for decades.

The principal points of the revision of the Foreign Exchange and Foreign Trade Control Law are as follows:

(1) Foreign exchange business can be engaged in freely, not through the medium of authorized foreign exchange banks.

(2) There is no obligation to file reports to the tax authorities for foreign remittances of up to ¥2 million.

(3) Foreign deposit accounts may be opened freely, requiring only subsequent notification.

(4) Anyone may engage in money-changing business.

(5) Foreign-currency transactions may be engaged in freely, including transactions between residents.

To summarize the history of Japan's foreign exchange law, the Foreign Exchange and Foreign Trade Control Law was enacted in 1949, though external transactions were prohibited in principle and the market was closed. Through a revision of the law in December 1980, it became possible to conduct foreign exchange transactions freely in principle, but in reality detailed prior approval and notification was required, which meant that it was the same as being subject to regulation. The recent revision of the law, however, has brought about genuine liberalization.

The biggest factor setting this genuine liberalization in motion was the sense of crisis about the hollowing-out of the Tokyo financial markets, disconnected from the global standard. Today the globalization of money and capital transactions is proceeding very rapidly, and we are in an age in which the parties to these transactions are able to select their markets. Previously, transacting parties had been confined within the limits of Japan, but with the progress of globalization, the reality is that these entities engaging in transactions are distancing themselves from Tokyo. Since globalization means that money and capital transactions are directed toward more efficient and convenient markets, financial markets will themselves be exposed to fierce international competition.

From now on, all external capital transactions are liberalized, and the buying and selling and lending and borrowing of foreign currencies between residents can be conducted freely. That is, companies and individuals are able to buy, sell, lend, and borrow dollars and other foreign currencies without going through the medium of banks. This is an era in which foreign currencies can be changed at convenience stores, raising the possibility that, in consequence, businesses of all types will come into being. But it will cause a decline in the income of banks, which formerly received commissions for changing money. And a variety of other changes are conceivable. For example when purchases are made through the Internet, if local bank accounts are used for the settlements, purchasers could benefit doubly from disparities between overseas and domestic prices and low commissions.

With regard to securities, if bank accounts are opened overseas, not only will the buying and selling of foreign stocks be able to be conducted from those accounts, but also trading in Japanese securities. When Japanese equities are bought or sold in London, securities transaction tax is zero, and stock brokerage commissions are only one-tenth the level in Japan. Thus, not only institutional investors but also individuals will engage in stock investment overseas.

In addition, whereas in Japan withholding tax is levied on receipts of deposit interest, interest on yen bonds, and stock dividends, in London there is nothing to pay. So unless rapid moves are made to abolish the securities transaction tax and liberalize commissions, Japan's securities and other financial markets will hollow out.

Accordingly, once the reform process has begun, it should initiate a chain reaction, whereas going back on the reforms would lead immediately to a decline in the competitiveness of the Japanese financial sector. Furthermore, once individual investors and industrial corporations have experienced the benefits of financial liberalization, they will naturally not want to part with the fruits of reform, such as low costs and convenience.

**Irrevocable Reform**

Nevertheless, even if the Japanese "Big Bang" goes according to plan, and the Japanese financial industry regains competitiveness on a par with that of London and New York, there will naturally still be a number of hurdles to cross before it can be determined whether the Tokyo market will become one of the world's three leading markets.

First, there is a danger that the pain caused by reform will persist for part of the Japanese population and Japanese industry, leading to political pressure. That will happen if private-sector companies do not press ahead with their own reform efforts, and if the cooperative relationship between the private sector and the supervisory authorities does not function well.

Second, there is a danger that the Japanese economy will not rise out of its persistent stagnation and the market environment will not improve. Indeed, the liberalization of the U.S. stock markets in the mid-1970s was unable to invigorate the markets in the latter half of the 1970s. Owing to the prolonged slump in the overall economic environment resulting from such factors as the oil crisis and misgovernment by the administration of President Jimmy

Carter, stock prices did not rise, and there was no increase in trading volume. The August 13, 1979, issue of *Business Week* contained a special feature on the “death of stocks.” It was not until the time of the administration of President Ronald Reagan in the 1980s that the New York market became active, indicating that it is not reform alone that invigorates markets and that an essential prerequisite is the invigoration of the economy. Japan’s economy is currently lacking in vigor, and its markets stubbornly reflect the economy.

The third hurdle is the extent of the recovery of transparency. English-language-based financial markets such as London and New York are easy to understand by people around the world, because their language is the most commonly used worldwide. In addition, as a nation of immigrants it is advantageous above all for the United States to operate its markets in accordance with rules based on regulations that are written down clearly.

The Tokyo market, being based on the Japanese language, starts out at something of a disadvantage. In Tokyo there are insufficient people with English-language ability who are capable of running either front offices or back offices adequate for the conduct of international financial business. What is more, even those that are employed cost a great deal.

It does not necessarily follow, however, that either Japan or the Japanese people are maladjusted to reform and competition. History shows that the Japanese implemented the reforms embodied by the Meiji Restoration, and overcame the confusion of the postwar era. A look at industry shows that manufacturing industry is right at the front rank globally in numerous sectors, a fact that in some respects is a testament to the flexibility of Japan and the Japanese people.

In any country, it is very difficult to discard ways of doing things once they have been successful. When new problems arise, people tend to cling to what has proven to be successful in the past. Both Japan and Germany have experiences of great success in the postwar era, and a unique industrial structure and employment system came into being during the period of high growth. Today, however, there is a need to forget these for now and to seek out new methods, because the economic environment has undergone serious change. The need has arisen for the unlearning of successful experiences, though this is not an easy thing to do; both Japan and Germany need time for the unlearning process.

Industries in the financial sector, which use words and software (including knowledge and concepts), certainly differ from manufacturing industries in the world of physical things. Accordingly, it is not known whether by the year 2010 Japanese finance will have climbed back to rank among the “things and natural features” described at the beginning, where I mentioned that “the perception of Japan among people around the world is limited to an extremely small number of things and natural features.”

One thing that can be stated with certainty,however, is that once reform has begun, it will initiate a chain reaction, and the Japanese financial sector in 10 years’ time will have undergone a considerable transformation.

**Yoichi Itoh**

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