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AN EVALUATION OF THE PROPOSED FAIR TRADE IN
FINANCIAL SERVICES ACT

Dennis Bower*

I. INTRODUCTION

The Omnibus Trade and Competitiveness Act of 19881 (OTCA) requires the Treasury Department to report every four years on the ways in which foreign countries discriminate against U.S. banking and securities firms.2 If a government is found to discriminate against U.S. banks, the President (or Presidential designee), "when advantageous," must hold discussions aimed at securing access to foreign markets for U.S. banks and securities firms.3 The proposed Fair Trade in Financial Services Act (FTFSA) seeks to "strengthen the Treasury's hand in any such negotiations."4 The FTFSA has traveled to the brink of passage several times, only to fail despite wide-spread expectations of success.5 It was re-introduced in late 1993, and is expected to become law due to bi-partisan support in Congress and backing by the Clinton Administration.6

The FTFSA authorizes two penalties for nations that discriminate against the United States in financial services: first, preventing their banks that currently have operations in the United States from expanding;7 and second, prohibiting entry to the U.S. market for their banks that currently

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* J.D. Candidate, Case Western Reserve University School of Law (1995).


2 Id.


do not have a U.S. presence. In essence, this act would allow the Treasury to abandon the current U.S. policy of “unconditional national treatment” for foreign banks that is embedded in the International Banking Act of 1978. The FTFSA would instead transform U.S. policy to one of reciprocal national treatment.

While supporters of the FTFSA express concern about closed markets in developing countries such as Korea and Taiwan, the FTFSA’s clear target is Japan. Its inspiration, at least in part, is the provocative set of facts regarding the comparative ownership of banking assets worldwide by U.S. and foreign interests. For example, U.S. banks control $230 billion in banking assets in Europe, while European banks and corporations control $184 billion of these U.S. assets. In Japan, however, the U.S. controls only $19 billion of banking assets, while the Japanese control $434 billion in U.S. assets. The relative magnitude of the U.S.-Japanese imbalance is perhaps even more striking: the United States controls one percent of Japan’s banking market, while Japan has fifteen percent of the U.S. market, and approximately twenty-five percent of the market in California.

Further inspiring the FTFSA is the decline in the number of U.S. banks on the list of the world’s largest banks. Thirty years ago most of the world’s largest banks were American, yet today no American banks are ranked among the top twenty (the largest U.S. bank, Citicorp, ranks only thirty-second); in contrast, Japan dominates the list of the world’s largest banks on the list of the world’s largest banks.

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8 Id. at § 18(e)(1)(c).
9 The practice of applying the same regulations, and no more, to foreign companies as domestic ones without requiring the same in return. “National treatment” is the approach to commercial regulation “under which foreign enterprises are treated as competitive equals with their domestic counterparts” and establishes “parity of treatment between foreign and domestic banks in like circumstances.” Conference of State Bank Supervisors v. Conover, 715 F.2d 604, 606 (D.C. Cir. 1983) (citing S. REP. No. 1073, 95th Cong., 2d Sess. 2 (1978)).
11 “Under this policy [reciprocal national treatment], we demand that foreign governments give American firms operating in their market the same economic opportunities offered to foreign firms in our market. It is the Golden Rule of international trade.” Hearings, supra note 4, at 26 (statements of Congressman Richard Gephart).
12 Id. at 15.
13 Garsson, supra note 4, at 3. See generally Hearings, supra note 4.
14 Id. at 11.
15 Id.
16 Id.
17 Id.
18 Ranking the World’s Largest Banks, INSTITUTIONAL INVESTOR, Sept. 1993, at 115,
largest banks, owning thirteen out of twenty of them.\textsuperscript{19}

This Note examines the assumptions underlying the FTFSA to determine if it can successfully eliminate this imbalance and force Japan to rid itself of discriminatory trade practices. The Note examines the idea that the imbalance is not simply the result of Japanese regulatory protectionism, but the result of macroeconomic factors, U.S. regulatory choices, and historical happenstance. Moreover, as the Note further concludes, the FTFSA is founded on the erroneous notion that the imbalance is harmful, when it has, in fact, provided benefits to the United States. Therefore, the FTFSA is misguided because it incorrectly places the cause of the imbalance and seeks, through provocative means, to “correct” a situation that does not require correction.

In Section II, the provisions of the FTFSA are discussed with regard to banking (provisions relevant to the securities industry, also contained in the FTFSA,\textsuperscript{20} will not be addressed). Section III explores the legality of the FTFSA under international law. Section IV proceeds to examine the validity of key assumptions on which the FTFSA is based. Several topics discussed in this Section include the impact of discriminatory trade practices on asset imbalance and the effect of regulations, both Japanese and American, on that imbalance. Section V reviews factors other than discrimination that may influence the asset ownership imbalance. Section VI tests the presumption that the asset imbalance is a danger to the United States. Section VII discusses the consequences of the FTFSA and contains the Note’s conclusion that the FTFSA is unwise and should not become law.

II. THE FTFSA

The FTFSA\textsuperscript{21} is intended to “encourage foreign countries to accord national treatment to U.S. Banks and Bank Holding Companies that operate or seek to operate in those countries.”\textsuperscript{22} “National treatment” occurs when a foreign country offers U.S. banking organizations the “same competitive opportunities (including effective market access) as are

\textsuperscript{19} Id. See also Clemens P. Work & Douglas Stanglin, Is Bigger Better in Banking, U.S. NEWS & WORLD REP., Oct. 12, 1987, at 52-54; James R. Kraus, Foreign Banks Still Seizing Greater U.S. Market Share, AM. BANKER, Feb. 27, 1990, at 1 (noting that Japanese banking assets in the U.S. amount to more than eight times the amount of the second place Italians).

\textsuperscript{20} H.R. 3248, 103rd Cong., 1st Sess. § 3 (1993).

\textsuperscript{21} H.R. 3248, 103rd Cong., 1st Sess. (1993) [hereinafter FTFSA].

\textsuperscript{22} Id. § 2 (adding IBA § 18(a)).
available to its domestic banking organizations." In identifying foreign countries that discriminate against U.S. banks, the Secretary of Treasury is not limited to the official report as required by the Omnibus Trading Act of 1988, but may inquire into recent information that the Secretary deems important.

Moreover, in determining if a foreign state denies national treatment to U.S. banks, the Secretary may look at such factors as the size of the foreign country’s market; the extent to which U.S. banks are operating or wish to operate there; and the extent to which U.S. banks may participate in the development of the foreign nation’s rules and regulations. The Secretary is also directed to consider the availability of a nation’s rules to the public and the degree to which they are objectively applied. However, no such determination may be made if it is inconsistent with prior bilateral or multilateral agreements.

If a determination is made that a foreign nation is not providing national treatment to U.S. banking organizations and that the denial of this treatment is having a significant adverse effect on U.S. banks, the Secretary must consult with the U.S. Trade Representative, the Secretary of State, and “any other department or agency that the Secretary deems appropriate” and, after such consultation, must publish the determination in the Federal Register. (Such a finding by the Secretary, in contrast to the OTCA, must be reviewed at least annually.) Further, the Secretary must inform the bank supervisors of each American state of his findings.

If a determination has been made that a nation discriminates against U.S. banks and this fact has been published in the Federal Register, then applications by banks to U.S. banking authorities made by that foreign
nation to expand operations or open operations in the United States may, with concurrence of the Treasury Secretary, be denied. There is a general exception provided for any nation meeting or exceeding the provisions of the Second Banking Directive of the European Community. The imposition of these sanctions is discretionary with the Secretary, and the Secretary is specifically directed to consider, in exercising this discretion, the extent to which a foreign nation is progressing towards offering U.S. banks national treatment and the extent to which U.S. banks can operate, even if it is with less than national treatment.

If a determination is made, the Secretary must initiate negotiations with the foreign state to achieve national treatment, and, even without an official determination, may initiate negotiations with countries that deny U.S. banks such treatment. However, negotiations are not required if the Secretary should deem them fruitless. If this is true, he must notify the Senate’s Committee on Banking, Housing and Urban Affairs and the House’s Finance and Urban Affairs Committee.

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The proper authority in the case of banks not insured by FDIC, but which are members of the Federal Reserve, is the Board of Governors of the Federal Reserve; in the case of insured banks, it is the Board of Governors of Federal Reserve, as defined by the Federal Deposit Insurance Act. Id. (adding IBA § 18(I)(A & B)).

The Second Banking Directive is defined as “the coordination of laws, regulations, and administrative provisions relating to the taking up and pursuit of the business of credit institutions and amending directive 77/789/EEC (89/646/EEC).” Id. (adding IBA § 18(I)(5)).
III. INTERNATIONAL LEGAL REGIME

A. United States-Japan Friendship, Commerce, and Navigation Treaty

The United States-Japan Friendship, Commerce and Navigation Treaty (FCN)46 provides that "[e]ach Party reserves the right to limit the extent to which aliens may within its territories establish, acquire interests in, or carry on . . . banking involving depository or fiduciary functions. . . ."47 This reservation establishes that, for banking, national treatment is not obligatory.48 However, it is circumscribed in two ways. First, "new limitations imposed by either Party upon the extent to which aliens are accorded national treatment, with respect to carrying on such activities within its territories, shall not be applied against enterprises [owned or controlled by the other Party] which are engaged in such activities . . . at the time such new limitations are adopted."49 Second, with regard to the reserved classes of activities, "companies of either Party, as well as enterprises controlled by such [companies] shall in any event be accorded most-favored-nation treatment."50 These exceptions apply to both branches of banks organized in the other country and subsidiary banks in the United States that are controlled by a company organized in Japan.51

47 Id. at art. VII(2).
48 "Nationalistic fervor of the post-war era . . . prevented universal application of the national treatment rule. Thus, in sensitive areas where the host country could not ignore the divided loyalties of foreigners . . . . . . " Spiess v. C. Itoh & Co., 643 F.2d 353, 359-60 (5th Cir. 1981), vacated on other grounds, Sumitomo Shoji America v. Avagliano et al., 457 U.S. 176, 189, (1982).
49 FCN, supra note 46, at art. VII(2).
50 The treaty defines "national treatment" as "treatment accorded within the territories of a Party upon terms no less favorable than the treatment accorded therein, in like situations, to nationals, companies, . . . of such Party." Id. at art. XXII(1).
51 Id. at art. VII(4).
52 "Most-favored-nation treatment" is defined by the FCN as "treatment accorded within the territories of a Party upon terms no less favorable than the treatment accorded therein, in like situations, to . . . companies. . . . of any third country." Id. at art. XXII(1).

In sensitive industries, the Parties were reluctant to award national treatment privileges, but were granted the lesser protection of most-favored-nation status. Spiess, 643 F.2d at 360.

51 In Sumitomo Shoji America v. Avagliano et al., 457 U.S. 176, 189 (1982), the Supreme Court held that for purposes of art. VII(1) of the FCN, subsidiary companies organized in the United States and owned by the Japanese were American, not Japanese.
The FTFSA may breach these restrictions in two ways. First, the FTFSA provides that if Japan is found to be discriminating against U.S. banks, Japanese banks currently operating in the United States may be prevented from expanding their operations here.\(^2\) Hence, the FCN's protection accorded to established enterprises from "new limitations" would be violated. Second, the FTFSA provides that Japanese banks not currently operating in the United States would be prevented from establishing operations in the United States if Japan nation was found to be discriminating against U.S. banks.\(^3\) Application of this portion of the FTFSA against Japan may violate the FCN's most-favored-nations provision, because banks of nations not found to be discriminating against the United States would be permitted access to the U.S. market;\(^4\) meaning in short, that Japan would be subject to less favorable treatment than other nations. Therefore, application of the FTFSA's sanctions may cause the United States to breach its obligations under the FCN.\(^5\)

The FCN provides that disputes between the United States and Japan as to interpretation and application of the FCN will, if not solved by diplomacy, be submitted to the International Court of Justice for resolution.\(^6\) Thus, the Japanese may, if the sanctions of the FTFSA are applied against it, seek resolution by the International Court of Justice.\(^7\) The Japanese may also resort to "reprisals."\(^8\) Although a material breach

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\(^2\) FTFSA, supra note 21, § 18(e)(2)(A)(I).

\(^3\) Id. § 18(e)(2)(A)(II).


\(^5\) See Fair Trade in Financial Services Legislation: Joint Hearing before the Subcommittee on Int'l Dev., Finance, Trade and Monetary Policy, and Subcommittee on Financial Institutions Supervision Regulation, and Insurance, of Committee on Banking, Finance, and Urban Affairs, 102 Cong., 1st Sess. 139-41 (1991) [hereinafter Joint Hearing] (Prepared comments of E.J. McAllister, Assistant Secretary of State for Economic and Business Affairs) (warning that such treaty violations would have a number of troublesome consequences, such as uncoordinated and inconsistent use of sanctions).

\(^6\) FCN, supra note 46, at art. XXIV(2).

\(^7\) Professor Schachter opines that when a treaty establishes rules for dispute resolution, reprisals, as described infra, should be restricted. OSCAR SCHACHTER, INTERNATIONAL LAW IN THEORY AND PRACTICE 192 (1991). For a discussion of the developing law on retaliatory action prior to arbitration, see id. at 188-89.

\(^8\) Actions that would otherwise be illegal - not normally permissible under interna-
of a treaty obligation permits the offended party to suspend or terminate the treaty, a more typical reprisal is the selective suspension of treaty obligations without suspension of the entire treaty. The result is "tit for tat" behavior, wherein the offended party responds in a proportionate and appropriate manner to the provocation. With regard to the FTFSA sanctions, Japan may respond by restricting American bank access to Japan in a manner similar to that dictated by the FTFSA. However, the reprisal need not be restricted to the field of the alleged treaty violation, and, thus, Japan may choose to take retaliatory action in some other industry or field.

Japan may also respond with acts of "retorsion." Retorsion is the most common form of state response to a violation of a duty owed to it and is often the politically and practically the most successful approach. Reprisals or treaty suspension tend to reduce trade and investment and tend to have a greater negative impact on the parties than the original violation. Thus, one possible Japanese response to FTFSA may be a lessening of diplomatic cooperation that may impact U.S. foreign or trade policy.

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50 Id. at 190. Treaty suspension is an act of reprisal. Id. "Material" breach requires something more than violation of a single term in the treaty. Id. Thus it is not clear if the FTFSA would constitute a material breach of the FCN. See also IAN BROWNIE, PRINCIPLES OF PUBLIC INTERNATIONAL LAW 616-19 (1990) (a material breach requires a violation essential to the agreement).

51 SCHACHTER, supra note 57, at 190-91.

52 For a reprisal to be deemed just, it must be considered in general equality with the acts of the offending state. Id. at 191.

53 For example, had the United States during the Iran-hostage incident in 1979-1980 responded to the Iranian actions by taking Iranian citizens hostage, the act may have been proportionate, but it would also have been "odious" and "inhuman" and, therefore, inappropriate. Id.

54 Id.

55 "[Actions] normally permissible for a State to take irrespective of any prior provocation." Id. at 185. Retorsion refers to actions that a State is legally free to take whether or not a treaty provision has been violated. Id. at 198. Examples include "rupturing" diplomatic relations and withdrawing gratuitous benefits. Id.

56 Id. at 198.

57 Id. at 186.

58 See id.
B. General Principles of International Law

The obligations of the FCN may be terminated by either party by giving one year's notice to the other party. Should this occur before the implementation of FTFSA sanctions, there does not appear to be general principles of international law that would render the FTFSA wrongful. International law dealing with trade is primarily in the form of treaties; there are few substantive areas of international economic law derived from customary norms. Even the most-favored-nation principle, which has a history reaching back to the twelfth century, is not considered by most scholars and practitioners to have entered the realm of customary international law. In short, absent a treaty to the contrary, "nations presumably have the sovereign right to discriminate against foreign nations in economic affairs as much as they wish." Thus, for example, a state is not required to admit aliens and may impose conditions on their admittance; economic policies and aspects of foreign policy may permissibly dictate restrictions on the "economic activities of foreign enterprises." Under principles of international law, it is not considered unlawful for one nation to exclude another's nationals from participating in certain sectors of the economy or for subjecting foreign firms to restrictions not placed on native firms. Moreover, economic coercion

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69 FCN, supra note 46, at art. XXV(3).
70 JOHN H. JACKSON, THE WORLD TRADING SYSTEM 21-24 (1989) [hereinafter TRADING SYSTEM]. "[W]hen dealing with international economic law, one is dealing primarily with treaties." Id. at 23 (emphasis added). "[I]nternational economic law . . . is a body of principles dependent on treaties and the powers of organized states . . . ." BROWNLIE, supra note 59, at 261. Furthermore, international economic law "is still a treaty law, and the problems are those of interpreting instruments." Id. at 261-62. "To a very large extent, the legal aspects of economic relations are governed by international agreements and practices under such agreements." SCHACHTER, supra note 57, at 300.
71 See supra note 50.
72 TRADING SYSTEM, supra note 70, at 133.
73 Id. at 23, 134.
74 Id. at 134.
75 BROWNLIE, supra note 59, at 519.
76 SCHACHTER, supra note 57, at 315-16. For example, native firms are often given preferential or exclusive rights to government contracts. Id. at 316.

In The Oscar Chinn Case (Eng. v. Belg.), 1934 PCIJ (ser. A/B) No. 63, at 66/5-75/14 (Dec. 12, 1934), a British national operating a shipping business was placed in an economically uncompetitive position when the Belgian Colonial government subsidized the operations of a competitor, which was part-owned by the Belgian government. Id. at 66/5-75/14. The British claimed that general principles of international law made
"appears to be seen as an acceptable, if not very nice, tactic of international relations... A State’s use of its economic power for economic or political ends has historically been viewed as legitimate." In sum, there is no legal bar to the FTFSA should the FCN cease to be in effect.

1. Alternative Legal Argument

Professor Schachter argues that some discriminatory economic treatment of foreigners does become wrongful when it is arbitrary and unreasonable. One such form of improper discrimination comprehend it "incumbent upon all States to respect the vested rights of foreigners in their [territory]" and that this obligation was violated when the Colony's subsidy to the competitor made Chinn's business commercially impossible to operate. "Id. at 81/20-82/21. The Permanent Court of International Justice did not dispute the principle of law, but held that the "possession of customers and the possibility of making a profit" did not rise to the level of a vested right. "Id. at 88/27. "No enterprise... can escape from the chances and hazards resulting from general economic conditions... Where this is the case, no vested rights are violated by the State." "Id. at 88/27.

Even dissenting opinions agreed in this regard. Of the Colonial government's unwillingness (at least initially) to extend the subsidies to all transportation operators, including Mr. Chinn, Judge Altamira said, "[It is true that this inequality would not, in principle, be regarded as an injustice in the normal life of a State. It might arise, without giving any ground for justified complaint on the part of enterprises not admitted to participate in advantages such [as the subsidy].... But, in the case of the Congo, where the special Statute created by [treaty] is in force, the question presents itself in a very different light." "Id. at 100/39 (Dissenting opinion of J. Altamira).

Moreover, the dissenting British Judge consented on this point, stating that the issue was "a short one which can be disposed of rapidly." "Id. at 121/60 (dissenting opinion of J. Hurst). "Chinn possessed no right [under treaty or general principle of international law] which entitled him to find customers in the Congo." "Id. at 121/60. Thus, because Chinn's right to fulfil existing contracts was not injured, no vested right was denied. "Id. at 122/61.

77 Stephen Zamora, Is There Customary International Economic Law?, 1989 GERM. Y.B. INT’L L. 9, 25-26. Zamora argues that U.S. case law indicates that U.S. courts do not base decisions on customary principles of international economic law, although they do reference them in a supporting role. "Id. at 36-37. Zamora posits, however, that this is not due to ideology (that somehow application of customary international law is not democratic) but, rather, is due to practicality: courts cannot reasonably be expected to sift through the world of customs, practices, pronouncements, etc., that would result in finding a binding rule of customary international law. "Id.

78 SCHACHTER, supra note 57, at 316. "Arbitrary" and "unreasonable" in this context are not well-defined and there is a "notable paucity of legal analysis" regarding them. "Id.

Zamora argues, in comparison, that customary international law controls states economic behavior at "the extremes." Zamora, supra note 77, at 35. Examples of
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hends governmental acts based on “group prejudice” and “social tensions.” Schachter provides the example of Uganda taking the property of persons of Asian dissent and the expulsion of Lebanese from Ghana. In each case the government action amounted to aiding and abetting mobs and was discrimination “for reasons of national origin” and “because of ethnic or ‘national origin.”

In Schachter’s view, State actions that place restrictions on businesses owned by a disfavored ethnic group or national because of prejudice should be regarded as unlawfully arbitrary or unreasonable and is “a sufficient basis for international liability.” Moreover, Schachter maintains that such discrimination is wrongful despite an official justification based on policy; for example, such discriminatory governmental conduct would not be justified in order to meet “popular demand” or “restore social tranquillity.”

In comparison, discrimination based on the economic characteristics of an enterprise and its relationship with the economic policies of the state are permissible, falling “within the sphere of State discretion.” Such discrimination may not be unreasonable or wrongful if it is rationally related to a state’s economic or security policies. Thus, such discrimination may be permissible based on protectionism, nationalism, or economic philosophy. In short, discriminatory measures based on economic or policy grounds are not arbitrary or unreasonable and, therefore, extreme behavior include permitting the counterfeiting of foreign currency and expropriation of foreigner’s property without compensation. Id. at 23-24, 31, 35.

The FCN expressly prohibits unreasonable or discriminatory measures: “[n]either Party shall take unreasonable or discriminatory measures that would impair the legally acquired rights or interests within its territories of . . . companies of the other Party.” FCN, supra note 46, at art. V(1).

Schachter also discusses the impermissability of discriminatory nationalization of property. See SCHACHTER, supra note 57, at 316-20.

Id. at 319.


81 SCHACHTER, supra note 57, at 319-20.
82 Id. at 316, 318-20.
83 Id. at 319-20.
84 Id. at 317.
85 Id. at 316 (pointing to the American Law Institute’s suggested standard).
are not unlawful.\textsuperscript{86}

On initial inspection, the FTFSA seems to fit comfortably within the category of permissible discrimination. First, the FTFSA is aimed at an economic actor, banks, whose characteristics as a matter of U.S. economic and national policy, have traditionally justified a high degree of regulation.\textsuperscript{87} Second, the goal of the FTFSA is to further economic and trade policies of the United States aimed, ostensibly, at opening foreign banking markets to U.S. companies.\textsuperscript{88} Finally, even if the FTFSA was objectionable as protectionist legislation, it would nonetheless be a permissible exercise of state discretion by Schachter's standard. Therefore, discrimination that may occur under the FTFSA seems to be permissible under Schachter's view of international economic law.

The temptation to apply the standard of wrongful discrimination to the FTFSA should not be allayed. However, as this Note concludes, if the imbalance in asset ownership is not harmful to the United States and, in any event, is caused by a myriad of factors and not simply discrimination against U.S. banks, then the FTFSA would seem to serve little or no useful purpose. Also, the clear target of the FTFSA supporters is Japan, while banks of other nations, British banks\textsuperscript{89} for example, seem to attract less attention. Finally, recent history of relations between the United States and Japan is replete with tensions in everything from automobile trade to ownership of baseball teams.\textsuperscript{90} Thus, there seems to be at least the colorable argument that the FTFSA is motivated by racial animus, making it the type of unreasonable discrimination Schachter deems to be

\textsuperscript{86} Id. at 316-17. Schachter suggests that this view is accepted by nearly all states permitting foreign business on their territory. Id. at 317.

\textsuperscript{87} See George S. Zavvos, Banking Integration and 1992: Legal Issues and Policy Implications, 31 HARV. INT’L L.J. 463, 468-69 (1990) (noting the E.C.’s difficulty in harmonizing banking regulations due to the industry’s critical role in the members’ national economies and their sovereignty, as reflected in such issues as monetary and credit policies).


\textsuperscript{88} See supra notes 1-20 and accompanying text.

\textsuperscript{89} See infra note 371 and accompanying text.

wrongful under international law. Although an in-depth sociological and historical analysis of the racial aspect of U.S. policy and its application to the FTFSA is beyond the scope of this Note, they do raise important concerns regarding both the actual motivations of U.S. policy and how that policy may be perceived in the international arena.

2. GATT Undermined

The FTFSA represents a bilateral approach to trade issues in contravention of the U.S. historic preference for multilateral agreements. A prime objective of post-World War II U.S. trade policy was to eliminate the protectionism of the U.S. depression-era policies that increased U.S. tariffs and instigated the creation of special trading relationships, to the exclusion of the United States, among the nations of the British Commonwealth. The U.S. preference for multilateralism was realized with the creation of, and membership in, the General Agreement on Tariffs and Trade (GATT), which was designed to insure that protectionism and spiraling tariffs and barriers did not hamper world trade. With U.S. leadership for over forty years, the GATT has successfully reduced tariffs on goods and is generally considered to have facilitated the modern international trading system and has greatly contributed to modern economic prosperity.

Several guiding principles, sometimes called the “theology” of GATT, represent its primary legal obligations. The principle of “first-difference reciprocity” forbids member governments from threatening to raise tariffs, even if such a threat might force another government to lower its tariffs. The “most-favored nation” (MFN) tenet establishes

92 As originally planned, the new system would be composed of the International Monetary Fund, the World Bank, and the International Trade Organization (ITO). Clive Cook, Nothing To Lose But Its Chains; The ITO That Never Was, ECONOMIST, Sept. 22, 1990, at 7 [hereinafter Cook-1]. The ITO was to have power to effect economic development, employment policy, and commercial policy. Id. The ITO, however, was still-born, threatening too much national sovereignty and independent action, and in its place, the GATT was created to limit protectionism. Id.
94 Id.
95 WORLD TRADE, supra note 91, at 194.
96 Cook-1, supra note 92. The “central obligation of GATT” is tariff concessions
that, from the perspective of a single country, no foreign trading partner is given less favorable tariff rates than those given to its most favored trading partner. Another concept, "transparency," encourages nations that are unwilling to eliminate all trade barriers to convert non-tariff barriers (quotas, unreasonable standards, etc.) into tariffs. Tariffs are believed to do less economic harm and are more easily measured impediments to free trade. Finally, the "national treatment" principle requires that imported goods will be treated in the same manner as domestically produced goods with regard to government actions, such as taxes or regulation; that is, once a good is in the country, it will be subject to no more regulation than the equivalent domestically manufactured good.

In practice, these principles act as follows: a nation seeking to foster entry of its exports to a trading partner is forbidden from threatening to raise tariffs in order to force tariff concessions (first-difference reciprocity). Instead, it may seek a reduction in the partner's tariff rates by offering, for example, to reduce its own tariffs, whether on the same or different goods, for the trading partner. It is important to note that the GATT principles do not require mirror-image tariffs; the countries need not seek an alignment of tariffs, only a lowering of them. Once tariff concessions are agreed upon between the nation and its partner, the MFN principle requires the parties to make the new lower tariffs available to all GATT members. The payoff is that the membership, in return, will be obliged to reciprocate in their trade dealings. The GATT whereby members commit themselves to limit the level of tariffs. TRADING SYSTEM, supra note 70, at 40.

97 Cook-1, supra note 92. See also WORLD TRADE, supra note 91, at 255.

During the formative period of GATT, the United States considered the MFN principle to be "absolutely fundamental" and basic to a liberalized trading system. Id. at 252. See generally GOLT, supra note 91, at 2-5 (stating that MFN is the central principle of GATT).

98 Cook-1, supra note 92.

99 Id. Countries may protect domestically produced goods, but may do so only by tariff and not by breaching the principle of national treatment; this insures the strongest competition among goods by providing merchants "clear knowledge of the trading conditions." GOLT, supra note 91, at 3-4. See generally WORLD TRADE, supra note 91, at 305-27.

100 Cook-1, supra note 92; WORLD TRADE, supra note 91, at 273-76. Examples of attempts to evade national treatment include special labeling and packaging of foreign-made goods, specious health and purity regulations, and taxes placed on goods after they have entered the country. WORLD TRADE, supra note 91, at 279-93.

101 Cook-1, supra note 92.

102 WORLD TRADE, supra note 91, at 255-59.

103 Cook-1, supra note 92.
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community, then, enjoys a downward-moving tariff environment. Finally, these tariff gains cannot be muted by disparate treatment once products are within an importing country. For example, a special sales tax, beyond the tariff, cannot be imposed on imported goods that are not also applicable to domestically produced goods. Thus, GATT harnesses each nations' liberalization of barriers for the benefit of its multinational membership.

This GATT approach has worked stunningly well for manufactured goods, reducing tariffs by over eighty-five percent (from an average forty percent in 1947 to about five percent today) and spurring a five hundred percent increase in the volume of trade between 1950 and 1975. Unfortunately, GATT has traditionally applied to products and not services, although recent efforts have been aimed at including services within GATT's umbrella. The most recent "round" of GATT negotiations, the "Uruguay Round," despite the attempt, has failed to bring banking services within GATT and, for the time being, banking has not been included in the multilateral GATT trading regime.

However, the multilateral, and successful approach enshrined in GATT is clearly undermined by FTFSA. It ignores the principle of

104 Id. Countries accounting for 80% of the world's trade subscribe to GATT. GOLT, supra note 91, at 2.
105 TRADING SYSTEM, supra note 70, at 42-44.
106 GATT has been periodically updated in negotiations referred to as "rounds." See generally id. at 52-57.
108 The failure to include banking services within the Uruguay Round has been cited as a reason for the Clinton administration's support of the FTFSA; the administration hopes to be seen as being active in the banking arena. James R. Kraus, Clinton Hopes to Repair GATT Deal's Omission of Banking, AM. BANKER, Dec. 16, 1993, at 5.
109 Even if GATT were applicable to banking services, the FTFSA would not contravene it: no determination of discrimination may be made to the extent that it is inconsistent with bilateral or multilateral agreements involving financial services that have been approved by both the Senate and the House of Representatives before passage of FTFSA. FTFSA, supra note 21, § 18(d)(2).
110 But U.S. commitment to multilateralism has been weakening. There is a growing belief that free trade "is for suckers." Cook-2, supra note 93. Moreover, the world is breaking into trading blocks — Europe, North America, and Asia-Pacific. Id. See also Bruce Stokes, Apres GATT, le Deluge, NAT'L J., Jan. 12, 1991, at 75.
111 Furthermore, during the 1980s, there was a trend by the United States and E.C. toward bilateral restrictions on trade — for example, voluntary export restrictions on automobiles. GOLT, supra note 91, at 11. Thus, the atmosphere leading up to the
first-difference reciprocity by threatening Japan with sanctions if it does not lower its barriers to U.S. banks. Rather, the FTFSA uses threats and, if necessary, punishment to achieve the goal of increased U.S. banking opportunities abroad. It invites retaliation and, like all retaliation-based approaches in the international arena, it is "dangerous and uncontrollable."

Moreover, the FTFSA seeks broader opportunities for U.S. banks by forcing concessions from other nations on a bilateral basis, rather than in a way that benefits the entire multilateral community. The FTFSA thus jettisons the cooperative spirit of first-difference reciprocity and proceeds down a bilateral path in contravention to the MFN. FTFSA could, then, lead to the trap, spiraling trade protectionism, that GATT principles were designed to prevent.

Furthermore, in two significant ways the FTFSA impairs the proliferation of the legal principles of GATT. First, the FTFSA, as the antithesis of GATT, is out of step with efforts to include services within the GATT and thereby undermines the ability of the United States to maintain its leadership role in the liberalization of trade in financial services. Second, and perhaps more troublesome, the FTFSA seems to represent a movement away from cooperative multilateralism; in short, it may communicate to the world the notion that "GATT principles are up for grabs," a notion that could "haunt" the United States in future trade negotiations.

In the Uruguay Round, for example, the E.C. wanted exemptions from GATT for trade in film and television programming and, yet, the United States "piously [insisted] that GATT principles must be

initiation of the Uruguay Round was marked by

a nagging feeling that there was little point . . . in a formal Round to discuss strengthening and extending the GATT in new areas, such as services, when the troubles arose from the clear unwillingness, or inability, of the major countries to live up to their professed attachment to liberal trade and to abide by existing rules of the GATT in the areas to which it already applied.

Id. at 12.

Japanese law provides national treatment on a reciprocal basis. See infra notes 169-76 and accompanying text. Japan has, moreover, been willing to exercise its reciprocity requirements; Mexican and Iranian banks have been prevented from establishing Japanese branches because those nations do not permit entry by Japanese banks.

Fair Trade In Financial Services Legislation, Hearings Before the Subcommittee on International Development, Finance, Trade, and Monetary Policy, Committee on Banking, Finance and Urban Affairs, 102nd Cong., 2nd Sess. 259 (1992) [hereinafter Part Two] (written answers to questions posed to Professor Hideki Kanda).


Industrial countries desired the Uruguay round to extend GATT principles into new areas, especially services. GOLT, supra note 91, at 14.

upheld.” There is more to fear, therefore, from FTFSA than Japanese retaliation in banking; the effect on U.S. leadership in issues of free trade generally and the dilution of GATT principles serve to frustrate the international trading regime credited with world economic prosperity.

3. Alternative Solution: Mutual Recognition

In stark contrast to the retaliatory approach for opening markets found in the FTFSA is the E.C. Second Banking Directive (Directive). The aim of the Directive was to forge a single European banking market out of the E.C. members’ widely differing financial organization without barriers to the flow of banks and banking services. Rather than take the politically difficult route of requiring formal restructuring and alignment of each member’s financial structure, the Directive’s solution is one of “prudential supervision.” Its basic premise is that a bank operating in a foreign country (the host country) will be regulated according to the laws of its home country and supervised by the authorities of its home country. Additionally, a license to operate a bank in the home country serves as a license to establish branches and offer services (within specified limits) in another E.C. country without further licensing by the host country (the “single license” principle). Thus, the E.C. has chosen to go beyond the principle of national treatment with the more liberal concept of “mutual recognition.”

In operation, this approach may mean that foreign banks could offer services not permitted for banks native to the host country. However, when a nation discovers that its native banks are at a competitive disad-

114 Id.
117 Zavvos, supra note 87, at 502.
118 Gruson, supra note 116, at 2.
119 Acceptable activities include acceptance of deposits, lending, and portfolio management. See id. at 6.
120 Id. at 3.
121 Id. at 3.
122 Zavvos, supra note 87, at 473.
vantage relative to banks of other nations due to regulatory differences, it will bring its regulation into alignment.\textsuperscript{123} The Directive creates, in effect, a single E.C. banking market and incentives for harmonization of laws.

For banks based outside of the E.C. that have not previously established European operations or which do not desire to set up European subsidiaries, the principal of reciprocity is applied.\textsuperscript{124} However, fears that the Directive would create a protectionist "fortress Europe" have been significantly allayed\textsuperscript{125} and "on balance . . . [the Directive] represents a . . . substantial step toward international free trade in services."\textsuperscript{126}

The Second Banking Directive offers an alternative model to both GATT and the FTFSA. It specifies as its objective the attainment of national treatment for U.S. banks\textsuperscript{127} and the opening of international markets to banking services. As will be shown,\textsuperscript{128} much of the responsibility for the U.S.-Japanese banking imbalance must be placed on U.S. regulatory burdens and the very different financial structures of each nation. Thus, a Second Banking Directive approach may offer one solution for alleviating regulatory barriers to banking. Unfortunately, such an approach would not possess a great chance of success in the current political climate. In the atmosphere of distrust and suspicion regarding Japanese banking asset ownership that fuels the FTFSA, it seems highly improbable that an approach of "mutual recognition" would be politically palatable.\textsuperscript{129}

\textsuperscript{123} Id. at 484. The goal is to thereby foster the creation of "universal banking" throughout the entire E.C. Id. at 480-81. "Universal banking" permits a bank to conduct both usual banking services and securities services within one corporate entity. Id. at 480 n.92.

\textsuperscript{124} Gruson, supra note 116, at 17.

However, "mirror image" reciprocity (i.e., the identical financial structure) is not required; rather it demands, at the least, \textit{de jure} national treatment and perhaps \textit{de facto} effective market access. Thus, there may be the risk that the Directive will thereby require non-E.C. members to give E.C. banks better treatment than native banks. See Zavvos, supra note 87, at 496-97.


\textsuperscript{126} Id.

\textsuperscript{127} FTFSA, supra note 21, § 18(a).

\textsuperscript{128} See infra Section IV.

\textsuperscript{129} See generally Thomas L. Friedman, Trade War Isn't So Swell Either, N.Y. TIMES, Mar. 6, 1994, at 4 (satirizing the war-like rhetoric of U.S.-Japan trade); Risking A Trade War, N.Y. TIMES, Mar. 5, 1994, at 22 ("Polls show Americans favor a tough stance toward the Japanese."); Thomas L. Friedman, President Revives Tough Trade Step to Pressure Japan, N.Y. TIMES, Mar. 4, 1994, at 1; James Sterngold, Hint of U.S.
IV. DISCRIMINATION AND REGULATION

The FTFSA is premised on the notion that protectionist trade regulation has caused the imbalance in banking asset ownership. This Section tests this contention by exploring the impact of regulation of bank expansion in both the Japanese and U.S. systems.

A. The Japanese Regulatory Environment

U.S. banks that wish to establish operations in Japan face several challenges. The first is to learn the peculiar Japanese style of regulation. The second is to compete in the structurally complex and compartmentalized banking market with its large and entrenched banking entities. The following discussion of the Japanese regulatory and banking environments illuminate the nature of the challenges facing banks seeking entry into Japan.

1. The Role of Regulators

(a) Ministry of Finance

While the outlines of Japanese banking are created by statute, the administrative power lies with the Ministry of Finance (MOF) and the Bank of Japan (BOJ). The MOF is one of the most respected bureau-

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Trade Escalation Draws Warning From Japan, N.Y. TIMES, Mar. 3, 1994, at D1 (Japan's Prime Minister warns President Clinton against trade sanctions against Japan); Barnaby J. Feder, Business Chiefs Praise Clinton for Stand on Japan, N.Y. TIMES, Feb. 21, 1994, at D1 (explaining that President Clinton's tough stance against the Japanese on trade gains support of important business figures).

See generally Part Two, supra note 110, at 2, 75-79 (prepared remarks of Professor Kanda).

Id.

FEDERATION OF BANKERS ASSOCIATIONS OF JAPAN, THE BANKING SYSTEM IN JAPAN 37 (1989) [hereinafter BANKING SYSTEM IN JAPAN]. For an overview of significant banking laws in Japan, see id. at 38-54.
cracies in Japan\textsuperscript{133} and one of the most powerful.\textsuperscript{134} It is the
government's main supervisory agent over banks.\textsuperscript{135}

The key tool employed by the MOF in regulating banking is the
power of "administrative guidance," which allows the agency to interpret
laws and issue regulations for which compliance is, in theory, voluntary.\textsuperscript{136} Administrative guidance, which is a common tool among Japa-
nese government agencies, is a request by an agency, acting within its
regulatory purview, that private parties cooperate in obtaining certain
objectives by taking, or refraining from taking, certain actions.\textsuperscript{137} Such
guidance is sometimes authorized by law,\textsuperscript{138} but such power also exists
without regard to specific statutory grants.\textsuperscript{139} Regardless of its legislative
basis, there is no legal requirement that such guidance be followed.\textsuperscript{140}
In practice, however, the effect is "compulsory."\textsuperscript{141}

\textsuperscript{133} "MOF men are some of the world's most incorruptible and indefatigable civil
servants. They are bureaucrat's bureaucrats; accountant's accountants. Their ministry pre-
dates most of the rest of the Japanese government, and it is considered the most presti-
gious career track in government." DANIEL BURSTEIN, YEN! 197-98 (1988) [hereinafter
YEN!]. See also R. Taggart Murphy, Power Without Purpose: The Crisis of Japan's
Global Financial Dominance, HARV. BUS. REV., Mar.-Apr. 1989, at 71, 74 ("The
quality of Japan's financial regulators is unsurpassed; they are recruited from the top
ranks of the best universities, and they average decades of training and experience.").

\textsuperscript{134} YEN!, supra note 133, at 197-98. See also EMMOTT, supra note 111, at 88.
\textsuperscript{135} RICHARD DALE, THE REGULATION OF INTERNATIONAL BANKING 113 (1986)
[hereinafter DALE-1]. The MOF is quite aggressive in monitoring banks and is charac-
terized by a "distinctive . . . willingness to intervene informally in situations where
market forces conflict with official policy objectives." Richard Dale, Japan's Banking
Regulations: Current Policy Issues, JAPANESE FINANCIAL GROWTH 33, 33 (Charles A.E.
Goodhart and George Sutija eds., 1990) [hereinafter Dale-2].

\textsuperscript{136} KAREL VAN WOLFEREN, THE ENIGMA OF JAPANESE POWER: PEOPLE AND POWER
IN A STATELESS NATION 343, 344 (1989) (arguing that "administrative guidance" leaves
bureaucracies in positions of great power and enables enforcement by intimidation).

\textsuperscript{137} Mitsou Matsushita, The Legal Framework of Trade and Investment in Japan, 27

\textsuperscript{138} That is, agencies may have statutory authority to make suggestions, recommenda-
tions, or issue warnings. Id. at 376-77.

\textsuperscript{139} Id.

\textsuperscript{140} Id. at 376 ("administrative guidance per se is not governmental compulsion," but
it "substitutes for legal compulsion.")

\textsuperscript{141} WOLFEREN, supra note 136, at 344. The power to interpret laws and issue regu-
lations is, in the Japanese system, coercive, giving bureaucrats great leverage in
enforcing their regulations; so companies "all abide by [administrative guidance] simply
because they want to continue to function." Id.
Several factors help illuminate the compulsory effect of mere requests. First, it has been suggested that within the Japanese business person’s psyche is the belief that government requests are to be respected, and confrontation avoided, even if such requests are wrongful. Second, there is a potent pragmatic reason for compliance: agencies have broad real authority and powers that lend weight to their requests. Thus, “faced with . . . administrative guidance, most companies will think twice before resisting it.” Administrative guidance has been criticized as a “regulatory system lacking transparency, in which rules and regulations are clear only to insiders, in which changes in procedures and policy are not accessible in a timely fashion; and in which foreign firms are frequently left out of the consultative process.” The relative absence of clearly written rules ensures “the bureaucracy monumental power to interpret the law as it deems fit, which includes the ability to intimidate foreign financial firms.” In comparison, the U.S. reliance on explicitly expressed laws and legal rulings is said to allow outsiders greater ease of understanding the regulatory environment.

Among the MOF’s formal authority is the power to insist on reports and perform on-premises examinations of banks. Also, the MOF has the authority to penalize “misconduct” by suspending bank operations, rescinding licenses to operate, and ordering banks to keep assets in Japan.

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for obtaining the objectives sought by the issuing agency; legislative empowerment of the agency that would, if employed, achieve the goals of the guidance with the compulsion of law; and, finally, incentives offered by the government, such as subsidies, for adhering to the guidance. Matsushita, supra note 137, at 377.

A 1982 banking law attempted to shift “emphasis away from administrative guidance towards a more formal regulatory scheme. However, . . . the [MOF] retains considerable discretionary powers. . . . Furthermore, informal guidance continues to be given outside the new legal framework.” DALE-I, supra note 135, at 113.

Matsushita, supra note 137, at 376-77.

Id. at 377.

Hearings, supra note 4, at 15 (testimony of Senator Jake Garn).

Joint Hearing, supra note 55, at 133 (prepared text of Eric W. Hayden).


BANKING SYSTEM IN JAPAN, supra note 132, at 47.
(b) The Bank of Japan

The BOJ is a quasi-private institution that acts as Japan’s central bank and is charged with the duty of issuing currency, regulating money supply and money markets, and insuring that the financial system runs smoothly. The essential functions of the BOJ are acting as a bank’s bank, acting as the government’s bank, and implementing monetary and credit control policies. Another important function is issuing “guidance” on bank lending (sometimes called “window guidance”). From its daily contact with Japanese financial institutions, the BOJ monitors lending activity by institutions and keeps such activity “within limits that the [BOJ] feels to be appropriate.” Other important powers include the setting, together with the MOF, of banks’ reserve requirements.

The government has broad control over the BOJ and the MOF has general supervisory powers over it. The BOJ is run by a Policy Board that includes representatives of the MOF, other government agencies, and private-sector bank and industry representatives. The government and the BOJ are in close contact and regularly cooperate. There is “no pretense that the BOJ is independent of the MOF or of general government policy,” unlike, for example, the Federal Reserve in the U.S., which “goes to great lengths to give an official appearance of independence from the Treasury and from the administration and Congress.”

2. Regulation Affecting Foreign Bank Entry Into Japan

The central law governing banking in Japan is the “Banking Law,” initially created in the 1920s. The Banking Law is “supplemented” by

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148 The government owns 55% of the stock. Id. at 20.
149 Id.
150 Handling account transactions, lending, and funds transfers among financial institutions. Id.
151 Id.
153 Id. at 325.
154 Id. at 313.
155 Id. at 314. The MOF also has the power to appoint and dismiss members of the policy board. Id.
156 BANKING SYSTEM IN JAPAN, supra note 132, at 20.
157 Suzuki, supra note 152, at 314.
158 CARGILL & ROYAMA, supra note 146, at 61-62.
159 BANKING SYSTEM IN JAPAN, supra note 132, at 38. Banking Law, Law No. 59
ordinances promulgated by administrative bodies and needs no legislative
imprimatur. In addition, the MOF uses "circulars" to explain laws and
ordinances and provide guidance for their application.

All banks, domestic and foreign, must be licensed by the MOF. In order
to obtain a license, the prospective bank must have capital of
one billion yen; must have reputable and competent management;
must fulfill an economic need; not be "detrimental to the existing or-
der;" and must meet any other requirements the MOF may consider
necessary for the public interest. Bank mergers and purchases also require
MOF approval. Although more deferential toward banks’ independent
decisions than in the years following 1945, MOF approval, in the form of
administrative guidance, is required for establishing branch locations and
their physical aspects, such as size and structure.

With regard to entry into Japan by foreign banks, Japan provides
"national treatment" for banks whose home nation provides Japanese
banks the same courtesy (i.e., reciprocal national treatment). "Foreign banks have the same legal position as Japanese... banks and
are considered to be banks according to the Banking Law." De jure national treatment of U.S. banks is a recent phenomenon.
For example, foreign firms were first permitted to operate trust banks
beginning in 1985. In fact, Japan’s deregulation of its financial mar-

\begin{itemize}
\item 160 Id. at 39. Ordinances come in two varieties, cabinet and ministerial. Cabinet ordi-
nances are used to enforce laws and ministerial ordinances are used by ministers to en-
force laws in their particular jurisdictional realm. Id.
\item 161 Id.
\item 162 Article 4 of the Banking Law. Id. at 40. See also DALE-I, supra note 135, at
113.
\item 163 Article 5 of the Banking Law established the minimum one billion yen figure,
but allows the government, by cabinet ordinance, to raise this figure. BANKING SYSTEM
IN JAPAN, supra note 132, at 41-42.
\item 164 DALE-I, supra note 135, at 113. This requirement is also characterized as "ad-
equate social credibility." BANKING SYSTEM IN JAPAN, supra note 132, at 40.
\item 165 DALE-I, supra note 135, at 113.
\item 166 BANKING SYSTEM IN JAPAN, supra note 132, at 40.
\item 167 Article 30 of the Banking Law. Id.
\item 168 Id. at 42.
\item 169 Id. at 5-6. Reciprocity is a tool to promote the internationalization of Japanese
banks and concluding that "naturally, this means that Japanese banks have to operate
in an extremely competitive environment both at home and overseas, but this will not
deter them from trying to establish a position in international finance." Id.
\item 170 SUZUKI, supra note 152, at 196.
\item 171 PETER S. ROSE, JAPANESE BANKING AND INVESTMENT IN THE U.S.: AN AS-
kets, which had been strictly controlled since World War II, began in earnest in the late 1970s. Reforms include the liberalization of the international trading of the yen and yen-denominated financial instruments, creation of the first certificates of deposit (CDs), and the ability of investors to buy foreign commercial paper. Also, interest rate controls were relaxed. In the mid-1980s, ten percent of Japanese bank deposits paid market rates; by 1990, that figure had risen to fifty-five percent.

Despite reforms and de jure national treatment, foreign banks have found it difficult to gain market share in Japan. For example, interest rate controls and restrictions on branching tend to benefit established banks with established branch networks and deposits (of course, such banks are native). Foreign banks, without the benefit of a large deposit and lending base also find themselves at a disadvantage (as do all private banks in Japan) when faced with competition from the government-run Postal Savings System (PSS). Thus, while Japan’s deregulation of its financial markets has resulted in de jure national treatment for U.S. banks, serious de facto barriers remain.

3. Structure of Japan’s Banking Market

After World War II, Japanese economic planners recognized the need to structure banking so as to keep capital within the country and insure its allocation to industry. Their solution was segmentation. Thus,
securities dealings are separated from commercial banking; long-term and short-term credit institutions are separated; finally, segmentation is further achieved in specialized banking institutions serving specific industries.¹⁸²

(a) Ordinary Banks

“Ordinary” banks act as the commercial and savings banks in the Japanese system.¹⁸³ Ordinary banks fill the role of the financial intermediary — taking deposits from corporations and individuals, then converting deposits into loans or securities,¹⁸⁴ and operating as a settlement of payment system (that is, checking accounts).¹⁸⁵ They are the equivalent of U.S. commercial banks.¹⁸⁶

Ordinary banks are divided into “City Banks” and “Regional Banks,” and include most foreign-owned banks in Japan. The City Banks, of which there are twelve, are headquartered in major cities and possess branch networks that stretch across the nation.¹⁸⁷ These banks head the lists of the world’s largest banks.¹⁸⁸ The City Banks hold twenty percent of all Japanese deposits and supply twenty percent of corporate credit.¹⁸⁹ Large corporations are the chief customers for City Banks: corporations capitalized at one billion yen are responsible for sixty percent of City Bank deposits and thirty percent of their lending.¹⁹⁰ Individuals account for only ten percent of City Bank lending.¹⁹¹

Japan’s sixty-four Regional Banks are located in the larger cities of Japan’s forty-seven prefectures.¹⁹² Although permitted to branch nationwide, the Regional Banks tend to focus their activities on their home locality, maintaining close ties with local industries and governments.¹⁹³

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¹⁸² An example is farming. See infra Appendix A.
¹⁸³ BANKING SYSTEM IN JAPAN, supra note 132, at 13.
¹⁸⁴ As permitted by Securities and Exchange Law No. 25 of 1948, art. 65, as amended.
¹⁸⁵ Suzuki, supra note 152, at 170.
¹⁸⁶ Id.
¹⁸⁸ For a complete list of City Banks see BANKING SYSTEM IN JAPAN, supra note 132, at app. 1, at 1.
¹⁸⁹ Id. at 23.
¹⁹⁰ Id.; Suzuki, supra note 152, at 171.
¹⁹¹ Suzuki, supra note 152, at 171.
¹⁹² Id. at 172; BANKING SYSTEM IN JAPAN, supra note 132, at 23-24.
¹⁹³ BANKING SYSTEM IN JAPAN, supra note 132, at 23-24. There are customary, not
Although generally not as large as City Banks, Regional Banks are still quite enormous.\(^{194}\)

Foreign banks operating in Japan tend to be ordinary banks.\(^{195}\) As of 1988, eighty-one foreign banks were operating in Japan.\(^{196}\) Because of their nature as foreign banks, these institutions tend to be heavily involved in foreign currency transactions,\(^{197}\) which among Japanese banks is done only by the Bank of Tokyo.\(^{198}\)

Foreign banks in Japan have not established large branch networks and, as a result, cannot rely on deposits as the funding source for lending activities.\(^{199}\) Deposits account for only fifty percent of the funds lent, with money raised on the Eurodollar markets supplying the rest.\(^{200}\)

(b) Other Financial Institutions

Japan’s banking system is complicated by a number of other specialized financial institutions.\(^{201}\) Long-Term Credit Banks collect deposits from governments and public bodies and lend on very long-term time horizons, notably for such investments as plant and equipment.\(^{202}\) The Japanese system also contains banking institutions that are limited to serving small and medium-sized customers. For example, “Sogo” banks may do business only with companies of three hundred employees or

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\(^{194}\) Suzuki, supra note 152, at 172. See, e.g., BANKING SYSTEM IN JAPAN, supra note 132, at app. 1, at 1 (Bank of Yokohama, a Regional Bank, has greater deposits than Hokkaido Takushoku Bank, a City Bank); World's Largest Banks, supra note 18, at 115, 116 (showing that four Japanese Regional Banks are ranked, by assets, as among the world's largest banks).

\(^{195}\) BANKING SYSTEM IN JAPAN, supra note 132, at 24.

\(^{196}\) Id.

\(^{197}\) Id. See also Suzuki, supra note 152, at 197.

\(^{198}\) Suzuki, supra note 152, at 172.

\(^{199}\) Id. at 197-98. “[D]eposits are the most fundamental source of funds for banks, but foreign banks in Japan have not hitherto expected to attract large deposit bases because of their small numbers of branches.” Id. Moreover, the largest share of deposits denominated in yen are from non-residents. Id. at 198-99.

\(^{200}\) Id. at 197-99.

\(^{201}\) For a more complete description of the institutions that follow, see infra Appendix A.

\(^{202}\) Suzuki, supra note 152, at 202; BANKING SYSTEM IN JAPAN, supra note 132, at 25.
less. Labor Banks, in turn, are restricted to taking deposits from public bodies and lending, primarily, to labor organizations and their members. There are also financial institutions devoted to servicing certain industries, such as farming and forestry. Complicating this already complex picture is the PSS. The PSS is the largest deposit institution in Japan (holding, in the mid-1980s, thirty percent of all personal deposits) and has had several competitive advantages over other banks, which included, until recently, controlled interest rates and tax-free status for interest paid to depositors.

(c) Securities Industry

The U.S. occupying forces instituted the so-called "Article 65" of the Japanese Banking Law of 1948 that separated the banking and securities industries. Like the U.S. law upon which Article 65 was modeled, the Glass-Steagall Act, banks are prohibited from dealing in securities but, unlike the U.S. law, Article 65 "places no controls whatsoever on the acquisition of securities and equities for investment purposes." As a result, Japanese banks were active buyers in the securities arena and today control as much as twenty percent of the Tokyo Stock Exchange.

(d) Summary

Japan's highly compartmentalized financial services industry has resulted in the creation of very large financial institutions that dominate the niches in which they operate. U.S. banks seeking to enter a market

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203 BANKING SYSTEM IN JAPAN, supra note 132, at 26.
204 Suzuki, supra note 152, at 228.
205 Id. at 235-37.
206 See infra Appendix A.
207 EMMOTT, supra note 111, at 101.
208 BANKING SYSTEM IN JAPAN, supra note 132, at 35.
209 Securities and Exchange Law No. 25 of 1948, as amended.
212 Suzuki, supra note 152, at 39-40. See also Dale-2, supra note 135, at 34.
213 Dale-2, supra note 135, at 35.
such as this encounter the challenges of operating in an unfamiliar environment and of competing against powerful and entrenched institutions. This highlights not Japanese protectionism, but the difficulties U.S. banks must consider in determining the cost-benefit of attempting to compete in Japan.

B. U.S. Regulations That Injure the Ability of U.S. Banks to Engage in Foreign Branching

U.S. banks seeking to expand abroad also face challenges from U.S. government-imposed regulations. The first are direct regulations that expressly set forth requirements that must be met in order to establish foreign operations. The second are regulations, not directly concerned with foreign expansion, but which nonetheless impact the bank's financial strength and ability to compete in foreign markets.

1. Direct Regulation of Foreign Branching

To establish a foreign branch, a U.S. banking company must have $1,000,000 in capital and apply to the Board of Governors of the Federal Reserve Board (FRB). The acceptance by the FRB of the application will entitle the applicant to either establish a branch in a foreign country or to hold the stock of a bank incorporated under the laws of a foreign country.

Foreign branches of U.S. banks are subject to the same lending limitations as U.S. branches, which is fifteen percent of the banks' capital. Thus, for example, a U.S. branch operating in Japan may be at a competitive disadvantage vis-à-vis a native Japanese bank which is subject

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214 See infra notes 224-27 and accompanying text.
215 See infra note 229 and accompanying text.
216 12 C.F.R. § 211.2(k) (1993) (defining "foreign branch" as "an office of an organization... that is located outside the country under the laws of which the organization is established, at which a banking or financing business is conducted."). See also Marilyn B. Cane & David A. Barclay, Competitive Inequality: American Banking In the International Arena, 13 B.C. INT'L & COMP. LAW REV. 273, 278 (1990).
219 Id.
to a lending limit of twenty percent of capital.\textsuperscript{221}

The branches of U.S. banks are permitted to “exercise such . . . powers as may be usual in connection with the transaction of the business of banking in” the foreign country.\textsuperscript{222} However, several limitations are imposed. First, the branch may not engage in the “general business of producing, distributing, buying, or selling goods, wares or merchandise.”\textsuperscript{223} Also, the branch may not engage in the business, directly or indirectly, of underwriting, selling, or distributing securities.\textsuperscript{224} This, however, is subject to an exception allowing the branch to deal in the securities of the government of the country in which it resides, if the FRB may “deem it necessary.”\textsuperscript{225}

Reserve requirements for foreign branches (of both members and non-members of the Federal Reserve System)\textsuperscript{226} are statutorily required to be the same as domestic U.S. branches for deposits owned by the bank’s U.S. offices; loans to U.S. residents made by the foreign branch; and assets held by foreign offices of a depository institution in the United States which were acquired from its domestic office.\textsuperscript{227}

Foreign branches are not included in the parent bank’s premiums for deposit insurance and, therefore, are not insured by the FDIC.\textsuperscript{228}

2. Regulation that Indirectly Inhibits Establishment of Foreign Branches

Regulations on U.S. banks at home limit their growth and profitability, having the dual effect of weakening their competitive posture in the United States relative to strong foreign banks and inhibiting the ability of U.S. banks to expand abroad. The two most striking of these limitations are restrictions on the type of business in which banks may engage and restrictions on the geographic area in which they may operate.

\textsuperscript{221} Id.
\textsuperscript{223} Id.
\textsuperscript{224} Id.
\textsuperscript{225} Id.
\textsuperscript{227} 12 U.S.C. § 461(b)(5)(A),(B),(C) (1988); 12 C.F.R. § 211.3(c) (1993); 12 C.F.R. § 204.1(c) (1993).
(a) Product Limitations

The Glass-Steagall Act—perhaps the most famous U.S. banking law—prohibits banks from directly or indirectly buying, selling, or distributing securities. Glass-Steagall was enacted in response to the widespread belief that the Great Depression was, at least in part, caused when banks and securities dealers were able to commingle their activities. Hence, the act built a wall between commercial banking and investment banking. "This statutory bar reflected a decision to impose direct regulatory controls on the assets and investments of banks, removing from banks' management the discretion to allocate resources among business opportunities." Also, the "competitive equality doctrine," as interpreted by the Supreme Court, restricts national banks to only those banking activities in which states permit their state-chartered banks.

231 However, the wall between activities has blurred, 12 C.F.R. § 225.25(b)(15) (1993) allows holding companies to engage in discount brokerage.
232 U.S. DEPT. OF THE TREASURY, MODERNIZING THE FINANCIAL SYSTEM: RECOMMENDATIONS FOR SAFER, MORE COMPETITIVE BANKS XVIII-6 (1991) [hereinafter RECOMMENDATIONS]. Congress had several motivating beliefs: it believed that banks engaged in securities tended to invest in speculative ventures "to the detriment of overall economic growth and stability." Also, it felt that the separation of investment and commercial banking activities was required to restore public confidence in the banking system. Lastly, investigations revealed significant "questionable activities," such as failure to disclose information regarding securities holdings and lending money to customers to finance security purchases. Id. But cf. John P. Laware, U.S. Banking System Must Diversify, AM. BANKER, Oct. 16, 1990, at 13 (remarking that the "most prominent of . . . discredited [theories on the cases of the Great Depression] is the one that blamed securities activities of the banks for the market crash of 1929 and the resultant Depression. That error of judgment lead to the Glass-Steagall Act and the separation from commercial banking of the brokerage and underwriting of securities.").
234 Garten, supra note 230, at 510.
235 Clark v. Securities Indus. Ass'n., 479 U.S. 388, 409 (1987) (noting that Congress intended to place national and state banks on a basis of "competitive equality" insofar as branch banking was concerned); First Nat'l Bank of Logan, Utah v. Walker Bank & Trust Co., 385 U.S. 252, 261 (1962) (stating that "competitive equality" is required only in "core" banking functions; hence, a bank's operation of a discount brokerage subsidiary was not subject to the doctrine.).
to engage.\textsuperscript{236}

Another example of product separation is insurance. Nationally chartered banks are strictly forbidden from selling insurance in areas with a population greater than five thousand (for areas with lesser population, the Comptroller of Currency, at its discretion, may permit insurance sales by banks).\textsuperscript{237} Furthermore, the United States requires international banks with controlling interests in both a U.S. bank and insurance company to divest either the U.S. bank or the insurance company.\textsuperscript{238} In contrast, E.C. law establishes no barriers between these industries.\textsuperscript{239}

Despite such restrictions, banks were able to remain very profitable until recently when new competitive forces eroded banking's traditional monopoly on financial products. Banks have increasingly competed for funds with various new competitors — money market mutual funds, for instance — and, therefore, they have experienced increasing costs of funding.\textsuperscript{240} Banks also faced stiffer competition in lending activities from foreign banks\textsuperscript{241} and financial markets.\textsuperscript{242} Also, so-called "non-bank" lenders provided fierce competition for the middle and smaller-
sized borrowers. Banks have faced increasingly potent competition in their traditional roles as lenders and deposit-takers, but have been prohibited from entering more profitable arenas, such as securities dealing.

Efforts to maintain profitability led banks to engage in riskier activities, such as lending for real estate, performing highly leveraged transactions, and making loans to less-developed countries. As discussed below, these limitations may have financially weakened U.S. banks and hindered their ability to expand overseas. Moreover, it is instructive to note that the E.C. views product limitation as the "first and most important obstacle to liberalization and harmonization of global finance."

(b) Geographic Restrictions

Another striking feature of the U.S. banking system is that a bank's ability to grow by branching has historically been limited to the state, county, city, or even building where it was created. Such geographic restrictions cannot be found in Japan, Germany, or Canada.

The Depression-era McFadden Act (as amended) allows nationally chartered banks to branch interstate with the approval of the Comptroller of the Currency and with the explicit permission of the state to which the bank is branching. Similarly, the passage of the Bank Holding Company Act of 1956 (BHCA) empowered banks to set up Bank Holding Companies and purchase banks in other states, running them as wholly

243 Garten, supra note 230, at 525.
245 RECOMMENDATIONS, supra note 232, at XVIII-6.
246 See supra note 226 and accompanying text.
249 12 U.S.C. § 36(c)(1) (1988). See generally First Nat'l Bank of Logan, Utah v. Walker Bank & Trust Co., 385 U.S. 252, 256-60 (1966). Since the founding of the nation there has been a bias against branching, reflecting the fear that capital would be concentrated into the hands of a few large banks with a wide geographic reach. This fear was still evident with the McFadden Act, which addressed the growing disparity between National Banks, which were not permitted to branch, with State Banks, which were increasingly gaining branching rights. The McFadden Act's solution was to allow National Banks to branch, but only to the extent that State banks were so permitted. Id.
owned subsidiaries. Even this attempt at liberalizing geographic restrictions was limited by the Douglass Amendment to the BHCA, which forbids an interstate acquisition by Bank Holding Companies unless the target bank’s home state allows their purchase and ownership.

States, subject to political pressure from local banks and eager to maintain their bank monopolies, were slow to allow interstate banking. In fact, in 1990 only thirty-nine states allowed branching statewide within even their own territory and two states prohibited branching altogether. The U.S. banking market remains very segmented with over 12,000 banks (not including thrifts).

This reluctance to allow interstate banking is ironic considering the advantages such banking would provide. First, it has been shown that interstate banking improves banks’ profit margins. The pretax profit margin of banks based in states that allow interstate banking are twelve percent greater than banks located in states without interstate banking. Furthermore, geographic limitations injure bank soundness, efficien-

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251 RECOMMENDATIONS, supra note 232, at XVII-2.
252 Id. at XVII-6.
253 In 1975, Maine became the first state to allow interstate banking. Id. at XVII-8. In 1982, New England allowed reciprocal interstate banking on a regional basis. Id. It was not until 1985 that the Supreme Court held that such interstate banking was legal in the United States. Id.
254 RECOMMENDATIONS, supra note 232, at XVII-7-XVII-8.
255 Figure as of 1990. Id. at XVII-16. If the United States had the same concentration of banks per capita as Canada, which has a nationwide branching system, the United States would have only 75 banks. Id. at XVII-17.
257 Bank soundness is injured by limiting diversification of geographic risks. RECOMMENDATIONS, supra note 232, at XVII-8-XVII-9. Nationwide branching would provide a "more diversified and stable base of depositors as well as a broader base of consumer and corporate borrowers" that in turn would help prevent situations like the banking disaster in Texas, infra Section V.F, in which a depressed regional economy severely injured local banks. Nash, supra note 253, at 1.
cy, and, significantly, size. Size is crucial to U.S. banks’ competitiveness in the world market and is especially critical in improving their ability to compete with Japanese and German banks. It is believed that to be “world-class,” competitive with foreign banks, a very large U.S. base is required.

Limitation in size and profitability, as geographic restrictions are, hampers a bank’s ability to compete for capital and acquisitions. “Most bankers and bank regulators recognize that capital is king in today’s banking environment.” Capital serves several valuable purposes: it provides a cushion for credit losses; helps maintain public confidence in the solvency of the financial institution; protects investors in case of credit losses and liquidation; permits banks, as an indicator of bank financial strength, to more cheaply raise capital in the stock market; and, importantly, it enables a bank to gain “competitive entry by acquiring the necessary infrastructure to operate.” Hence, one solution for increasing U.S. bank capital is the consolidation of geographically dispersed banks, making the large financial institutions “better equipped to compete globally with the banking giants of Japan, Germany, France, and England.”

It is instructive to note one last point with regard to restrictions on interstate banking. Finding it “alarming” that U.S. laws permit discrimination against banks of “sister states,” the E.C. regards such restrictions as a trade barrier and a denial of national treatment.

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258 The duplication of branches, support functions, computer systems, and the limitation on economies of scale. RECOMMENDATIONS, supra note 232, at XVII-10 - XVII-11.
259 Berg, supra note 248, at D1.
260 Nash, supra note 253, at 1. Another advantage is the ability to perform large transactions. Id.
261 Id.
262 Timothy W. Koch, The Emerging Bank Structure of the 1990’s, BUS. ECON., July 1992, at 32. Capital reduces bank risks in three ways: first, it is the “cushion” that absorbs losses; second, it produces high capital levels, a sign of strength in banking, allowing banks to more easily access money via the stock and bond markets at a low price; and third, high levels of capital restricts available funds to be lent out, which, restrains risk-taking. Id.
264 Koch, supra note 262.
C. Summary

While U.S. bank entry into Japan was formerly severely limited by direct regulation, this is no longer true. Now, U.S. banking institutions suffer from the same regulatory burdens placed on their Japanese counterparts and are subject to no more direct regulatory disadvantages than those competitors. Japanese "national treatment" of U.S. banks is, however, conditional. The Japanese Banking Law makes it clear that such treatment in Japan is based on reciprocity. The FTFSA is retaliatory and, if implemented, would justify the Japanese in recision of national treatment — the exact opposite reaction envisioned by the FTFSA supporters.

More importantly, it is dangerous to misplace the blame for the imbalance. A significant amount of responsibility for the slow expansion of U.S. banks into Japan, and their weakened position at home when competing with the increased Japanese presence, must be placed on our own regulatory choices. Direct restrictions, while perhaps relatively minor, are nonetheless barriers to overseas expansion. More importantly, regulations imposed on U.S. banks in response to the Great Depression are still at work limiting the ability of U.S. banks to gain capital, profitability, and size.

V. ALTERNATIVE EXPLANATIONS FOR THE ASSET OWNERSHIP IMBALANCE

Regulatory barriers alone do not explain the imbalance of banking asset ownership. To evaluate the effectiveness of the FTFSA, which contemplates unfair trade practices as the cause of asset ownership imbalance, other possible causes of the imbalance should be explored. Towards that purpose, this Section presents several forces that may have contributed to the current imbalance in asset ownership.

A. Twin Deficits

The U.S. budget deficit ballooned during the 1980s, quintupling to four trillion dollars. Simultaneously, U.S. consumers consumed more

266 The chief of Citibank's North Asia Division has been reported as saying, "[b]arriers? Not a single one that matters. Japan is now one of the most attractive markets in the world." Carla Rapoport, You Can Make Money In Japan, FORTUNE, Feb. 12, 1990, at 85. But cf. Citicorp's chairman supports the FTFSA, reversing his earlier position. Citicorp's Reed Now Backs Fair Trade Bill, AM. BANKER, Oct. 27, 1993, at 2.

267 Mark Memmott, Getting to the Bottom of Debt, USA TODAY, Oct. 29, 1992, at
than they produced, in an amount over one trillion dollars. The result was a borrowing binge by the United States and a lending binge on the part of the Japanese. The Japanese were well-positioned to play such a role. Japanese families and business people save more than they invest in their home economy. Moreover, Japan experienced net trade surpluses during the 1980s amounting to $360 billion flowing into the country. The deregulating world of the 1980s meant that “capital [flowed] across national borders with as little regard for ‘sovereign’ boundaries as the weather has” allowed these two conditions, the Japanese surplus and the U.S. deficit, to collide.

The growth of Japanese banks at home and abroad need not be explained by unfair practices by Japanese banks or the Japanese government:

4B.

268 The sum of yearly trade deficits during 1980 through 1989, was $1042.7 billion, as reported in the following articles: Oil Widens Trade Gap in Month, N.Y. TIMES, Jan. 29, 1981, at D1; Trade Gap Narrowed Last Month, N.Y. TIMES, Jan. 29, 1982, at D1; '82 Trade Gap is Record, But December Improved, N.Y. TIMES, Jan. 27, 1983, at D13; 1983 Trade Deficit Hit $69.4 Billion, N.Y. TIMES, Jan. 28, 1984, at 29; Peter T. Kilbom, U.S. Trade Deficit Set Record in 1984, N.Y. TIMES, Jan. 31, 1985, at A1; Clyde H. Farnsworth, Year's Trade Deficit Hit Record $148.5 Billion, N.Y. TIMES, Jan. 31, 1986, at D1; Robert D. Hershey, Jr., U.S. Trade Deficit in Reversal, Fell 44% in December, N.Y. TIMES, Jan. 31, 1987, at 1; Robert D. Hershey, Jr., U.S. Trade Deficit Narrows Further as Export Grow, N.Y. TIMES, Feb. 13, 1988, at 1; Robert D. Hershey, Jr., U.S. Trade Deficit Shrinks to $11.9 Billion, N.Y. TIMES, Feb. 17, 1989, at A37; Robert D. Hershey, Jr., Trade Gap Reaches 5-Year Low, N.Y. TIMES, Feb. 17, 1990, at 35.

269 See Joint Hearing, supra note 55, at 16-17 (Senator Ted Kennedy lamenting that the United States is “completely addicted” to debt).

270 Bill Orr, Competing With Japanese Banks, ABA BANKING J., Sept. 1990, at 39. Households in Japan save, on average, as much as 19% of their annual income, while U.S. households save less than five percent. Murphy, supra note 133, at 72.

271 Orr, supra note 270, at 39.

272 In the 1970s and continuing throughout the 1980s the United States deregulated banking in many ways. Id. See, e.g., RECOMMENDATIONS, supra note 232, at 1-19. In 1978, deposit interest rates were deregulated and S&L's were authorized to sell six-month certificates of deposit. Orr, supra note 270, at 39. In 1980, the Depository Institutions Deregulation and Monetary Control Act authorized the complete elimination of deposit interest rate ceilings, by 1986, and allowed banks to offer NOW accounts — interest-paying consumer checking accounts — and, in 1991, Savings and Loans were authorized to offer adjustable rate mortgages. Orr, supra note 270, at 39.

273 Orr, supra note 270, at 39.
there is nothing surprising or even sinister about the strength of Japanese banks... It is a direct by-product of Japan's successful economy and the fact that, since 1982, Japan has become the world's largest exporter of capital. For all sorts and nationalities of banks, their business can crudely be summarized as 'have money, will travel.'

Further, the increased presence of Japanese banks can be explained in terms of "following the customer." The combined trade deficit and budget deficit led to an increased presence in the United States of Japanese manufacturers and investors. In exchange for Japanese money, the United States purchased goods from around the world, including Japan. The Japanese accepted U.S. government securities, stocks, and bonds, and such direct investment as purchases of businesses and real estate. Japanese purchases of property, plants, and equipment in California increased 129% between 1982 and 1986. The Japanese banks have very close ties with their customers, so when Japanese exporters and investors made their way to the United States, Japanese banks followed.

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274 EMMOTT, supra note 111, at 166-67.
275 See infra Section V.
276 Orr, supra note 270, at 39.
277 Id. Japanese new direct foreign investment jumped from $4.5 billion in 1982 to $20 billion in 1987, with greater than half going to the United States. EMMOTT, supra note 111, at 136.
278 Orr, supra note 270, at 39. Cost advantages aside, it has been suggested that the Japanese were eager to invest in the United States to avoid the growing protectionism in the country. DOUGLAS FRANTZ & CATHERINE COLLINS, SELLING OUT: HOW WE ARE LETTING JAPAN BUY OUR LAND, OUR INDUSTRIES, OUR FINANCIAL INSTITUTIONS, AND OUR FUTURE 31 (1989).
279 See infra Section V.E.
280 "[B]ankers have a reputation as being conservative. They have... left the honour of first entry into hostile foreign territories to others, playing a supportive role as camp followers. The Japanese expansion abroad has been no exception." Gunter Dufey, The Role of Japanese Financial Institutions Abroad, in JAPANESE FINANCIAL GROWTH 132, 144 (Charles A.E. Goodhart & George Sutija eds., 1990) [hereinafter Dufey]. Also, "[t]he pronounced sense of mutual obligation in Japanese culture" may have "induced Japanese banks to follow their customers." Id. Japanese banks go to great lengths to maintain their relationships with their Japanese customers. Id. at 144-45. This is a "gravitational" explanation of Japanese Bank behavior. Robert Z. Aliber, Comment, in JAPANESE FINANCIAL GROWTH 166, 167 (Charles A. E. Goodhart & George Sutija eds., 1990). See also Orr, supra note 270 ("Banks follow trade."); FRANTZ & COLLINS, supra note 278, at 231.
B. Cost of Capital

During the 1980s, the Tokyo Stock Exchange (TSE) skyrocketed, surpassing, in 1987, the value of the New York Stock Exchange. This directly impacted the bottom line of Japanese banks. As noted Japanese banks held a large percentage of the TSE. Japanese regulation permitted a large percentage of these holdings to be applied to banks’ capital reserves. Hence, when the TSE rose, correspondingly less cash needed to be set aside, freeing capital for lending and investment purposes. Moreover, Japanese regulation required a lower level of reserves than was required by U.S. regulators; hence, again, the Japanese used less of their cash resources for capital requirements. Simply put, with less cash sitting idle in reserves, the Japanese banks enjoyed a cost of capital advantage.

In a worldwide effort to increase the soundness of banks, the Basel Committee on Banking Regulation and Supervisory Practices, made up of the banking officials of the twelve leading Western economies, recommended that each nation adopt a minimum capital ratio of eight percent, half of which could include such assets as security holdings and physical plant. Each country was given great leeway in determining how to achieve this goal. The U.S. refused to include premises value, fixed assets, or securities in its valuation of capital. Japan, however,

281 YEN!, supra note 133, at 38. The value of Nippon Telegraph & Telephone on the stock exchange was greater than the combined sum of IBM, AT&T, General Motors, General Electric, and Exxon. Id.
282 See supra Section IV.A.3(c).
283 Dufey, supra note 280, at 155-58.
284 Regulatory reserve requirements that exceed actual liquidity needs, while reinforcing solvency, act as a form of taxation, increasing the cost of capital. ROSE, supra note 171, at 158-59.
285 A striking example of this impact can be seen by comparing the Japanese City Banks’ capital-asset ratios in 1986 — which ranged in value between 1.75% to 2.99% — with the largest U.S. banks, which had ratios in the 3.39% to 6.87% range. See Dufey, supra note 280, 155-58.
286 The standards are not legally enforceable as treaty nor do they impose an independent legal obligation on the Parties. Alford, supra note 263, at 201. For a detailed explanation of the calculation for U.S. standards under the Basel agreement, see id. at 193-96.
288 A Method for Evaluating Interest Rate Risk In U.S. Commercial Banks, 77 FED. RES. BULL. 8, 625.
289 Basel Committee Issues Final Risk-Based Capital Standards, BANKING REP.
permitted its banks to use forty-five percent of the value of their securities holdings — which, as mentioned above, are quite significant — towards the four percent. Moreover, the eight percent figure represented an increase for many U.S. banks, forcing the banks to increase reserves during a period of particularly harsh operating conditions.

Another effect of the inflated Japanese stock market was the ability of Japanese banks to raise funds. In 1989, Japan’s top banks had a price-earnings (PE) ratio of 45.7 to 130.8. Top U.S. banks, on the other hand, had PEs of 6.4 to 7.9. Such a differential gives Japanese banks a “privileged access to low-cost capital.” All else being equal, an issuance of stock by a Japanese bank would raise five to twenty times the amount of the issuance of the same amount of stock by a U.S. bank. “With ludicrously low cost of capital, of course, Japanese banks have an easier time penetrating foreign markets and repelling foreign banks at home.”

The advantages of the 1980s have become Japan’s disadvantages of the 1990s. The TSE, after reaching a high in 1989 fell over forty percent by 1992. This meant that the Japanese banks that had relied on their TSE holdings to meet capital standards could no longer meet them. Moreover, the necessary capital could not be easily raised, as the TSE collapse meant that “the days of raising buckets of cheap equity to fuel growth [were] over.”

C. The Yen

Another reason Japanese banks displaced U.S. banks on the lists of the world’s largest banks has been the great appreciation of the value of the yen. This has been a factor allowing them to aggressively enter the U.S. market during the 1980s and is continuing so far in the 1990s. In November 1982, the yen/dollar ratio was 268.05; by November 1990, it stood at 130.10; and in November 1993, the figure was 107.95.

(BNA), July 25, 1988, at 135.

290 Dufey, supra note 280, 155-58.

291 See infra Section V.F.

292 Orr, supra note 270, at 39.

293 Dale-2, supra note 135, at 43.


295 See generally Tough Times, supra note 176, at 66.

296 Id. at 67.


298 Closing price on November 28, 1990. Dollar Up After Comments By Greenspan
— a doubling in the strength of the yen. Japanese assets stated in dollar terms, would have doubled as a simple matter of mathematics. In fact, one researcher has stated “[t]he growth in U.S. dollar assets of leading Japanese banks is as much due to the depreciation of the U.S. dollar vis-à-vis the yen as it is due to growth in real assets of leading Japanese banks.” Purchase of U.S. assets by Japanese banks, therefore, was made easier, while, correspondingly, the purchase of Japanese assets by U.S. banks was more difficult. The exchange rate made U.S. assets look cheap.

D. Deregulation

Ironically, the very deregulation of the Japanese system that is constantly being thrust upon the Japanese may have helped spur the rapid growth of Japanese assets abroad. The Japanese financial system was designed to meet the post-war severe credit deficit; it worked so well that by the early 1980s it held a surplus of capital. Therefore, when Japan instituted financial liberalization in the late 1970s and early 1980s, the dam burst and pent-up capital was more free to seek out new opportunities. The Japanese Federation of Bankers Associations maintains that “structural limitations of Japan’s economy make overseas investment an attractive prospect.”


299 Closing price on November 9, 1993.

Dollar Posts Broad Gains While Gold Also Advances, N.Y. Times, Nov. 10, 1993.

300 Dufey, supra note 280, at 141. The growth in assets when expressed in current U.S. dollars on non-U.S. banks can be “decomposed approximately as the sum of” the following:

1. the growth rate in real assets of foreign banks, expressed in constant units of the banks’ home-country currency;
2. the depreciation rate of the U.S. dollar;
3. the inflation rate in the home country of the bank.

Id. at 140-41.

301 FRANZT & COLLINS, supra note 278, at 31-32.

302 EMMOTT, supra note 111, at 97-98 (permitting, for example, the issuances in Europe of yen-denominated bonds, making the yen more important as an international currency).

303 Id. at 99. See also ROSE, supra note 171, at 51-54.

304 BANKING SYSTEM IN JAPAN, supra note 132, at 5.
E. The Japanese Way of Banking

A final way in which the Japanese may have gained competitive advantage is the way, based on cultural factors, in which they conduct business.

First, the Japanese are notorious for having long-term investment horizons. Japanese banks “will tolerate lower profit margins and thus lower prices than will their banking rivals.” Lower profit margins clearly act to discourage firms from entering their home market and this serves as a Japanese advantage when they enter new markets.

Second, Japan’s banks maintain very close relationships with their large clients. Before World War II, Japanese industry was dominated by “zaibatsu” corporations which were family-owned conglomerates that controlled companies in diverse trades, from manufacturing to trading and finance. After the war, such entities were disbanded by the military occupiers. However, they were reborn in the form of “keiretsus,” with banks, instead of families, at the center. A keiretsu is, in essence, a group of companies — typically an insurance company, a trading company, and several manufacturers or marketing companies, and a single central bank that establish a very close working relationship. In a process called cross-sharing the keiretsu member companies purchase sizable portions of each other’s stock (known as “relationship shares”). Although banks are limited to owning no more than five percent of the securities of another corporation, after each member of the keiretsu has purchased the others’ shares...

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306 EMMOTT, supra note 111, at 167. See also ROSE supra note 171, at 55 (noting that in recent years U.S. banks have experienced a return-on-assets of close to one percent, while the Japanese have experienced .5% - .6%).
307 CARGILL & ROYAMA, supra note 146, at 45.
308 Id.
309 Id.
311 YEN!, supra note 133, at 231.
312 Id. Firms are evaluated on their willingness to hold each other’s shares on a long term basis; it is expected that keiretsu members will hold the shares for the long term. Id.
313 ROSE, supra note 171, at 54 (noting that the restriction has been effective only since December 1987).
shares, twenty to thirty percent of each firm's stock is controlled by the
keiretsu.\textsuperscript{314} This ownership fosters a strong preference for intra-keiretsu
purchasing of goods and services\textsuperscript{315} and is clearly a factor of "who does
business with whom."\textsuperscript{316}

Keiretsu member presidents, acting as a shadow board of directors,
typically meet on a monthly basis.\textsuperscript{317} The nature of these meetings is
somewhat mysterious, but it likely serves as some combination of a social
and informal decision making function.\textsuperscript{318} These managerial links pro-
vide closer personal ties as well as cooperation in long-term strategic
planning and operational integration.\textsuperscript{319} Banks, although playing a central
role, are not dictatorial; rather the keiretsu decision making, which
reflects Japanese style, is based on consensus.\textsuperscript{320}

The keiretsus offer banks many advantages, because companies
expect that relationship shares will be held for the long term, banks can
place long-term goals ahead of short-term goals, sacrificing short-term
profits without injuring investor confidence.\textsuperscript{321} Indeed, it has been re-
ported that the Japanese keiretsu members value long-term stability over
profits;\textsuperscript{322} in fact, the primary purpose of relationship shares may be the
creation of "intercorporate bonds," not an investment aimed at obtaining
an ownership interest or return on capital.\textsuperscript{323} For members generally,
there is reduced business risk due to financial, service, and product
interdependence; low risk members "can borrow from banks and simulta-
necessarily act as intermediaries to the higher risk member by providing
trade credit."\textsuperscript{324} Thus it is clear the banks "play a role far beyond trans-

\begin{itemize}
  \item \textsuperscript{314} Wilmarth, \textit{supra} note 310, at 1057. \textit{See also} Mark J. Roe, \textit{Some Differences in
  Corporate Structure in Germany, Japan, and the U.S.}, 102 \textit{Yale L.J.} 1927, 1936
  (1993) (claiming cross-sharing amounts to 50% of stock).
  \item \textsuperscript{315} Razin, \textit{supra} note 305, at 362.
  \item \textsuperscript{316} YEN!, \textit{supra} note 133, at 231.
  \item \textsuperscript{317} Roe, \textit{supra} note 314, at 1943.
  \item \textsuperscript{318} \textit{Id.} at 1943-45.
  \item \textsuperscript{319} Razin, \textit{supra} note 305, at 361.
  \item \textsuperscript{320} \textit{See} Roe, \textit{supra} note 314, at 1943-45. "Wa" — harmony — profoundly influences
  Japanese culture and directly impacts keiretsu practices. Razin, \textit{supra} note 305, at 361.
  \item \textsuperscript{321} Wilmarth, \textit{supra} note 310, at 1063.
  \item \textsuperscript{322} CARGILL \& ROYAMA, \textit{supra} note 146, at 46-47.
  \item \textsuperscript{323} Razin, \textit{supra} note 305, at 359.
  \item \textsuperscript{324} CARGILL \& ROYAMA, \textit{supra} note 146, at 46-47. The benefits of keiretsu include
  the following:
    \begin{itemize}
      \item Financing members are given "extensive input" into the borrower's operations,
      while borrowers have access to "otherwise unobtainable" funds. Razin, \textit{supra} note 305,
      at 359.
      \item Relationship shares provide equity financing and closer corporate ties. \textit{Id.} at 359-
    \end{itemize}
\end{itemize}
ferring funds" and further illuminates their willingness to "follow their customers" to the United States.

However, the keiretsus are not as powerful as they may appear. They are not as powerful as German banks which, in comparison, are allowed unlimited stock ownership of industrial corporations. They are increasingly under "severe stress" due to market forces and financial liberalization in Japan. The large industrial corporations that make up the keiretsu increasingly have access to international financial markets, modern financial products (such as securitization of debt), and significant retained earnings. Since the early 1970s, then, there has been a sizable decrease in keiretsu member firms' dependence on the main bank for funding. This fact makes it clear that "Japanese industry is [not] tied by unbreakable ropes to its banking partners, as is the case in [Germany]. . . . Once it was in industry's clear interest to break its ties, that is what happened." In addition, Professor Ramseyer suggests an alternative hypothesis for describing the phenomenon of cross-sharing, arguing that banks' shareholdings are not the result of murky keiretsu motivations, but rather of old-fashioned investment savvy. Banks learn of their clients' profit potential when evaluating creditworthiness, thereby becoming privy to a certain degree of insider information. Acting on this information allows banks to "buy stock simply because they find it underpriced."

60. - Relationship shares provide tax advantages; Japan's tax scheme is skewed in favor of capital gains and intercorporate dividends. *Id.* at 360.
   - Reduction in costs due to operational harmonization. *Id.* at 362-63.
   - Pooling of human and technical resources. *Id.* at 364-65.

 225 CARGILL & ROYAMA, supra note 146, at 46-47.
 226 Roe, supra note 314, at 1937. For example, Deutsche Bank owned 41% of the auto manufacturer Mercedes Benz. *Id.*


 228 CARGILL & ROYAMA, supra note 146, at 46.
 229 EMMOTT, supra note 111, at 104.

 300 J. Mark Ramseyer, Columbian Cartel Launches Bid for Japanese Firms, 102 YALE L.J. 2005, 2013-14, 2020 (1993). Ramseyer reaches this conclusion by debunking several popular explanations for shareholding. First, Ramseyer maintains, Japanese banks do not seek to control or influence their customers in order to reduce risk. If this were the goal, however, the result could be achieved just as effectively and more cheaply by simply altering their banking activities (shorter term lending, refusing new loans to troubled borrowers, etc.). *Id.* at 2007-08. Second, shareholding is not the result of a desire to insulate firms from takeovers; such motivation is a "classic" invitation to
The 1980s were difficult for U.S. banks. They stumbled from one banking disaster to the next — agricultural loans, energy-sector loans, Lesser Developed Country (LDC) loans and the lingering recession of 1990 — and simultaneously faced increased competition from “non-banks” and foreign banks.

The first banking disaster of the decade was the result of a stunning growth in farm exports during the 1970s (rising from seven billion dollars in 1970 to forty-one billion dollars in 1980), which lead to large bank exposure in farm debt (including real estate).\(^3\) In the early 1980s a combination of forces\(^3\) caused farm income to implode and with it many banks. Between 1984 and 1987 over 200 banks with large exposure to agricultural loans collapsed.\(^3\) Also during the decade, a similar, but more intense set of events took place in the oil producing states. Between 1981 and 1985, oil prices ranged between thirty-one dollars per barrel and forty-one dollars per barrel. Then, in the eight months between November 1985 and July 1986, oil plunged to twelve dollars per barrel.\(^3\) The collapse of the oil states’ economies was rapid and extensive.\(^3\) In Texas, Louisiana, and Oklahoma 486 banks failed between 1984 and 1989.\(^3\) Finally, the increase in lending to LDCs during the 1970s resulted with the “debt crisis” of the 1980s from which large money center banks suffered huge losses.\(^3\) In the third quarter of 1987, large U.S. banks added $21.2 billion to their loan loss reserves; Citibank alone set aside three billion dollars.\(^3\)

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adverse selection — the banks’ risk levels would increase because the most poorly run firms would need takeover protection and, therefore, would seek the umbrella of kieretsu shareholdings. \(\text{id. at 2009-10.}\) Third, banks do not seek to enhance monitoring of their borrowers by investing in stock; there is no evidence that the cost-benefit analysis of such a premise. \(\text{id. at 2010-11.}\) Finally, banks have no reason to buy stock in order to insure long-term relationships; however, the very fact that shares can so easily be sold indicates the weakness of this insurance. \(\text{id.}\)

\(^{31}\) RECOMMENDATIONS, \(\text{supra note 232, at 1-23.}\)

\(^{32}\) This combination included high production, unfavorable exchange rates, foreign buyers’ debt problems, and increased foreign production. \(\text{id.}\)

\(^{33}\) \(\text{id.}\)

\(^{34}\) \(\text{id.}\)

\(^{35}\) \(\text{id. at I-23 to I-24.}\) The effect rippled throughout the oil states. Dallas had office vacancy rates in excess of 30% in 1987. \(\text{id.}\) In the fourth quarter of 1987, mortgage foreclosures in Texas reached 15% of outstanding mortgages. \(\text{id.}\)

\(^{36}\) \(\text{id. at I-24.}\)

\(^{37}\) Work & Stanglin, \(\text{supra note 19, at 53.}\)

\(^{38}\) \(\text{id.}\) While no bank failures have been blamed primarily on the LDC debt
Another factor in the weakened position of U.S. banks in the 1980s was an increasingly more competitive financial market place. Between 1980 and 1989, banks' share of financial sector assets fell from thirty-three percent to twenty-seven percent, after falling a mere one percent in the preceding decade. During the 1980s mutual and money market funds increased their share of the financial assets picture from 3.06% to 8.08%. Moreover, banks faced increasing competition in financial services from “non-banks” such as Sears, Roebuck and Co. and American Express.

The 1990s began inauspiciously for banks. The overborrowing of the 1980s, especially in real estate, caused severe problems for banks when the recession hit in 1990. Compounding the problem was the requirement that U.S. banks build their already damaged balance sheets to meet higher capital standards required by the Basel Committee agreement. Hence, in 1990-91, U.S. banks actually reduced commercial and industrial lending by 5.5%, contributing to the widely perceived “credit crunch” that was thought to deepen the recession and delay the recovery.

The fact that, during the 1980s, U.S. banks did not expand into Japan as rapidly as Japanese banks did in America may have been due to the financial weakness of the U.S. banks. Such weakness is especially significant when considering the costliness of entering the Japanese market — a costliness colored by barriers such as the competitive advantages of existing Japanese banks (size, existing customer base, and keiretsu), the deflated dollar, and the infamous high cost of doing business in Japan. It cannot be a surprise that the extremely complex and “frightfully” competitive Japanese banking markets have caused U.S. banks to reassess their efforts to enter a market that is “clearly overbanked and unprofitable.”

problem, it did increase the “fragility of the banking system.” RECOMMENDATIONS, supra note 232, at I-24.

339 RECOMMENDATIONS, supra note 232, at I-25.
340 Id. at I-25, table 7.
341 Work & Stanglin, supra note 19, at 53.
342 James R. Kraus, Foreign Banks Prove Staunch Allies for U.S. Firms, AM. BANKER, Apr. 23, 1992, at 3A.
343 Id.
344 Id.
345 See Part Two, supra note 110, at 75-79 (prepared comments of Professor Kanda).
346 To purchase real estate in Tokyo is a mind-boggling expensive proposition. For example, the Imperial Palace in the heart of Tokyo, in the late 1980s, was said to have a market value greater than some states in the United States. Murphy, supra note 133, at 72.
347 Joint Hearings, supra note 55, at 134-35 (prepared text of Eric W. Hayden). De-
In short, added to the historic problems of foreign banks, e.g., limited access to local funds, restricted branching opportunities, and onerous regulatory intervention are the sober realities of a shrinking market and steadily soaring costs. It is particularly the latter, the result of a strong yen and high fixed operating expenses, which has led several major American banks to scale back, shut down, or re-focus their Japanese operations. Further, because of the extraordinary price of acquisition, "no American bank is . . . even remotely considering the purchase of a local bank's branch network."  

VI. EVALUATING THE IMBALANCE

Another premise of the FTFSA is that the asset ownership imbalance is harmful. This Section seeks to examine the validity of this assumption by surveying, first, the concerns raised by the imbalance and, then, the positive effects of foreign investment in U.S. banking.

A. Harmful Effects

Popular literature that addresses the imbalance tends to be general in its assertions, focusing on a narrow set of facts and restating statistics.

During the 1980s there were many reports, articles, and speeches on the subject of the growth of Japanese financial institutions in international markets. While much of the literature is quite superficial, tending to be purely descriptive at best, it often has an alarming undertone; that Japanese financial institutions, in mysterious and inscrutable ways, are able to underprice their services, exploiting unfair advantages never quite precisely defined, by which they make life difficult for their competitors in international and domestic markets alike.

An example of such behavior is the concern of a sponsor of FTFSA, Senator Reigle of Utah, that "control over a nation's financial institutions means control over which businesses are provided with credit and allowed to grow." Within itself, this seems incontestably true. The notion, however, falls apart on its most visceral word "control." Imbedded in the word control is one of the following assumptions, none of which seem true. The Japanese will use control over credit to deny credit to U.S. concerns. This is odd, considering much of Japanese assets in the U.S.

spite the large number of banks in the United States, there are more branch locations per 100,000 people in Japan. See G. BROKER, TRENDS IN BANKING STRUCTURE AND REGULATION IN OECD COUNTRIES: COMPETITION IN BANKING 24 (1989).

348 Joint Hearings, supra note 55, at 134-35 (prepared text of Eric W. Hayden).
349 Dufey, supra note 280, at 133.
350 Hearings, supra note 4, at 11.
are in the form of subsidiaries that are separately capitalized. Moreover, and most damaging of all, it assumes a monolithic Japanese actor that has inscrutable motives. Of course, this seems improbable. Japanese banks are self-interested business actors advancing their business interests as they think proper.352

There are more genuine concerns that arise. First, if Japanese banks, exploiting their competitive advantages, enter the U.S. market, and underprice U.S. banks, both banks and U.S. taxpayers may be impacted. That is, U.S. banks, losing their best customers to the low-cost competition, will be forced into making loans to riskier clients. This in turn places a bank in more serious danger of failure, and the U.S. taxpayer may be left with the bill.353 Yet, this proposition neither recognizes the benefits to consumers and businesses from lower prices on banking services, nor the fact that such deleterious competition is only one portion of the overall declining profitability of U.S. banks, which has been the result of a host of competitive and macroeconomic factors. Therefore, it is important to note that when the U.S. Treasury made recommendations for the improved safety and soundness of U.S. banks, the solution was not to eliminate competition with banks, but to increase the banks’ ability to compete.354

Another risk with foreign investors is that their money is “less stable.” That is, for external reasons or otherwise, they may need to withdraw quickly from the market. For instance, the Japanese may have been responsible for the collapse of Continental Bank of Illinois in 1984 when, nervous about its soundness due to exposure to the energy sector, they rapidly withdrew their funds. However, as a general practice the Japanese have been stable investors. Furthermore, subsidiary companies, the bricks and mortar investment, are less liquid than U.S. treasuries or deposits; hence the dangers of a Japanese abandonment of

351 Japanese financial dominance is disturbing “not because Japan is conspiring to rule the world or is creating unholy alliances to command the world economy.” Murphy, supra note 133, at 74.
352 See Ramseyer, supra note 327, at 117 (explaining that for Japanese banks, “self-interest may matter far more than many sociologists suggest, while reputational capital and the prospect of repeated dealings may matter much less than some economists suggest.”).
353 Hearings, supra note 4, at 11.
354 See generally RECOMMENDATIONS, supra note 232, at 1-74.
355 Sender, supra note 294.
356 Id.
357 Murphy, supra note 133, at 72.
358 Sender, supra note 294.
the banking market seems remote.

A more intriguing concern raised about Japanese financial dominance is that Japan "lacks the ideological and political commitment necessary to fulfill the obligations that go with financial power." In short, the United States and Britain, when each ruled the commercial waves, provided the leadership to encourage free trade, despite some cost to themselves. Now that Japan is the largest creditor nation in the world, there is fear that Japan is unwilling to make the necessary sacrifices to advance the interests of free trade. The irony of this contention within the context of the FTFSA debate, is that the FTFSA, as retaliatory legislation, is hardly an example of U.S. willingness to sacrifice short-term self-interest and provide free trade leadership-by-example.

B. Benefits from Foreign Investment

Foreign banks contribute to the U.S. economy in several ways. They provide increased credit for U.S. borrowers; increased depth and liquidity of financial markets; increased competition and innovation in banking services; and they facilitate trade and investment (including significant quantities of export financing). A Federal Reserve Board member has stated: "U.S. markets are the most efficient, most innovative, and sophisticated" in the world and it "is not a coincidence that our markets are also the most open to foreign competition." During the credit crunch of the early 1990s, foreign banks maintained their level of lending, while U.S. banks decreased theirs by twelve percent. In 1990-91, U.S. banks decreased industrial lending by 5.5%. Foreign banks, however, increased lending during that period by five percent helping to mitigate this "credit crunch." Also, in that same

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359 Murphy, supra note 133, at 74.
360 See generally id. at 72-83.

Senator Ted Kennedy has expressed a variation on this leadership theme, lamenting the Japanese unwillingness to take a leadership role in foreign aid to poor nations: "I just think that, in a country that is so wealthy and so powerful, there is the need for better leadership." Joint Hearings, supra note 55, at 5.

362 Joint Hearing, supra note 55, at 17-18 (comments of John P. LaWare).
364 Kraus, supra note 342, at 3A.
period, foreign banks increased their U.S. loans for real estate by 35.7%. Highlighting the importance of foreign banks to the U.S. economy, a Japanese bank, in an unusual move for the publicity shy Japanese banks, ran an advertisement stating “[a]s long as American industry waits in line for money, American workers will wait in line for jobs.”

Thus, one observer has found that “without question” the growth of Japan’s banks inside the United States has resulted in “substantial savings” for U.S. customers, resulting from lower interest rates, reduced charges for non-credit services (such as those of trust and cash management), as well as an increase in the number and range of services.

C. Summary

The asset ownership imbalance is not harmful for the United States, and the benefits have been considerable. Moreover, the fact that concern has arisen over the imbalance with Japan adds an unpleasant hint of racism. Although the Japanese banks dramatically increased their presence in California during the 1980s — from 1980 to 1988, their market share increased from ten percent to twenty-five percent — total foreign bank ownership increased by less than three percent. In essence, the Japanese replaced the British, who abandoned the states in droves during the 1980s. Similarly, while there is clearly a Japanese investment imbalance in banking, as the numbers bear out, the Japanese are still only the third largest investors in the United States, following the British and the Dutch.

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367 Kraus, supra note 342, at 3A.
368 ROSE, supra note 171, at 148-49.
369 Orr, supra note 270, at 39.
370 Id.
371 British banks held 15% in 1982, but sold most holdings in the state during the 80s. Id. See, e.g., Bates, supra note 366, at D1 (Sanwa Bank, taking “advantage of the British retreat from California,” purchased the operations of Lloyd’s Bank).
372 FRANTZ & COLLINS, supra note 278, at 342.
VII. CONSEQUENCE OF FTFSA AND CONCLUSION

A. General Limitations of FTFSA

The FTFSA, if applied against Japan, would limit the many benefits of their investment in our banking market. Moreover, it is clear that the ripple affect of FTFSA goes beyond Japan. Since many nations do discriminate against the U.S. banking industry, the application of FTFSA would mean that “almost everyone else with a financial-services industry worth the name, would get nothing more than the access they have today.” Considering the many benefits provided by foreign investment in banking, it should be asked if such a result is desirable. Furthermore, the retaliatory nature of the FTFSA and its subsequent wide-ranging implications, suggests that financial services protection cannot be viewed in a void. Rather, it is merely part of a larger agenda of U.S. trade policy — NAFTA and the Uruguay Round being just two examples — and U.S. foreign policy.

B. The FTFSA and Japan

Perhaps the most potent argument against FTFSA is that a notion on which it rests that the Japanese only respond to force, is false. Efforts to force Japan into liberalization have not worked in the past and it is not clear they will work now. First, the regulatory liberalization that the Japanese have already made in their home market was the result of domestic economic requirements, not simply foreign pressure. Second, it is difficult to determine which nation is in the better position to apply force to achieve its ends: the Japanese are the dominant financial power in the world, sitting on the “largest cache of wealth ever assembled,”

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372 Id. at 82.
374 See generally Hearings, supra note 4, at 61-66.
375 Rep. Schumer of New York, a sponsor of FTFSA, has based his support of the bill, in part, on the success of such an approach when Japanese securities dealers were blocked from participation in U.S. markets during the mid-80s. The Japanese securities markets were subsequently opened and Rep. Schumer places that success on U.S. pressure. Hearings, supra note 4, at 21-23.
376 Suzuki, supra note 152, at 30; CARGILL & ROYAMA, supra note 146, at 16-17. However, foreign pressure may have provided a convenient foil to provide the political impetus for change. EMMOTT, supra note 111, at 98.
377 Murphy, supra note 133, at 71. See also Hearings, supra note 4, at 21 (Representative Schumer: “It should be perfectly clear... that [the] era of U.S. economic domination is over.”)
the United States, conversely, is sitting on the largest debt in the world\textsuperscript{378} and has benefitted profoundly from the use of Japan's wealth to fund its government\textsuperscript{379} and invest in its banks and services.\textsuperscript{380} Thus, with all the United States has to lose by implementation of FTFSA, it is not at all clear whether in this endeavor the United States is, so to say, in the driver's seat.

A final implication of the FTFSA is that, with it, the United States is firmly claiming the moral low ground.\textsuperscript{381} As noted, many of the competitive disadvantages of U.S. banks must be laid at the steps of Capitol Hill and the capitols of the individual states. And, while the federal laws offer national treatment to foreign banks, the states, to whom the current national banking laws defer, are not so generous. As of 1990, there were still four states that did not even allow banks from other states to enter their territory.\textsuperscript{382} It seems inappropriate that the United States adopt protectionist legislation in an area in which it does not have the cleanest hands, and at a time when it is attempting to play a leadership role in such free trade initiatives as NAFTA and GATT.

C. Conclusion

The trouble with FTFSA is that there is no problem for it to correct. In terms of regulation, the Japanese offer U.S. banking companies national treatment. Although the Japanese have in the past been discriminatory, just as has the United States, any future imbalance in ownership is due to Japanese customary banking behavior and macroeconomic factors (such as the U.S. budget deficit, the value of the dollar, and the behavior of the two nations stock markets), and U.S. laws that hamper the growth and profitability of its own banks.

Moreover, it is difficult to determine who gains from the FTFSA. From a consumer standpoint in the United States, the FTFSA is mean-

\textsuperscript{378} \textit{Hearings, supra} note 4, at 21.
\textsuperscript{379} Senator Ted Kennedy has lamented the fact that the United States has a difficult time getting "tough" with Japan because it is "completely addicted" to debt, and Japan alone bought $50 billion in U.S. securities. \textit{Joint Hearing, supra} note 55, at 16-17.
\textsuperscript{380} For example, Japanese banks provide 20\% of all credit in California. Murphy, \textit{supra} note 133, at 72.
\textsuperscript{381} Federal Reserve Board Governor LaWare asserts that the passage of the FTFSA would mean that the United States could "no longer hold to a principled position in advocating liberalization in international financial circles." \textit{Joint Hearings, supra} note 55, at 18-19.
\textsuperscript{382} \textit{RECOMMENDATIONS, supra} note 232, at 50, XVII-7 - XVII-8, table 1 (listing Hawaii, Kansas, North Dakota, and Montana as the four states disallowing interstate banking).
ingless because competence, not nationality, is what is important in banking. From an American investor’s point of view, the FTFSA artificially limits the universe of buyers for the investors’ bank stock holdings. From a depositor’s point of view, national regulations, applied evenly to foreign-owned entities and domestically owned entities, can insure that banks behave in a safe and sound manner. In short, nobody gains from the FTFSA, except, perhaps, advocates of simple solutions and seekers of scapegoats.

383 EMMOTT, supra note 111, at 146.
APPENDIX A

MISCELLANEOUS JAPANESE BANKS

I. LONG-TERM BANKS

There are two types of long-term credit institutions, Long-Term Credit Banks and Trust Banks. The Long-Term Credit Banks, of which there are only three, can accept deposits only from their borrowers, local governments, and other public bodies.

Lending for long-term needs, such as plant and equipment, Long-Term Credit Banks played an extremely important role in Japan’s rapid growth after World War II.

Trust Banks, seven of which are Japanese-owned, obtain their funds from trusts, and lend to corporations for capital investments.

II. BANKS SERVING SMALL AND MEDIUM-SIZED BORROWERS

The Japanese system of banking contains an odd-lot collection of financial institutions that service specific fields or small and medium-sized companies.

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384 Industrial Bank of Japan, Long-Term Credit Bank of Japan, and Nippon Credit Bank. BANKING SYSTEM IN JAPAN, supra note 132, app. 1, at 4. By assets, these banks are, respectively, the 8th, 17th, and 40th largest in the world. World’s Largest Banks, supra note 18, at 115, 116, 118.

385 Suzuki, supra note 152, at 202. BANKING SYSTEM IN JAPAN, supra note 132, at 25.

386 "The trust business is a set of transactions in which a trust owner transfers, through a set of legal acts (act of trust), the property rights of his own property to another party (the trustee) and at the same time entrusts the management and disposal of these assets to the trustee for a specified purpose. . . for the benefit of society, himself, or a third party (the beneficiary)."

Suzuki, supra note 152, at 206.

387 Id.

388 Suzuki, supra note 152, at 201.

389 BANKING SYSTEM IN JAPAN, supra note 132, at 25.

390 BANKING SYSTEM IN JAPAN, supra note 132, at 25.
A. *Banks Serving Small and Medium-Sized Companies*

**Sogo Banks**

Sogo Banks (of which there are sixty-eight) act very much like Regional Banks, taking deposits, lending, and transferring funds. Their clients, however, are restricted to doing business with 300 employees or fewer, and have a maximum capital of 800 million yen.

**Shinkin Banks**

There are approximately 455 non-profit organizations carrying out the same type of business as ordinary banks and Sogo banks. All business is conducted on a membership basis. Membership is restricted to companies with 300 employees or less (and their workers) which have maximum capitalization of 400 million yen. Membership is further restricted to residents within limited geographic areas.

All Shinkin Banks, in turn, are members of the Zenshinren Bank, which lends, takes deposits, and transfers money between its member banks, and serves the borrowing needs of local governmental bodies and non-profit organizations. It acts as a banker’s bank, lending to Shinkin Banks with capital shortages with monies gotten from deposits derived from Shinkin banks with deposit surpluses. The Zenshinren Bank also acts as a “mutual aid” system for the Shinkin Banks, providing low-interest loans to troubled Shinkin banks when necessary. Zenshinren Bank is, in asset terms, the sixty-second largest bank in the world.

**Credit Cooperatives**

Credit Cooperatives are similar to Shinkin banks, except that they are organized as for-profit mutual benefit companies. All Credit Cooperatives are members of the National Federation of Credit Cooperatives, an

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391 *Id.* at 25-26.
392 *Id.* at 26.
393 *Id.*
395 *Id.*
396 *Banking System in Japan, supra* note 132, at 26.
398 *Id.* at 224.
399 *World’s Largest Banks, supra* note 18, at 115, 120.
400 Suzuki, *supra* note 152, at 227. In 1985, there were 448 such institutions. *Id.* at 226.
organization that serves the same purpose as Zenshinren Bank. The regulation of these institutions is done by the prefectural governments, not the MOF.

Labor Banks

Labor banks are "cooperative-type financial institutions" that "carry out the financial business that is necessary in order to promote the improvement of living standards for workers and to promote the joint welfare activities of organizations such as labor unions, [and] consumer co-operatives. . ." The main business of Labor Banks is to accept deposits from members and governments and lend to labor organizations and members of those organizations. Membership is limited to labor organizations (and their constituent members) that are within a geographic area.

The Rokinren Bank acts in the same capacity of the Zenshinren banks for the benefit of Labor Banks.

Shokochukin Bank

Shokochukin Bank was designed to service the needs of credit cooperatives formed by small businesses. Its lending is limited to member organizations, their constituent members, and governmental bodies; deposit taking is limited to member organizations and governmental bodies. The government supplies part of the Bank's capital and, although the bank is a private institution, it is strongly involved with its operations (the MOF appoints directors, for example). The interest rates are set by the government. In terms of assets, this bank is the fiftieth largest in the world.

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401 Id.
402 Id. at 225.
403 BANKING SYSTEM IN JAPAN, supra note 132, at 27.
404 Suzuki, supra note 152, at 228.
405 Id.
406 Id.
407 BANKING SYSTEM IN JAPAN, supra note 132, at 28.
408 Suzuki, supra note 152, at 230.
409 Id. at 231.
410 Id. at 230.
411 See id.
412 World's Largest Banks, supra note 18, at 115, 118.
Banks Serving the Agricultural, Forestry, and Fishing Industries

Each of these three industries has special financial institutions set up to service its needs. The banks, of which there are over 4,000, are cooperative in form, with management entrusted to the members. The primary purpose of the institutions is to take deposits and lend to members.

Nearly all persons engaged in these industries are members. Each prefecture maintains a federation of cooperatives, with the federation taking deposits and making loans to members banks. In turn each federation of cooperatives is a member of the Norinchukin Bank. The Norinchukin Bank serves the same function as Zenshinren and Rokinren Banks. Norinchukin went private in 1986 but still acts as a conduit of government aid to these sectors of the economy. Norinchukin is Japan’s largest institutional investor and, in asset size, ranks as the ninth largest bank in the world.

III. POSTAL SAVINGS SYSTEM

The first financial intermediary in Japan, established in 1875, the PSS was designed to promote savings by individuals and to supply funds for industrial capital. Even today, the system is administered by the Postal Ministry and not the MOF. There are several features which set the PSS apart from other financial institutions. First, it is extremely large. There are 24,000 branches — post offices — that by the mid-1980s held thirty percent of all personal deposits in Japan. Second, it is an agency of the government and, therefore, it does not need to make

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413 Suzuki, supra note 152, at 235.
414 Id. at 237.
415 Id.
416 Id. at 236.
417 BANKING SYSTEM IN JAPAN, supra note 132, at 30.
418 Id. at 32.
419 Suzuki, supra note 152, at 232 n.6.
420 EMMOTT, supra note 111, at 108.
421 World’s Largest Banks, supra note 18, at 115, 116.
422 BANKING SYSTEM IN JAPAN, supra note 132, at 35; Suzuki, supra note 152, at 288. Postal banking systems are common throughout Europe. See generally Europe’s Postal Banks; Under Fire, ECONOMIST, June 20, 1992, at 81.
423 EMMOTT, supra note 111, at 100; Suzuki, supra note 152, at 149.
424 Suzuki, supra note 152, at 288.
425 EMMOTT, supra note 111, at 101.
a profit. Third, until 1988, interest on deposits, which were limited to five million yen, was not taxed and interest rates were set by the Postal Ministry. After 1988, interest on deposits have been taxed at the same rate, with limited exceptions, as other financial institutions. Fourth, the Postal Ministry controls the rate of interest on deposits, although free market interest rates are gradually being introduced. Finally, the PSS has grown beyond its deposit taking function, offering such services as automatic payment for utility bills, loans backed by PSS savings accounts, automatic wage deposit, use of automatic teller machines, and automatic remittance of dividends.

Needless to say, this system has often been accused of creating unfair competition. Moreover, the system is not popular among Japanese private bankers. There is a growing consensus that the system has outgrown its usefulness and is in need of a "thorough review."

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426 Id. at 101.
427 BANKING SYSTEM IN JAPAN, supra note 132, at 35. Because deposits were not taxed, Japanese tax officials were not permitted access to the deposit records. As a result, falsified accounts were rampant and the System had more accounts than the combined sum of all men, women, and children in Japan. EMMOTT, supra note 111, at 101.
428 The disabled, those over 65 years of age, and working single mothers earn interest tax free. Id. at 102.
429 BANKING SYSTEM IN JAPAN, supra note 132, at 35.
430 EMMOTT, supra note 111, at 101-02.
431 BANKING SYSTEM IN JAPAN, supra note 132, at 35.
432 Suzuki, supra note 152, at 288-99.
434 EMMOTT, supra note 111, at 101 (quoting one City Banker as calling the Postal System "the cancer on the Japanese financial system.").
435 BANKING SYSTEM IN JAPAN, supra note 132, at 35. See also Feldman, supra note 436, at 11.