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Using Legislation to Open Japan's Financial Markets: An Analysis of the Trade Bill's Primary Dealer Provision

I. INTRODUCTION

In the past, most of the attention given to trade friction between the United States and other countries, Japan in particular, has focused on the area of product trade (manufactured and agricultural goods). However, a less publicized trade dispute but one which is a crucial part of trade policy is the area of financial services. Over the past several years there has been considerable concern in the U.S. over the limited access afforded to U.S. banks and securities firms to the Japanese financial services market.¹

In an attempt to address these concerns, Congress included the Primary Dealer² Provision (provision) in the recently enacted³ Omnibus Trade and Competitiveness Act of 1988⁴ (Trade Bill). The provision's language makes clear that it is aimed at Japan.⁵ Under the provision, if Japan does not institute considerable liberalization of its government bond market, the Federal Reserve Bank (Fed) will remove the primary dealer status of

1. U.S. firms have complained that barriers exist in Japan which keep U.S. firms from equal access to Japan's financial markets. Areas where foreign firms have experienced a lack of equal access include the Tokyo Stock Exchange and the Japanese government bond market. U.S. GEN. ACCT. OFF., *Market Access Concerns of U.S. Fin. Insts. in Japan*, Mar. INT'L FIN. 1, 12 (1988) [hereinafter *Market Access*].

2. Primary dealers are financial institutions that deal directly with the Federal Reserve (Fed) when trading U.S. government securities. Primary Dealerships are a coveted prize since some large institutional investors will only conduct U.S. government securities business through primary dealers. Graven, *Trade Bill's Proposal on Primary Dealers Causes Concern at U.S. Firms in Japan*, Wall St. J., Apr. 21, 1988, at 41, col. 1 [hereinafter *Proposal*].

3. On August 23, 1988 President Ronald Reagan signed into law the Omnibus Trade and Competitiveness Act of 1988. *President Signs Omnibus Trade Bill, Says Law Will Boost U.S. Competitiveness*, 51 Banking Rep. (BNA) No. 9, at 371 (Aug. 29, 1988) [hereinafter *President Signs Trade Bill*].

4. Omnibus Trade and Competitiveness Act of 1988, Pub. L. No. 100-418, 1099 U.S. CODE CONG. & ADMIN. NEWS (102 Stat.) 1107, § 3502 [hereinafter *Trade Act*].

5. The provision does not specifically state that it is aimed at any particular foreign country. However, all of the findings mentioning discrimination of U.S. firms abroad refer specifically to barriers faced by U.S. firms in Japan. *Id.* at (a).

several Japanese securities firms⁶ on August 23, 1989.⁷ As such, the provision has been the subject of controversy from its early drafting stage to the present.

This comment will deal with three aspects of the provision. Section II will analyze the provision's meaning by examining its actual language. Section III will address the controversy between the U.S. and Japan which led up to the provision's drafting and passage. Finally, section IV will discuss whether legislation is the best way to pressure Japan to open its financial markets, concluding that the provision has been at least partially effective in that respect.

II. WHAT THE PRIMARY DEALER PROVISION MEANS

The Primary Dealer Provision is divided into three major areas: findings,⁸ general rule,⁹ and exceptions.¹⁰ The findings pertain primarily to the barriers U.S. financial firms face in Japan which prevent them from gaining equal access to Japan's financial markets. The first two findings state that if given fair access to foreign markets American companies can successfully compete and that a trade surplus for the U.S. in services could offset its deficit in manufactured goods.¹¹ The remaining findings state that although Japanese firms enjoy fair access to U.S. financial markets, U.S. firms face discriminatory barriers in Japan.¹²

6. An April 1, 1987 Wall Street Journal article indicated that the provision's restrictions could strip Nomura Securities International Inc., Nikko Securities Co. International Inc., and Daiwa Securities America Inc., of their primary dealerships. Langley & Mossberg, *Most of Big Trade Bill Clears Congressional Conference but Several Items That Could Provoke a Veto Remain*, Wall St. J., Apr. 1, 1988, at 12, col. 1. Yamaichi Securities Co.'s, recently obtained primary dealer status also places it within the scope of the restrictions. Sesit & Herman, *New York Fed Reportedly Will Name Yamaichi a Primary U.S. Bond Dealer*, Wall St. J., Sept. 29, 1988, at 3, col. 2.

7. The provision provides for the restrictions to go into effect one year after its August 23, 1988 enactment. *Trade Act*, *supra* note 4, at (e); *President Signs Trade Bill*, *supra*, note 3 at 371.

8. *Trade Act*, *supra* note 4, at (a).

9. *Id.* at (b)(1).

10. *Id.* at (b)(2), (c).

11. *Id.* at (a)(1), (2).

12. The other barriers identified include: (1) limited membership on the Tokyo Stock Exchange (TSE); (2) high fixed commission rates charged to non-members of the TSE; (3) limited participation in equity and bond underwritings; (4) limited access to automated teller machines; (5) arbitrarily applied employment requirements for opening branch offices; (6) long delays in processing license applications; and (7) restricted participation in Japan's Ministry of Finance (MoF) policy advisory councils. *Id.* at (a)(4).

The provision's general rule focuses on one specific controversy: limited access of U.S. firms to Japan's government bond market.¹³ The general rule requires that U.S. firms be given national treatment.¹⁴ The provision states:

Neither the Board of Governors of the Federal Reserve System nor the Federal Reserve Bank of New York may designate, or permit the continuation of any prior designation of, any person of a foreign country as a primary dealer in government debt instruments if such foreign country does not allow to United States companies the same competitive opportunities in the underwriting and distribution of government debt instruments issued by such country as such country accords to domestic companies of such country.¹⁵

In other words, foreign firms will be denied primary dealer status if their country of origin does not allow U.S. companies the same access to its government bond market that the country allows to its domestic companies.

In accordance with the provision, if Japan does not provide national treatment to U.S. firms operating in its government bond market the Fed will be required to strip four large Japanese securities firms of their primary dealerships in the U.S.¹⁶ Certain other Japanese companies will not lose their primary dealerships due to an exception to the rule for companies that were designated primary dealers prior to July 31, 1987.¹⁷ However, the pressure that the provision exerts on Japan to liberalize its financial markets remains since none of the four Japanese securities houses referred to above fall within this exception.¹⁸

13. The U.S. Congress has long complained that Japan has limited the participation of U.S. firms in the underwriting and distribution markets of Japanese government bonds. *U.S. Senate to Cancel Japan's Primary Dealerships*, Kyodo News Serv. (Apr. 20, 1988) (LEXIS, Nexis library, Omni file) [hereinafter *Cancel Dealerships*].

14. National treatment requires that foreign companies in a particular nation will enjoy the same competitive opportunities given domestic companies. *Market Access*, *supra* note 1, at 6.

15. *Trade Act*, *supra* note 4, at (b)(1).

16. Langley, *supra* note 6, at 12, col. 1; Sesit, *supra* note 6, at 3, col. 2.

17. The exception also requires that before that date, the control of the company was acquired from a U.S. company by a foreign person; or that the U.S. company informed the Federal Reserve of the intention of the foreign person to acquire control of the U.S. company. *Trade Act*, *supra* note 4 at (b)(2). The exempted Japanese companies are Industrial Bank of Japan Ltd., Sanwa Bank Ltd., and Long Term Credit Bank of Japan Ltd. Langley, *supra* note 6, at 12, col. 1.

18. Langley, *supra* note 6, at 12, col. 1; Sesit, *supra* note 6, at 3, col. 2.

The provision provides an additional exception for countries having or negotiating bilateral agreements with the United States.¹⁹ However this exception does not affect Japan and Japanese firms.²⁰

III. THE CONTROVERSY BETWEEN JAPAN AND THE UNITED STATES

For several years, Congress has complained that U.S. firms have had limited access to Japan's financial markets and has pushed for increased liberalization.²¹ Although Japan made limited efforts to reform its policy and open its markets, criticism persisted that Japan's system of selling government bonds largely excluded U.S. participation in that market. In an apparent response to these complaints, drafters of the provision singled out Japan as the provision's target,²² hoping to use the provision as leverage to open Japan's markets.

A. Japanese Efforts at Reform

Prior to the late 1970s Japan's financial markets remained highly regulated. Since that time, however, Japan has taken on a limited program to liberalize its markets.²³ Japan's actions to open its markets over the past few years have included additional membership of foreign firms to the Tokyo Stock Exchange and some expansion of foreign firms' share in Japanese government bonds.²⁴ Despite these changes, however, dissatisfaction

19. *Trade Act*, *supra* note 4, at (c).

20. According to a Senate/House of Representatives conference report this exception applies only to primary dealers from Canada and Israel. H.R. CONF. REP. NO. 100-576, 100th Cong., 2d Sess. 856 (1988).

21. At the forefront of congressional pressure for reform has been Representative Charles Schumer of New York, the provision's main sponsor. He has argued that U.S. firms can successfully compete in Japan but that they have faced a variety of discriminatory barriers. *Trade Bill Could Strip Japanese Firms of Primary U.S. Securities Dealer Status*, 48 Banking Rep. (BNA) No. 13, at 589 (Mar. 30, 1987). Schumer and other members in Congress have been voicing their criticisms since as early as January of 1986. Sesit & Herman, *Japanese Firms Make Controversial Bid in the U.S. Government Securities Market*, Wall St. J., Jan. 7, 1986, at 32, col. 1.

22. See *supra* note 5 and accompanying text.

23. *United States Access to Japanese Financial Markets, 1987: Hearing Before the Comm. on the Budget, United States Senate, 100th Cong., 1st Sess. 52-54 (1987)* (Appendix III to the testimony of E. Gerald Corrigan, Pres., Fed. Reserve Bank of New York) [hereinafter *Hearing*].

24. *Market Access*, *supra* note 1, at 20-21.

with the pace of liberalization continued prior to enactment of the provision.²⁵

B. Limited Access to the Government Bond Market

Of great concern to U.S. and other foreign financial firms in Japan has been the problem of limited access to the Japanese government bond market.²⁶ The Japanese government bond market is the largest bond market in Japan²⁷ and the second largest bond market in the world.²⁸ Historically, however, opportunities to participate in it were largely reserved to Japanese firms. According to a study done by the Government Accounting Office (GAO), as of March, 1988, despite Japan's recent measures to increase foreign participation,²⁹ foreign firms were still relegated to a minor role in Japan's government bond market.³⁰ The study's conclusion echoed complaints of U.S. firms operating in Japan that Japanese reform in the government bond and other markets had been too slow and too little.³¹ These com-

25. In reference to Japan's admission of an additional 16 foreign members (six of which were U.S. firms) to the Tokyo Stock Exchange, Congressman Schumer contended that while the admission was an important step toward satisfactory liberalization, Japan was still moving too slowly, with a long way to go. Graven & Salwen, *Tokyo Stock Exchange Opens Its Doors to Six U.S., 10 Other Foreign Firms*, Wall St. J., Dec. 17, 1987, at 5, col. 1. See *infra* note 31 and accompanying text.

26. In contrast to Japan's liberalization of the Tokyo Stock Exchange, actions to increase foreign firms' share of the government bond market have done little to increase share and alleviate concerns. *Market Access*, *supra* note 1, at 12.

Some of the concerns regarding access to the government bond market may have been eased as a result of an announcement by Japan in September, 1988, that it intends to give a larger share of that market to foreign firms. See *infra* notes 92-96 and accompanying text.

27. *Market Access*, *supra* note 1, at 15.

28. Sesit, *Japanese Plan Auction Sale of Some Bonds*, Wall St. J., May 12, 1987, at 29, col. 1.

29. During 1987 Japan made several changes in the government bond market in an attempt to increase the foreign share of bond offerings. As of November, 1987, Japan had introduced a limited auction for about 20% of each 10-year bond issue. It was very limited however, in that under the process, firms only bid on the volume of bonds they wanted to purchase without knowing the issue terms. Other changes included issuing 20-year government bonds through an auction rather than a syndicate. *Market Access*, *supra* note 1, at 15-16.

30. *Id.*

31. Eugene Atkinson, President of Goldman Sachs (Japan), indicated that Japan's moves to liberalize were proceeding much too slowly. Sesit, *U.S. Lawmakers, on Mission to Japan, to Press for Opening of Tokyo Markets*, Wall St. J., Apr. 10, 1987, at 19, col. 3 [hereinafter *U.S. Lawmakers*]. "[M]any foreign bankers are angered by what they see as a piecemeal, plodding approach to change" and "many U.S. firms are growing increasingly frustrated with Japan's relatively closed system for issuing government bonds

plaints and the study's conclusion help explain why Congress thought it necessary to introduce the provision in order to encourage reform.

C. *Japan's Use of a Syndicate to Sell Bonds*

The main subject of controversy concerning access to the Japanese government bond market has involved the manner in which the bonds are sold. Unlike the United States, where bonds are sold by auction,³² in Japan most sales are made through the use of a syndicate. Under the syndicate system, Japan's Ministry of Finance (MoF) indicates to the syndicate what terms and conditions it desires in the forthcoming issue. Representatives of the syndicate study the terms and then decide whether to accept them. If the terms are unacceptable, negotiations proceed between the syndicate and the MoF to resolve the deadlock.³³ As of June, 1988, 80% of government bonds were being sold through a syndicate with the remaining 20% being auctioned.³⁴

Historically, the syndicate portion has been divided into two major categories, banks and securities companies. The banks are given 74% of the bonds issued and securities companies receive up to the balance (26%).³⁵ Through this system, foreign firms have been systematically excluded. A recent survey showed that in 1987, foreign firms only underwrote a total of 6%³⁶ of Japan's total government bond offerings.³⁷

In the past, the U.S. Treasury and foreign financial institutions have tried, without much success, to persuade Japan to use a full auction to sell government bonds where issue terms could be determined through open market competition.³⁸ There are

... ." Sesit, *How Slow Can You Go*, Wall St. J., Sept. 18, 1987, at 13D, col. 1 & 2.

32. See *A Fair Slice of Pie Depends on the Point of View*, EUROMONEY, Mar. 1987, at 126 [hereinafter *Pie*].

33. *Houses Find Treasury Bond System Archaic*, EUROMONEY, April Supp. 1987, at 85 [hereinafter *Archaic*].

34. *Japan Finance Ministry to Let Foreign Firms Underwrite More Government Bonds*, 50 Banking Rep. (BNA) No. 23, at 969 (June 6, 1988) [hereinafter *Underwrite*].

35. *Archaic*, *supra* note 33, at 85.

36. Stevens, *Japanese Firms' Increasing Ownership of U.S. Primary Dealers Draws Protests*, BOND BUYER, June 10, 1988, at 3 (LEXIS, Nexis library, Omni file).

37. This is in sharp contrast to the share allowed Japanese firms in the U.S. According to Deryck C. Maughan, managing director and general manager of Salomon Bros. Asia Ltd., based in Tokyo, there is no restriction on the amount of U.S. government bonds a Japanese securities house can acquire at auction in the U.S. As a group, Japanese bond buyers take as much as 30% of U.S. bond issues. *Pie*, *supra* note 32, at 127.

38. *Market Access*, *supra* note 1, at 16.

three reasons why observers feel Japan should adopt a full auction system. First, use of an auction system would be a step in establishing market practices in Japan which would bring its government bond market more in line with practices in the United States and Great Britain.³⁹ Second, an open auction would be beneficial to the Japanese government as it would reduce the cost of their borrowing.⁴⁰ The open competition for rates would tend to reduce the interest rate the government would have to pay. Third, a competitive auction system would give foreign firms fairer access to the lucrative government bond market.⁴¹

Despite these reasons for moving to a complete auction system, the Japanese government has been hesitant to do so. Since Japan budgets its interest for each year, government officials fear that if initial issuance of bonds was done by auction, new maturities could cost more because the MoF might be forced to raise interest rates in order to attract buyers.⁴² With the current syndicate system, the Bank of Japan has the power to manipulate rates in any direction.⁴³ The government fears that under an auction system it would lose control of interest rates.⁴⁴

Japan's greater concern is that an auction system could result in the government's failure to sell all of the bonds it issues.⁴⁵ Much of the support for the syndicate system exists because all of an issue is sold through allocation. Hence, under such a system there is no fear of an inability to raise the funds necessary to finance Japan's expanding debt.⁴⁶

Foreign businessmen in Japan give other reasons for the government's hesitance to move to a full auction system. For example, the large Japanese syndicate members fear that an auction system would bring increased competition.⁴⁷ In the past, U.S. firms have found eager customers in the Japanese market

39. *Hearing, supra* note 23, at 35-36 (Statement by E. Gerald Corrigan).

40. *Pie, supra* note 32, at 126.

41. In 1986 the Japanese government bond syndicate is estimated to have earned about \$300 million in capital gains in return for being at risk for about only one week. *Id.*

42. *Sesit, supra* note 28, at 29, col. 1.

43. *Pie, supra* note 32, at 128.

44. *Id.*

45. *Id.* at 131.

46. *Archaic, supra* note 33, at 86-87.

47. *Pie, supra* note 32, at 128.

who were willing to buy the firms' share of Japanese government bonds. Therefore, syndicate members fear that if U.S. firms obtain a larger share through an auction system, U.S. firms could make further inroads into their market.⁴⁸ Consequently, in reaction to pressure of syndicate members, the MoF has found excuses to keep the syndicate system.⁴⁹

Another reason given for Japan's reluctance to liberalize its bond market is that it wants to give domestic companies time to develop a protected base in Japan.⁵⁰ Observers claim that Japan has used this method to prevent competition in more than one industry.⁵¹ They fear that a failure to act quickly to force reform in Japan's government bond market will allow Japanese firms to lock in their competitive advantage.⁵²

Ironically, two of Japan's big four securities dealers, Nomura and Daiwa, have joined calls for liberalization of the bond market. They support adoption of an auction system to sell Japanese government bonds and feel that they could hold their own in any auction sale.⁵³

The legitimacy of Japan's reluctance to further liberalize its government bond market has faded as an issue. It appears now that the Trade Bill is law, Japan is being forced to do as the U.S. Congress, the financial services industry, and its own securities firms have asked it to do, whether reasons for keeping the present system are legitimate or not.⁵⁴

48. Selling bonds by auction could allow foreign firms to capture part of the syndicate members' market share. *See id.*

49. According to Shoji Oshima, Tokyo general manager of Citibank's Vickers da Costa securities affiliate, the Japanese government "will put forth any excuse to support the present system. But the reality is that the Japanese houses have a franchise and they don't want to lose it. I can't think of any other reason why the present system continues." *Id.* at 127-28.

50. *See While Japan Deregulates*, 20 NAT'L J. 249 (1988).

51. Representative Schumer argues: "The Japanese have closed off their internal market to foreign firms in industry after industry until they've developed a complete lock on those markets and [they] then use that as a base with which to expand." Sedit, *supra* note 21, at 32, col. 1.

52. *See While Japan Deregulates*, *supra* note 50, at 249.

53. Sedit, *supra* note 31; *U.S. Lawmakers*, at 19, col. 3. Support by Nomura and Daiwa is perhaps not so ironic since they stand to lose their primary dealerships in the U.S. under the Primary Dealer Provision. *See supra* note 6 and accompanying text.

54. For an analysis of Japan's reaction to legislative pressure, *see infra* notes 75-96 and accompanying text.

IV. IS LEGISLATION THE BEST WAY TO OPEN JAPAN'S FINANCIAL MARKETS

While it appears that more reforms are needed in Japan to liberalize its financial markets, a principal question is whether or not legislation is an appropriate tool to accomplish this goal. Strong arguments exist on both sides of the issue. Some observers feel that it is the only effective method to quickly achieve further opening of Japan's markets. Others view it as too heavy handed with the potential of backfiring, producing animosity and retaliation from the Japanese.

A. Arguments Against the Use of Legislation

The Fed believes that the Primary Dealer Provision is the wrong way to open Japan's financial markets. In a Senate hearing, a Fed official expressed his opposition to the then pending provision and said it "could have the effect of stalling rather than accelerating discussions and negotiations, while possibly producing unintended adverse side effects—both in terms of general attitudes toward market liberalization and attitudes regarding capital inflows to the U.S."⁵⁵ This statement indicates a fear that the demands in the provision would anger Japan, causing it to cut off any ongoing negotiations on liberalization and halting efforts at reform.

In the same Senate hearing, an industry representative stated that the best way to obtain increased liberalization from Japan was not through legislation but through efforts by the Administration and Treasury to negotiate toughly and fairly with Japan's MoF.⁵⁶ He stated that while "[t]he threat of legislation might get their [Japan's] attention" it is "strong administrative pressure that gets results."⁵⁷

The Treasury Department has also opposed the provision. In a Department letter, the Treasury Secretary expressed his concern that "the amendment could be counterproductive, both in terms of promoting and maintaining foreign investment in U.S. government securities, and national treatment for U.S. fi-

55. *Hearing, supra* note 23, at 39-40 (Statement by E. Gerald Corrigan, President, Federal Reserve Bank of New York).

56. *See Hearing, supra* note 23, at 75 (Testimony of Robert H. Binney, Senior Vice President, Chase Manhattan Bank).

57. *Id.*

nancial firms abroad."⁵⁸ He pointed out that the Treasury was already making progress in obtaining liberalization of Japan's markets through negotiations. As such, legislation was not warranted since it could potentially result in decreased rather than increased liberalization of foreign financial markets.⁵⁹

Financial industry observers have also called the legislation a misguided method to open Japan's financial markets. They claim that using legislation is too rigid and inflexible, resulting in damage to innocent parties.⁶⁰ Furthermore, they fear that restrictions in the legislation will send an unwarranted message that we want to get even with the Japanese for doing a better job than us.⁶¹

Those who question the wisdom of the legislation fear the backlash effect it may have on the U.S. economy by driving Japanese investors from the U.S. bond market.⁶² The Japanese have long helped to finance the U.S. budget deficit by purchasing an estimated 30% of thirty-year treasury issues.⁶³ Consequently, U.S. monetary authorities worry that if the legislation drove Japanese investors away from the bond market it would disrupt the ability of the Treasury to raise the necessary funds needed to service the deficit's related debt.⁶⁴

In addition, a Japanese exodus from the U.S. bond market could force the Treasury to raise interest rates in order to attract new investors.⁶⁵ If this were to occur, the hike in rates would have an immediate impact on millions of Americans,⁶⁶ adversely affecting the U.S. economy as a whole.

B. *Are the Criticisms Valid?*

There is a possibility that the provision could result in the Japanese leaving the U.S. government bond market. It is un-

58. Letter from Treasury Secretary James A. Baker, III to Senate Committee on Banking, Housing, and Urban Affairs Chairman William Proxmire (May 19, 1987).

59. *See id.*

60. According to Samuel Hayes III of Harvard Business School, "Legislation tends to be rigid, inflexible and oftentimes a bludgeon that attempts to correct a problem but crushes down on a lot of innocent parties. . . ." *Presidential Reprieve*, *EUROMONEY*, July Supp. 1988, at 45 [hereinafter *Reprieve*].

61. Opinion of Leonard Weil, former president of Mitsui Manufacturers Bank in Los Angeles. *Id.* at 48.

62. *See supra* note 58 and accompanying text.

63. *Cancel Dealerships*, *supra* note 13.

64. *Id.*

65. *See The Sun Rises over the U.S.*, *EUROMONEY*, July Supp. 1988, at 5 [hereinafter *Sun*].

66. *Id.*

likely, however, the Japanese would risk losing the opportunity to participate in the U.S. market by refusing to further open their own financial markets to U.S. firms. There are two reasons a pullout is unlikely. First, the stability of the U.S., both economically and politically, makes it very attractive to Japanese investors.⁶⁷ Japanese invest in the U.S. because they have confidence in it.⁶⁸ For the Japanese to divest themselves of opportunities to participate in the world's largest financial market (the U.S. market) by refusing to further open their own markets would be too costly and as such, is only a remote possibility.⁶⁹

Second, a pullout could damage Japan's own domestic economy. If the Japanese no longer participated in the primary U.S. securities market, U.S. interest rates could rise.⁷⁰ This could create a chain reaction in Japan since Americans would be less able to buy Japanese products.⁷¹ A reduction in Japan's ability to sell products in the U.S. would adversely affect Japan's own economy and further mitigates against the possibility that Japan would allow the provision's restrictions to take effect.

C. Arguments Favoring the Legislation

Supporters of the provision feel that legislation (and the threat of it) is the best way to get the message across that Japan must further open its financial markets. Supporters in Congress claim that the pending legislation has attracted the attention of the Japanese⁷² and has been the driving force behind much of Japan's progress to date.⁷³ That the legislation has been helpful in inducing reform has also been recognized by industry observers.⁷⁴

67. *Id.*

68. *Id.*

69. *See id.*

70. *Id.*

71. View of Richard Sprayregen, of Kenneth Leventhal and Co., a large CPA firm. *Id.* at 7.

72. According to Congressman Schumer "[T]he (proposed) legislation had them scared; it was a two-by-four that got their attention." Sesit, *U.S. to Press Nakasone for More Access in Japan for American Financial Firms*, Wall St. J., Apr. 27, 1987, at 21, col. 3.

73. Referring to Japan's December, 1987, announcement that the Tokyo Stock Exchange would add an additional 16 foreign members, Congressman Schumer stated, "We've gotten the changes we have because the Japanese realize our legislation is going to pass." Sesit & Herman, *New York Fed to Admit Nikko Unit As Primary U.S. Dealer*, *Sources Say*, Wall St. J., Dec. 22, 1987, at 3, col. 3.

74. Harvard's Samuel Hayes, III observed that Congress's "sabre-rattling" has been

The real test of whether or not the provision has been effective is to consider the effect it has had in opening Japan's government bond market. The effect of the provision is best shown by an examination of the changes in Japan in light of Congress's initial threats of legislation and subsequent steps leading up to the provision's enactment as part of the Trade Bill.

As early as January, 1986, there was a willingness in Congress to introduce legislation meant to open Japan's financial markets.⁷⁵ Initially, Japan did not appear to take Congress seriously. This was evidenced by the MoF's indication in December, 1986, that Japan would not be forced into making changes and was not planning to do away with its syndicate system in favor of an auction system.⁷⁶ However, as the primary dealer legislation grew increasingly probable, Japan's reluctance to make changes was transformed into increased willingness.⁷⁷ This change in Japan's attitude and its apparent correlation to the threatened Primary Dealer Provision and its eventual enactment can be illustrated by the following chronology of events:

1-7-86: Representative Schumer and thirty seven other members of the House Banking Committee urge N.Y. Fed President to reject Japanese applications for primary dealerships until U.S. firms receive reciprocal treatment in Japanese securities markets.⁷⁸ In addition, Rep. Schumer indicates willingness to introduce legislation with a goal of opening Japan's financial markets.⁷⁹

12-3-86: MoF indicates Japan will not speed up liberalization of its financial markets due to foreign pressure and that it does not plan to abandon its present syndicate system for selling government bonds in favor of an auction system.⁸⁰

12-11-86: While designating Nomura and Daiwa Securities as new primary dealers, N.Y. Fed warns that the firms could lose their new status if Japan doesn't continue to open its domestic markets.⁸¹

used to "spur the Japanese financial services sector into accepting change." *Reprivee*, *supra* note 60, at 48.

75. *Sesit*, *supra* note 21, at 32, col. 1.

76. *Sesit*, *Official Defends Japan's Record in Opening Market*, *Wall St. J.*, Dec. 4, 1986, at 53, col. 1.

77. *See infra* notes 78-92 and accompanying text.

78. *Sesit*, *supra* note 21, at 32, col. 1.

79. *Id.*

80. *Sesit*, *supra* note 76, at 53, col. 1.

81. Tsuruoka, *Japan Planning Moves to Widen Finance Markets*, *Wall St. J.*, Dec.

- 12-17-86: MoF confirms that it plans to further open financial markets to foreign competition.⁸²
- 4-29-87: House passes its Primary Dealer Provision.⁸³
- 5-12-87: MoF announces that it plans auction sales for some of its government bonds.⁸⁴
- 5-19-87: Senate Banking Committee approves its version of Primary Dealer Provision.⁸⁵
- 5-27-87: MoF announces that in the near future Japan will begin auctioning twenty-year government bonds and 20% of ten-year bonds.⁸⁶
- 11-87: Japan's first limited auction of ten-year government bonds.⁸⁷
- 3-30-88: Senate and House subconferrees agree on Primary Dealer Provision.⁸⁸
- 5-88: MoF gives foreign firms a larger share in the syndicate for ten-year government bonds.⁸⁹
- 6-24-88: N.Y. Fed, under pressure from Congress, denies primary dealership to Yamaichi Securities.⁹⁰
- 8-23-88: President Reagan signs new Trade Bill into law.⁹¹
- 9-88: Japan announces major liberalization of government bond market. Reforms include: selling 40% of ten-year government bonds through auction; increasing foreign underwriters' fixed share of syndicated portion of bond offerings from 2.5% to nearly 8%; and allowing foreign firms to become co-managers in the syndicate.⁹²

17, 1986, at 27, col. 4.

82. *Id.*

83. Sesit, *supra* note 28, at 29, col. 1.

84. *Id.*

85. Langley & Sesit, *Panel Votes to Curb Japanese Dealings in U.S. Securities*, Wall St. J., May 20, 1987, at 23, col. 1.

86. *Japan to Make Concessions to U.S. on Bond Auctions*, Wall St. J., May 28, 1987, at 44, col. 1.

87. *Market Access*, *supra* note 1, at 21.

88. *Trade Bill Conferees Adopt Primary Dealer Provision Taking Effect in 1 Year*, 50 Banking Rep. (BNA) No. 14, at 566 (Apr. 4, 1988).

89. *Underwrite*, *supra* note 34, at 969.

90. Soars & Kelly, *3 Government Securities Dealers Win Primary Status from NY Fed*, AMERICAN BANKER, June 28, 1988, at 19.

91. *President Signs Trade Bill*, *supra* note 3, at 371.

92. Sesit & Gallagher, *Japan Unveils New Measures to Widen Foreign Role in Government Bond Mart*, Wall St. J., Sept. 7, 1988, at 3, col. 2-4.

As illustrated above, Japan has taken a series of steps toward liberalizing its government bond market. During this same period the Primary Dealer Provision has been moving through Congress. It appears that the timing of the Japanese moves has been more than coincidentally related to pressure put on them by the legislation. Thus, even before enactment, the provision was having its desired effect of forcing open Japan's financial markets.

Of particular importance has been Japan's announcement in September, 1988, subsequent to the Trade Bill's enactment, of plans to further open its government bond market.⁹³ This is seen as a major step towards the liberalization that Congress,⁹⁴ the Fed⁹⁵ and the financial services industry⁹⁶ have been seeking and it appears that the use of legislation has paid off without having the negative repercussions feared.

Whether or not Japan's recent moves of liberalization have been sufficient to prevent the Primary Dealer Provision's penalties from going into effect on August 23, 1989 remains uncertain. Since the Fed is responsible for implementing the provision, how the Fed⁹⁷ will interpret and apply it in light of Japan's September, 1988, reforms remains to be seen.⁹⁸

V. CONCLUSION

The Primary Dealer Provision is evidence of increased U.S. efforts to open Japan's financial markets. It appears Japan can no longer allow barriers to exist to prevent foreigners from having fair access to those markets. Regardless of the arguments for or against using legislation to force Japan to open its financial markets, it appears that the Primary Dealer Provision has, thus far at least, partially achieved its goals.

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93. *Id.*

94. Schumer called the Japanese announcement "a huge step forward." Quint, *Japan Giving Foreigners Bigger Bond Role*, N.Y. Times, Sept. 7, 1988, at D9, col. 3.

95. The Fed called the moves "far reaching" and a "very constructive development." *Japan Agrees to Use Price Auction System to Sell 40 Percent of New 10-Year Bonds*, 51 Banking Rep. (BNA) No. 11, at 511 (Sept. 19, 1988).

96. Thomas Strauss, President of Salomon Brothers, said the announcement "was a very positive step by the Japanese and a significant plus for our business in Japan." Quint, *supra* note 94, at D1, col. 5 and D9, col. 3.

97. *Trade Act*, *supra* note 4, at (b)(1).

98. In a telephone conversation with a N.Y. Fed spokesman, the spokesman indicated that the Fed is not currently prepared to discuss whether or not Japan's recent moves will be sufficient to preclude imposition of the provision's restrictions. Telephone interview with Bart Sotnick of the N.Y. Fed (Mar. 6, 1989).