Chapter 4: The 'Jusen' Problem

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The “Jusen Problem”

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Abstract and Keywords

Examines financial regulation and the resolution of financial institution failure in Japan by analysing how informal rules contributed to the collapse of Japan’s home mortgage lending (jusen) industry and its resolution. The authors focus on this event in part because the “jusen problem” was the first of a series of crises in the Japanese financial sector, and it represents the paradigmatic case of financial regulatory failure that sadly still manifests itself in Japan today. As Robert Higgs has noted, ‘There is no way to substitute pure theory for a knowledge of history’. By getting to the bottom of the recent jusen history, one can understand much of what ails Japan today. Just as importantly, the authors present this case because it is an elaborate illustration of the dynamics between law and private ordering at work in a crucial industry.

Keywords: financial sector, informal rules, Japan, jusen, law, mortgage, regulation

INTRODUCTION

The depths of Japan’s bad debt problem are by now universally known. Excellent works have been devoted to analyzing the banking crisis and possible path of recovery for the industry. Yet, perhaps because they are usually conducted by economists, analyses of how the Japanese financial industry fell into crisis seldom devote in-depth coverage to the role of Japanese regulatory style in the creation and resolution of that country’s financial crisis. For a book such as this one, devoted to the impact of formal and informal rules on the Japanese economy, perhaps no episode in postwar history deserves more careful treatment than the collapse and resolution of Japan’s home mortgage lending
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(“jusen”) industry, the first of several Japanese financial crises in the 1990s and early 2000s.

The jusen problem arose when a special class of home mortgage lending companies abandoned their original mandate and lent heavily to real estate developers and speculators during the bubble economy. Directly at stake in the jusen problem was as much as ¥13 trillion ($130 billion) in unrecoverable loans. Moreover, the jusen companies were an integral part of a bad debt problem that may have totaled ¥80 trillion ($800 billion) at its peak, twice the size of America’s S&L disaster measured as a percentage of GDP. The struggle to resolve the jusen crisis and to allocate the massive resulting losses captured the attention of regulators, politicians, and taxpayers, as well as the entire world financial community, from late 1995 to the summer of 1996. As explored at the end of the chapter, in subtle but significant ways, the ramifications of the jusen problem are still being felt.

The creation and resolution of the problem is one of the most striking examples of regulatory failure, intense political and bureaucratic activity, strategic interest group bargaining, and large-scale dispute resolution in recent Japanese history. For decades, commentators have debated the substance and success of Japanese regulatory methods, and the role of the bureaucracy, politics, and law in Japanese economic activity. The debate has raised more questions than it has answered: For example, what role do interest groups, politicians, and bureaucrats play in the political economy of Japan? To what extent have Japanese regulatory methods contributed to Japan’s economic strength, and more recently to its financial woes? And the debate has largely bypassed other crucial issues, such as the strategic use of law to further the bargaining positions of Japanese interest groups.

(p.74) This chapter adds fresh insights to this debate based on a detailed study of regulatory interaction in the Japanese financial industry during a time of unprecedented disruption and dissention. In the Introduction, we approvingly noted the adage that “There is no way to substitute pure theory for a knowledge of history.”² This chapter is principally devoted to a recounting of recent history as a means of understanding Japanese postwar regulatory practices. Yet, we believe some simple theory helps sharpen the telling of that history. In this chapter, Japanese regulatory interaction is modeled as a network of (mostly informal) interrelated institutions that facilitate coordinated public–private decisionmaking—a system of financial governance we call a “regulatory cartel.”³ Briefly, as the term is used here, a regulatory cartel is an interlinked system for cooperative decisionmaking and enforcement among the public and private sectors, which operates according to reasonably well-understood substantive and procedural rules, and which has as its purpose and effect the control of
entry, production, and price, not only within specified industries, but also across industrial sectors.

The term “regulatory cartel” is not intended to be pejorative; rather, the concept is employed here because it captures (imperfectly, but nonetheless powerfully) the dynamics of decisionmaking and enforcement that characterized Japanese finance in its heyday. Simply put, the jusen problem was an outgrowth of the incentives generated by this regulatory cartel. The implications of the model go beyond the jusen problem, however. The model helps to explain the relatively infrequent use of formal procedures and legal institutions in postwar Japanese finance, and offers insights into the nature of legal change in a mature, post-industrial Japan.

The chapter is organized into five sections. Drawing on cartel theory, Section I creates a simple model of regulatory interaction in Japanese finance composed of two sets of norms that have governed both the bargaining dynamics and substantive outcomes of Japanese financial regulation in the postwar period. Section II provides an overview of the jusen problem. Section III examines the efforts by regulated groups, regulators, and politicians to resolve the problem, with special attention devoted to bargaining strategies and the use and non-use of law in fashioning a solution. Section IV discusses the series of legal and institutional reforms implemented in the wake of the jusen problem, which constitute important facets of the template for Japanese financial regulation today. Section V shows that the jusen problem and its resolution are consistent with the model of regulatory interaction developed here, and shows that the response to the jusen problem illustrates the slow process of transition underway in Japanese financial regulation.

I. REGULATORY INTERACTION IN JAPANESE FINANCE
Cartel theory offers useful insights into both the process and content of financial regulation in postwar Japan. We use it here in a simple model of public–private interaction to explain Japanese financial regulation.

A. Japanese Finance as a Regulatory Cartel
The model is composed of two sets of norms, which we call “bargaining norms” and “substantive norms.” Bargaining norms arise out of the institutional context of Japanese finance. They shape the structure of negotiations and the resolution of disputes in the financial industry, thereby determining the process by which regulation is made and enforced. The dynamics unleashed by these bargaining norms in turn generate a second set of norms that substantively shape the operation of the financial industry. Substantive norms govern primary conduct and encourage or discourage particular forms of behavior. Together, these norms constituted the rules of the game in Japanese finance until their graduate demise, a process ongoing to this day.
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The essence of a cartel is coordinated decisionmaking. In standard cartel theory, the object of agreement is price, output, or allocation of markets. In Japanese finance, the object of coordinated decisionmaking is the substantive terms of regulation. Japanese finance can profitably be viewed as a “regulatory cartel” in which both the regulated and the regulators cooperate in order to enforce market segmentation, control entry, regulate output, and allocate the gains of the cartel’s activities among the various participants. We describe the Japanese system as a “regulatory” cartel because in place of the private rule-making, enforcement, and dispute resolution activities that characterize a typical industrial cartel in standard economic theory, the functions of control of output and entry are vested in government agencies as well as in private sector cooperation. The Japanese regulatory cartel, moreover, is characterized, not only by control of output and entry within a particular product market, but also by cross-market connections, functioning either at the administrative or the political level, which sometimes bring non-competing industries into contact with one another within the framework of an economy-wide network of regulated industries.

Coordinated decisionmaking, particularly over long periods of time, is not a naturally occurring phenomenon; it requires constant and extensive information exchange, intensive cooperation, and effective dispute resolution. In Japan, coordinated decisionmaking on matters of financial regulation, particularly prior to reforms in the late 1990s designed to separate policy making and enforcement functions in the Ministry of Finance (MOF), was facilitated by extensive ministerial compartmentalization and “patterning.” That is, bureaucratic compartmentalization is extensively replicated elsewhere in the policymaking apparatus. In MOF’s pre-reform institutional design, separate and relatively autonomous bureaus oversaw the banking and securities industries. Individual bureaus were further subdivided into sections that mirrored specific segments of the regulated industries, such as trust banking. These arrangements infused bureaucratic decisions with private party input from below, and channeled issue-specific political interests from above. Simultaneously, they provided mechanisms for public–private interaction, dispute resolution, and consensus-building.

(p.76) The concentrated and compartmentalized nature of Japanese financial oversight had important effects on the formulation of policy and the resolution of disputes. MOF’s sweeping mandate to regulate virtually the entire financial industry reduced the number of issues requiring cross-jurisdictional adjustment, and facilitated interest balancing. As one American scholar of Japanese finance observed, “[b]ecause MOF is a single institution, it is able to forge decisions that take into account its various sections.” Indeed, MOF’s policies often seemed calculated principally to balance the interests of competing groups under its jurisdiction.
The structure of the financial industry itself facilitated policy coordination among competitors in the same sector. Both the banking and securities industries were and continue to be led by a small group of major players serving as front-line contacts with the regulators. The major firms often led their industries by example after consultation with senior Finance Ministry officials. Leadership is also provided by gyōkai dantai—powerful industry associations led by the same major firms. These respective roles are played by the largest of the city banks and the Federation of Japanese Bankers Associations in the banking industry and by the “Big Four” securities firms (down to three after the demise, in 1997, of Yamaichi Securities) and the Securities Industry Association in the securities industry. Consultations and conflict resolution within an industry and between an industry and its regulator often occur through the medium of the industry associations.

Employment patterns in the banking and securities industries enhanced information exchange and identity of interests between the major industry players and MOF officials. Specific bank and securities firm employees at each stage of the corporate hierarchy were often assigned to remain in daily contact with their counterparts at the relevant MOF bureau, a practice that is now declining. The large firms benefited from these practices through close, ongoing contacts with the regulators; ministry officials, in turn, obtained information, advice, and favors from the major firms.

For smaller firms especially, another important employment-related practice is amakudari, in which bureaucrats parachute into lucrative private-sector positions at the end of their careers in public service. While the prevalence of the practice varies across Japanese industries, historically it was widespread in finance. The traditional rationale behind amakudari is that retired bureaucrats provide an important link between the new host firm and the ex-official’s former agency. Lacking such established links, smaller firms disproportionately hired retired bureaucrats. It was believed that a firm’s contact base, information flow, and public image of stability and competence would all be enhanced by hiring an ex-official. (In Chapter 8, we explore amakudari further, and show that the practice has waned considerably in recent years, as deregulation, bureaucratic scandals, and other factors have undermined the rationale for hiring ex-officials.)

Yet another institution that facilitates coordinated public–private interaction is the shingikai (consultative committee). Statutorily created shingikai are attached to and appointed by administrative agencies. Their principal ostensible role is to examine significant policy issues under the charge of their parent agencies. Although the shingikai are often derided as ornamental rubber stamps, to dismiss them as meaningless would be a serious mistake. In fact, the shingikai perform an important role in facilitating group decisionmaking and resolving disputes. This they accomplish in a number of ways. They provide a
supplementary channel for public–private interaction beyond the means previously described. They serve as listening posts for ministry officials while shielding the bureaucrats from direct exposure to interest group influences, and they give affected interests a stake in policy outcomes, since interested parties have participated in the process of policy formulation. Above all, they are a means of adjusting conflicting interests within the affected ministry.

At the top of the policymaking network, a distinctive political mechanism infuses the regulatory process with interest-group concerns. LDP legislators coalesce into issue-specific groups called *zoku* (tribes), which exert influence on the ministries. The *zoku* legislators work to support industries in their districts by developing a special relationship with the relevant bureaucracy. Once the relationship is established, they lobby for policy proposals, mediate between the bureaucracy and interest groups, and participate in the pertinent LDP policymaking process. Once again patterning is evident, as the *zoku* legislators are arranged hierarchically according to their degree of influence with the ministry and specialized according to the bureau or section of the ministry where they operate.

This segmented and hierarchical institutional design gave rise to the following set of bargaining norms that controlled consensus formation and conflict resolution in postwar Japanese finance:

1. *Internal Cooperation*: If possible, policy conflicts or issues were to be resolved within the group principally affected, without percolation up to the next level. Large firms and industry associations led the coordination process.

2. *Brokerage and Facilitation*: If internal resolution proved impossible, policy conflicts or issues percolated up to the next major level of authority—typically the appropriate bureau within the ministry responsible—with brokerage and facilitation services provided by that higher-level authority. Such services could include extensive consultations with affected groups, sponsorship of negotiations, informal persuasion, interest balancing, and public relations efforts.

3. *Negotiated Inter-jurisdictional Resolution*: If policy conflicts or issues spilled over between jurisdictional lines, they were resolved through negotiations between higher level authorities, if possible. The higher level authorities were the Administrative Vice Minister and other upper echelon career officials within a single ministry if the issue affected two industries under the jurisdiction of the same ministry. If the issue affected two industries under the jurisdiction of different ministries, the higher-level authorities were the ministers of the two ministries.

4. *Channeled Political Intervention*: If resolution through inter-jurisdictional negotiations was unsuccessful, policy conflicts or issues were resolved through overt political intervention in the bargaining
process. Often, political intervention (p.78) would take the form of pressure applied by zoku legislators at the bureau or section level of the relevant ministry.

These bargaining norms represent approaches the regulatory cartel undertook to deal with increasingly difficult problems. It should be noted that when a problem proved incapable of resolution at one level so that the system moved to the next level of bargaining, the process would not necessarily cease at the previous level. The relevant actors could continue discussions at the previous level, even after impasse, on the theory that consensus might still be possible at the lower level once the higher-level bargaining process has commenced, or at least that continuing lower-level discussions could facilitate the bargaining at higher levels. Accordingly, as a problem became more complex and difficult to resolve, several levels of bargaining were likely to occur simultaneously.

These bargaining norms and the institutional design which generated them supplied the infrastructure for regulatory coordination in Japanese finance. For example, a policy conflict or issue involving only the banking industry was resolved internally by the banking industry if possible, typically through the mechanism of the Federation of Bankers Associations. If an internal solution was not possible, the Banking Bureau would broker a resolution of the issue. If the issue affected the securities industry as well, resolution would implicate both the Banking and Securities Bureaus. If possible, such problems were worked out between the director generals of these bureaus, with input from the industry associations and major firms in the industries. Particularly thorny issues affecting both industries were resolved at the ministry level in consultation with the Administrative Vice Minister. The most problematic issues, and those most likely to be resolved through overt political intervention, were those involving industries under the jurisdiction of more than one ministry. Such issues were resolved through high-level inter-ministerial consultation. The operations of senior political leaders and zoku legislators was evident in these cases.

The practice of nemawashi (laying the groundwork for a consensus-based decision) can best be viewed as the organic manipulation of the institutional machinery by actors subject to these bargaining norms. Discussions led by industry associations and major firms are held at the industry level to formulate an initial policy position; bureaucrats broker deals and facilitate negotiations among competing interests with an eye on political realities; shingikai are assembled to coordinate and legitimate compromises; and zoku legislators are mobilized when the process does not appear to be generating a result favorable to specific interest groups.
B. The Dynamics of Cartel-like Cooperation and the Creation of Substantive Norms

Borrowing again from cartel theory, we next show that the dynamics set in motion by these bargaining norms have had substantive effects on Japanese financial regulation. Colloquially, commentators have dubbed the propensity of Japanese regulators to protect all members of the financial industry—however weak—the “convoy policy.” It is useful to disaggregate this policy into several distinct, legally unenforceable but widely followed practices (norms). These norms, in turn, flow directly from the impulses generated by the regulatory cartel.

Cartel theory predicts that once a mutual understanding has been reached as to price and division of output, the second task of cartel members is to “promote mutual confidence that there will be adherence to these decisions.” Adherence to the group’s decisions is problematic because cartels are inherently unstable. Since each individual member of a cartel will be better off if it can provide consumers slightly better terms than those offered by other cartel members, there are powerful incentives to cheat on the cartel. Simply put, the raw allocations of profits, power, and prestige that accompany cartel-like behavior constantly threaten to undermine the cooperation essential to continued functioning of the cartel. Those with the most to gain (or the least to lose) by operating outside of the agreed system will have incentives to discontinue cooperation. Thus, institutional settings and bargaining norms that facilitate coordinated group decisionmaking simultaneously unleash powerful incentives for individual members to defect from the group.

As members of a cartel, players in Japanese finance were subject to the same centrifugal forces. In order to deal with incentives that are self-destructive to the group, substantive norms were generated by the bargaining dynamics in Japanese finance.

1. Survival of the weakest. Policies (rates) are set to permit the survival of the weakest member of the group. The weakest member of the group is often the one most likely to defect from the group’s norms because the benefit this member obtains from abiding by those norms may be outweighed by the benefit it can obtain through defection. Because defection by one member can threaten the entire structure, the weakest member has a credible threat that places it in a strong bargaining position vis-à-vis its counterparts. In consequence, the substantive norms of the group are likely to protect the weakest member in order to ensure this member’s continuing loyalty to the group.

The norm of survival of the weakest benefits the stronger as well as the weak members. In addition to enhancing the durability of the cartel as a whole, the survival of the weakest norm may support pricing arrangements that allow the weakest member to stay in business, while allowing more efficient producers to earn supercompetitive profits.
2. No exit (no failure). A corollary of the principle of survival of the weakest is that of no exit: No group member is allowed to exit (fail). This enhances stability both by preventing failure by weaker members and by increasing public confidence in the management of the group.

3. Responsibility and equitable subordination. When the danger of financial failure grows, the parent or principal source of funding for the failing entity is expected to take responsibility by extending financial assistance and by subordinating its claims to those of other creditors, even if not legally required to do so. This norm encourages monitoring by stronger group members, by imposing both monetary and reputational costs on stronger players who allow smaller players under their jurisdiction to fall into difficulty.

4. Implicit government insurance. The preceding norms lead naturally to a substantive norm of implicit insurance provided by the government. If strong members are expected to assist weaker members and if no member of the group is allowed to fail, some entity must backstop the strong members. Thus, an implicit grant of government insurance is inherent in the operation of the other norms. Put differently, the responsibility and equitable subordination norm extends even to the government.

We believe that the best explanation for the existence of these norms is the incentive to cheat on the regulatory cartel. Together, the substantive norms instill confidence in and prevent exit from the group, enhance group stability, and encourage monitoring of weaker group members by stronger members.

C. The Effects of Cartel-like Cooperation in Finance

Viewing the bargaining and substantive norms as animated by cartel-like dynamics provides a powerful explanation for the observable behavior of regulators and regulated in the Japanese banking industry for most of the postwar period. Due to its central position in the decisionmaking matrix, control over group entry, and role as ultimate guarantor of the financial system, MOF served as an enforcer of the regulatory cartel (subject to potential intervention by the LDP if MOF proved unable to resolve a conflict). The function of the cartel was to coordinate decisionmaking on the regulation of the financial industry and to maintain both group member and public confidence in those decisions.

As with cartel behavior generally, a central aim of cooperation in this regulatory system was to generate and allocate rents: Votes and political patronage were allocated among political elites; regulatory property rights and concomitant distributions of power, prestige, and budgetary appropriations were allocated among separate ministries; similar rights were allocated among intra-ministry bureaus; licenses to engage in lucrative activities were allocated among industries; and profits were allocated among large and small firms.
The cartel perspective helps explain the traditionally infrequent resort to formal legal institutions in Japanese finance, and we believe, in Japan generally. Informal “ex ante monitoring” or “ preclearance” is the process by which the decisions of the regulatory cartel were made and enforced. Until recently, courts were virtually never involved in Japanese finance because they are competing enforcement agents whose basic attributes undermine cooperation and politically attuned interest balancing. Institutional, courts lie outside the network of consensus-building mechanisms that facilitate the regulatory cartel. Courts deal only with litigants, (p.81) who almost by definition are one-time players that have strong incentives to defect from a cooperative game. Similarly, formal administrative procedures are designed to protect the integrity of bureaucratic decisionmaking and to provide redress for those aggrieved by agency action. There are far fewer occasions to use such procedures where public–private interaction takes place among a limited number of repeat players following informal norms that govern the regulatory process.

Cartel-like regulatory interaction in Japanese finance had substantial positive effects and considerable staying power. It provided stability in times of stress caused by high growth, led to enormous public confidence in the abilities of bureaucratic elites to manage the economy wisely and in the public interest, and virtually eliminated costly resort to formal legal institutions and divisive litigation in the formulation and enforcement of financial regulation. Plausible arguments might be made that ex ante monitoring is justified on efficiency grounds over formal rule making. 10

However, as the jusen problem dramatically illustrates, cartel-like regulatory activities produced harmful effects as well. Such activities are non-transparent by definition, making it difficult to discern the rationale supporting policy decisions and the process by which decisions are reached. The possibility of corruption or undue influence cannot be entirely discounted. Cartel-like activities are rigid to the extent that they protect vested interests and remain impervious to outside influences. Perhaps most seriously, the need to prevent cheating by barring exit from the group creates enormous moral hazard by forcing the government implicitly to underwrite risky behavior. Over time, the incentives generated by informal, cartel-like regulation can create an environment in which individual actors rationally pursuing their own interests lead to disaster for the system as a whole. This, in essence, is the story of the jusen problem.

II. THE JUSEN PROBLEM
We now turn from a general explication of the bargaining and substantive norms of Japanese finance to the causes of the jusen problem itself.
A. Establishment and Monitoring of the *Jusen* Companies

The *jusen* companies were established in the early 1970s, principally for the purpose of providing housing loans to individuals. From the time of their establishment, the *jusen* companies fell into a curious regulatory lacuna. As nondepository institutions, the *jusen* companies did not fall directly under MOF’s jurisdiction as regulator of the nation’s banks. Nor were the *jusen* companies engaged in the insurance or securities businesses, which would have similarly brought them under MOF’s broad ambit. And they were certainly not engaged in other activities, such as imports and exports, that could have brought them under the jurisdiction of another agency such as the Ministry of International Trade and Industry. In the case of the *jusen* companies, policymakers reached the (p.82) conclusion—curious in hindsight—that these companies should not be directly regulated by any agency. The *shingikai* advising the Minister of Finance on the creation of a separate class of mortgage lending institutions recommended that the *jusen* companies not be treated as an integral part of the financial system. The panel’s 1973 report states, “At least for the present time, there is little need to regulate the *jusen* companies from the standpoint of protecting consumers. Rather, it is appropriate for the time being to observe what type of housing finance institution best suits our national circumstances.”

At least in theory the *jusen* companies did not escape all regulatory oversight; the formal basis for their regulation, however, was indirect and opaque. As businesses engaged in lending, the *jusen* companies were subject to a registration requirement and to the “investigative” authority of MOF. For reasons that have never been made clear, however, the relevant statutes distinguished between MOF’s authority to “investigate” the business and finances of the *jusen* companies, and its power to “inspect” other registered businesses engaged in lending. MOF officials asserted that the former power was weaker, but the exact import of the distinction is not apparent from the relevant statutes. Regardless of the legal distinction, MOF apparently did not exercise any regulatory authority over the *jusen* companies from the time of their establishment until 1991.

Further obscuring the *jusen* regulatory picture is the practice of *amakudari*. The *jusen* companies were attractive landing places for MOF officials. As of 1995, thirteen directors of the *jusen* companies were former MOF officials. All of these retired bureaucrats held senior positions in their new companies. Ten of the twenty-six men who served as presidents of the *jusen* companies were former MOF officials. Seven of the eleven chairpersons were retired MOF officials. And twelve of ninety-five representative directors were originally employed by MOF. These figures lend support to popular speculation that MOF encouraged the establishment of the *jusen* companies, in part because they would provide attractive second career opportunities for financial bureaucrats.
Amakudari created an insidious set of incentives in relation to regulation of the jusen companies. Current MOF officials were loath to criticize their former superiors at the ministry who had retired and were now managing the jusen companies. Moreover, there was little reason to exercise MOF's attenuated formal regulatory authority when so many informal channels to jusen management already existed. MOF was clearly in a position to monitor and influence the jusen companies through the major banks, insurance companies, and securities firms that were their founding institutions, all of which fell under MOF's jurisdiction. As shown below, however, to the extent that MOF exercised any such influence, it contributed to rather than alleviated the monitoring problems that beset the jusen companies. As a result, the jusen companies remained essentially unregulated entities from the time of their establishment until the seriousness of their financial situation became apparent in the early 1990s.

For distinct reasons, shareholder and director monitoring of the jusen companies were also ineffective at preventing risky lending behavior. The founding institutions held most of the stock of the jusen companies, and almost 90 percent of the directors of the jusen companies were dispatched from the founding institutions. In Japanese financial circles, there is an understanding that some activities which would be unacceptable if performed directly by a major financial institution are permissible if performed indirectly through an intermediary. The jusen companies provided just such a buffer, even though they remained under the influence of the founding institutions.

This business climate led to a practice known in Japan as "introduction finance" and other practices that increased the risk of the jusen companies' loan portfolios. High-risk or unsavory borrowers who would not have qualified for loans from major banks were "introduced" by the founding institutions to their jusen company affiliates, often for a substantial finders' fee. Over half of the loan business of some jusen companies consisted of this type of introduction finance. There is also widespread understanding in the Japanese financial community that the jusen companies were forced to take nonperforming assets off the books of the founding institutions, and were used to evade lending limits applicable to the parent banks.

The lack of close monitoring by the shareholders and directors of the jusen companies was also a product of the times. As discussed below, most of the riskiest and most questionable business practices of the jusen companies coincided with Japan's bubble economy, one of the most remarkable examples of financial speculation in history. Speculative behavior and lax oversight were exemplified by, but by no means limited to, the jusen companies.

In short, the jusen companies were not closely monitored by their regulators, shareholders, or directors.
B. Financial Liberalization and the Business of the *jusen* Companies

As noted above, the *jusen* companies were founded to provide home mortgages to individuals. At the time of their establishment, commercial banks were not eager to engage directly in this line of business. In 1971, banks provided just 29 percent of all individual home mortgage loans.\(^\text{18}\) Gradually, however, financial liberalization changed the landscape of Japanese banking. Regulatory constraints that had limited access to the capital markets and held corporate borrowers in long-term relationships with their bankers began to weaken. As banks began to lose corporate finance business to the capital markets in the mid-1970s and 1980s, the home mortgage lending business became more attractive. By 1980, the banks' share of the home mortgage lending market had grown to 39 percent.\(^\text{19}\) This newfound banking business grew at the expense of the *jusen* companies. From a peak of just over 7 percent of the market in 1980, the *jusen* companies' share of the home finance business fell to 5 percent in 1985, and then shrank at a rate of about 1 percent per year from 1985 to 1988, falling to less than 2 percent in 1993.\(^\text{20}\)

To compensate for the loss of the home mortgage lending business to the founding institutions and other banks, the *jusen* companies abandoned their *original* mandate and began lending heavily to corporate borrowers. In 1980, the *jusen* companies lent just ¥15 billion ($150 million) to corporations compared to ¥317 billion ($3.17 billion) in lending to individuals.\(^\text{21}\) In 1986, the percentages of corporate and individual lending were almost equal. By 1988, the *jusen* companies were lending almost twice as much to corporations as to individuals. And by 1990, corporate lending had reached ¥973 billion ($9.73 billion), against just ¥265 billion ($2.65 billion) in lending to individuals.\(^\text{22}\) Many of these corporate borrowers were real estate developers and speculators too small for the capital markets, and of insufficient credit quality for the banks.

Thus, although the *jusen* companies were established to engage in home mortgage lending, they changed their focus to corporate lending as the home mortgage business was largely lost to commercial banks in the decade after their founding.

C. The Agricultural Credit Cooperative System and the *jusen* Companies' Source of Funds

At the same time as their core business was being eroded, the *jusen* companies began borrowing huge sums from agricultural cooperatives, which constitute a separate financial system and a potent political force in Japan. These cooperatives were established in virtually every village in Japan shortly after the end of the Second World War to provide financing for agricultural development. The political power of the cooperatives derives from the importance of agricultural policy in Japan and the vote gathering capacity of the system for the LDP. As a network of farm institutions with millions of members spread throughout every electoral district in Japan, the agricultural cooperatives are a
powerful political medium. Although organized ostensibly for technological and financial purposes, the cooperatives provided a ready-made channel through which the interests of the farmers could express themselves in the political process. The farmers, moreover, are an interest group which in Japan, as in the United States, has inherent advantages in the political process: They are dispersed throughout the country and, because they have a large, nondiversified investment in their businesses, the value of which is heavily dependent on government policies, they tend to be politically active both in voting and in campaign contributions.\textsuperscript{23} Not surprisingly, the zoku legislators who focus on agricultural interests, called nōrinzoku, are among the most powerful and effective.

As the economics of Japanese agriculture changed, the credit cooperatives drifted away from their initial function of serving the credit needs of farmers. Farmers' demand for credit fell as the percentage of Japanese GNP occupied by agriculture declined. And as the income of farmers diversified and increased, the deposits of the credit cooperatives grew dramatically. To resolve the mismatch between liabilities and assets, the agricultural cooperatives increasingly turned to the jusen companies. Consequently, agricultural cooperative loans to the jusen companies increased almost sixfold between 1985 and 1992.

\textbf{(p.85) D. The Bubble Economy and its Impact on the Jusen Companies}

The final step in the creation of the jusen problem was Japan's bubble economy, which lasted from 1988 to 90. The bubble economy had a profound effect on the jusen institutions. One important ingredient was the sudden riches that came into the hands of Japan's farmers, already quite prosperous as a result of favorable government policies towards agriculture and extensive outside income. Many farmers, especially in the areas abutting major cities, found that they could sell their properties and become instantly wealthy. They began to sell agricultural land to developers in large numbers, depositing much of the proceeds in their local agricultural credit cooperative. Investment in these cooperatives was by no means an irrational decision: They were convenient, well known, paid a good rate of return, and appeared to be perfectly safe. Thus, large amounts of new money flowed into the local agricultural cooperatives. Deposits in the local cooperatives jumped from ¥39 trillion ($390 billion) in 1985 to ¥61 trillion ($600 billion) in 1991.

The massive inflow of funds to the local cooperatives was accompanied by stagnant or even decreasing loan demand for traditional farming credit. The net effect of the bubble economy on the agricultural cooperatives, therefore, was to create a mountain of cash looking for a profitable investment. The jusen companies appeared to be perfect candidates for such investments. Cooperative lending to the jusen firms became particularly pronounced after the bubble economy began to collapse in 1990. In that year, lending surged from ¥2.9 trillion ($29 billion) to ¥4.9 trillion ($49 billion). This spike can be traced directly
to a MOF administrative circular issued in March of 1990. The administrative guidance was designed to rein in lending for speculative real estate transactions, which was contributing to dramatic asset inflation. The circular provided that each bank should restrict the growth in its real estate lending to no more than the growth in its overall loan portfolio. To help enforce the restrictions, in the same circular, the banks were advised to notify MOF of all loans made to the real estate, construction, or non-bank industries.

There were two crucial omissions in this administrative guidance that would play a major role in agricultural cooperative and jusen financing over the next five years. First, while a companion circular addressed to the agricultural cooperatives similarly limited the growth of their direct real estate lending, they were not required to report loans made to the real estate, construction, or non-bank industries. Second, no restrictions of any kind were placed on real estate lending by the jusen companies. The practical effect of these omissions was to create a financing pipeline from the agricultural cooperatives, through the jusen companies, to the real estate industry. The agricultural cooperatives could lend unlimited amounts to the jusen companies without so much as a reporting requirement; the jusen companies, in turn, could lend unlimited sums borrowed from the agricultural cooperatives to real estate developers and speculators. There was a dramatic increase in jusen borrowing from the agricultural cooperatives after the March 1990 administrative guidance.

When the bubble burst, the quality of real estate loan assets held by the jusen companies deteriorated substantially, and corporate bankruptcies skyrocketed. As a result of these developments, it had become clear as early as 1991 that the jusen companies were in serious financial difficulty. Land and stock prices had begun a steep descent, and corporate borrowers were encountering increasing financial problems. MOF undertook its first on-site investigation of the jusen companies in 1991. The investigation showed that the seven jusen companies held a total of ¥4.6 trillion ($46 billion) in nonperforming loans, equivalent to 38 percent of their total loan portfolio. The jusen companies were in serious trouble, but the worst was yet to come.

III. RESOLVING THE PROBLEM
In this Section, we examine the attempts to resolve the nonperforming loan problem of the jusen companies. While we defer our analysis of these attempts to Section IV, the narrative below clearly illustrates the stress this problem placed on the bargaining and substantive norms of cooperation and coordinated decisionmaking, and the failure of traditional methods to address adequately a problem of this magnitude. Indeed, as will be shown, reliance on the norms actually exacerbated the problem, leading to a crisis in 1995. Ultimately, the bargaining and substantive norms were employed only in modified form in the jusen context, and a partial infrastructure was put in place to move Japanese
financial regulation toward a new, more legally oriented and transparent set of standards.

**A. Initial Attempts to Restructure *jusen* Loans**

In view of the serious financial condition of the *jusen* companies, five-year restructuring plans for each company were devised under MOF supervision in late 1991 and early 1992. These plans involved reductions in lending, interest rate reductions on loans made by the founding institutions, loan support from non-founding lenders, and cost-cutting measures.²⁸

These plans, however, failed to improve the financial condition of the *jusen* companies. In fact, their condition continued to deteriorate, and by early 1993 it was necessary to formulate a second restructuring plan. MOF rejected a Sanwa Bank proposal to undertake a full-scale restructuring of the *jusen* company it had founded, and instead orchestrated the formulation of a new, ten-year restructuring plan for each of the *jusen* companies, using Sanwa’s *jusen* affiliate as a model.

The centerpiece of these second restructurings was interest rate reduction. The founding institutions completely eliminated the interest charged on their loans to the *jusen* companies. Other bank lenders reduced their interest rate to 2.5 percent, the official Bank of Japan discount rate at the time. The agricultural credit cooperatives reduced their interest rate to 4.5 percent, their cost of funds at the time.²⁹

During the process of consensus-building among the regulators and interested private parties that preceded the second restructuring, a memorandum was (p. 87) exchanged that would become controversial when the *jusen* problem developed into a crisis two years later. At a meeting in February of 1993, the Director General of MOF’s Banking Bureau provided a memorandum to his counterpart in the Economic Affairs Bureau of MAFF. The memorandum, a masterpiece of bureaucratic obfuscation, can be interpreted as providing that the founding institutions, backed by MOF assurances, would guarantee the principal amount of all loans made by the agricultural cooperatives to the *jusen* companies. The critical passage of the memorandum states:

> The founding financial institutions will take responsibility for dealing with the restructuring plan of [the relevant *jusen* company] (MOF will take responsibility for guiding [the parties involved] so that no burdens will be imposed on the agriculture-related institutions … beyond those contemplated by the current measures).³⁰

The exact import of this language is unclear; indeed, the passage is pregnant with studied ambiguity. To be sure, the founding institutions do not explicitly guarantee the agricultural cooperatives’ loans to their *jusen* company affiliates. Nor does MOF explicitly provide such a guarantee on behalf of the founding
institutions. Indeed, as a regulatory agency, MOF possesses no legal authority to issue such a guarantee in the name of private financial institutions. Yet, the passage is open to the interpretation that MOF was providing assurances that the agricultural cooperatives' losses in connection with the *jusen* company workouts would be limited to interest rate reductions under the restructuring plans. Given the traditional rules under which players in Japanese finance have operated, and given MOF's influence over the institutions involved, it is not unreasonable to assume that MOF had the informal power to make good on such a commitment, if indeed one was made.

The February 1993 memorandum would appear to represent a significant concession by MOF, since MOF appeared to be making some kind of commitment that the assets of the founding institutions would stand behind the agriculture-related institutions' *jusen* loans. Why would MOF, supposedly a champion of banking interests, agree to such terms? Part of the answer appears to be the fact that the agricultural cooperatives had the power to destroy the *jusen* companies by withdrawing their loans. Thus, it is possible that MOF needed to issue this extraordinary memorandum because it feared a withdrawal of agricultural cooperative money from the *jusen* companies. By 1992, the agricultural cooperatives had become a vital source of funding for the *jusen* companies, accounting for ¥5.6 trillion ($56 billion) out of ¥14 trillion ($140 billion) in total loans. Foreign lenders had already begun to withdraw their funding in anticipation of serious problems. If the agricultural cooperatives had similarly ceased lending, the *jusen* companies would have quickly collapsed. This threat was mitigated, to some extent, by the fact that if the *jusen* companies collapsed as a result of withdrawals by the agricultural cooperatives, the cooperatives would not, in fact, be able to withdraw all their funds, and the remaining investments in the *jusen* companies would lose much of their value. The threat, nevertheless, had some (p.88) credibility because the cooperatives had less to lose from the collapse of the *jusen* companies than did either the founding institutions or MOF. For the founding institutions, collapse of the *jusen* firms would represent both a large financial loss and also a reduction in prestige and public confidence. For MOF, a *jusen* collapse would be extremely embarrassing because of MOF's role in creating these companies and staffing them with *amakudari* officials. Moreover, a *jusen* collapse would have raised questions both in Japan and around the world about the stability of the Japanese financial sector generally.

In the face of this situation, although MOF could not issue a guarantee, it also could not afford to lose the support of the agricultural cooperatives. The result was conscious ambiguity. When the memorandum surfaced publicly two years later, the finance and agriculture ministry officials involved disputed its significance.\(^{31}\)
This ambiguity was a natural byproduct of the intense negotiations that ensued between MOF and MAFF officials. MOF was under tremendous conflicting pressures from the farm lobby and MAFF on the one hand, and the banks under its jurisdiction on the other. At the time, the memorandum must have seemed a brilliant solution to the problem, and one that was fully consistent with the substantive norms of Japanese financial regulation, including the government’s implicit role as ultimate guarantor of the financial system.

Indeed, the second restructuring vividly illustrates the bargaining and substantive norms of Japanese financial regulation in action. In this case, a serious problem that spilled over jurisdictional lines was resolved through inter-ministerial negotiations, following intense mobilization of industry and political forces on both sides. MOF officials, at the center of this activity, facilitated a solution based on accepted substantive principles. Consistent with the survival of the weakest norm, the agricultural cooperatives were granted the most favorable deal in the restructuring. The founding institutions, under the responsibility norm, took on far more than their pro rata share of the burden of interest rate reductions. The first *jusen* company to be established, which was founded by a major bank with close relations to MOF, was used as the model to be followed in the restructuring of the other *jusen* companies.

The second “restructuring” of the *jusen* companies was also a classic example of regulatory “forbearance”: An attempt to buy time in the hope that economic conditions would improve, lifting the *jusen* companies out of their financial problems. Under this policy of forbearance, however, the nonperforming assets of the *jusen* companies multiplied rapidly. The nonperforming assets of the seven *jusen* companies increased by 75 percent during the four years between MOF’s first on-site investigation of the *jusen* companies and a second on-site investigation in August of 1995. Real estate prices did not recover as forecast by MOF, and a serious financial situation turned desperate. By March 1995, the *jusen* companies had borrowed a total of almost ¥13 trillion ($130 billion) and had made loans of ¥10.72 trillion ($107 billion). Even according to MOF’s calculations, considered by independent analysts to be optimistic, ¥8.13 trillion ($81 billion) of these loans were nonperforming; and ¥6.27 trillion ($63 billion) of these nonperforming loans were deemed to be completely unrecoverable.

By March 1995, almost 75 percent (¥9.697 trillion, $97 billion out of a total of ¥13.060 trillion, $130 billion) of the combined assets of all seven *jusen* companies were nonperforming. Almost 60 percent (almost ¥6.3 trillion, $63 billion) of the loans made by the *jusen* companies were completely unrecoverable. All seven of the *jusen* companies were insolvent by September of 1995.
In spite of, or perhaps more accurately due to, the initial attempts to deal with the jusen companies’ nonperforming loans, the jusen problem had reached catastrophic proportions.

B. Pressure Builds

By the summer of 1995, the jusen problem had taken on practical and symbolic significance at the center of the bad debt crisis facing the Japanese financial system, particularly because the jusen companies were the first class of Japanese financial institutions that simply could not continue to operate under their current weight of nonperforming loans.

An interim report of the Financial System Stabilization Committee, part of a standing MOF advisory panel, explained that because

Jusen companies hold a large amount of problem loans and many financial institutions give financing to Jusen companies, the Jusen problem can have a significant influence on the stability of the financial system as a whole. Thus, the Jusen problem has become symbolic in the non-performing loan problem and should be urgently addressed.  

A number of other factors added to the sense of crisis surrounding the Japanese financial system. The Daiwa Bank scandal (see Chapter 2) and persistent doubts about the accuracy of MOF’s estimates of the amount of nonperforming loans held by Japanese financial institutions diminished its credibility as a regulator. Moreover, the international financial community began to perceive an unusual systemic risk in Japanese finance arising from the no failure norm and the informal purchase and assumption transactions (in which a strong bank purchases the assets and assumes the liabilities of an insolvent bank) MOF had used to enforce the norm. The concern was that MOF, in an effort to rescue troubled financial institutions at any cost, would jeopardize the health of otherwise strong institutions by forcing them to acquire institutions that should have been allowed to fail.

The international financial markets began to exact a price for these concerns in the form of the “Japan Premium,” an additional risk premium charged by non-Japanese banks on loans to Japanese banks in international money markets. In September of 1995, the Japan Premium was fifty basis points (0.5 percent), a significant premium given the razor-thin margins of international money markets. The Japan Premium was particularly galling to major Japanese banks, because no matter how strong they were financially, the international financial markets were penalizing them for their country’s bad debt crisis and financial regulatory style. The Japan Premium was also intensely embarrassing to the Japanese government and its economic agencies.
The coalescence of these domestic and international forces created a public outcry over the jusen problem reminiscent of America’s S&L crisis in the late 1980s, and made the formulation of concrete measures to deal effectively with the jusen problem not only unavoidable, but also urgent.

C. Early Negotiations

To develop actual measures addressing the jusen problem, the Financial System Stabilization Committee chose to rely on time-honored Japanese methods. Its interim report urged the jusen companies and the founding institutions to “play substantive roles in agreeing on the basic future policies and disposal scheme of problem loans.” The Committee encouraged discussions among the interested parties, particularly between the founding institutions and the agricultural credit cooperatives, and requested that all parties concerned “make as many concessions as possible, with due recognition of their own responsibilities in the Jusen problem, considering the historical background and other relevant factors.” Simultaneously, the report encouraged the regulators to promote the formation of consensus among the parties in creating an overall framework for the solution of the problem.

To address the jusen issue specifically, MOF initiated negotiations between the founding institutions and the agricultural credit cooperatives in the fall of 1995 in order to divide the approximately ¥7.5 trillion ($75 billion) of immediate losses connected with the jusen companies. While there are an infinite number of potential ways to apportion the losses, the actual theories discussed followed a few stylized models, reflecting disparate views about responsibility for the jusen problem in light of the substantive norms of Japanese finance.

The agricultural institutions asserted that the founders should bear the entire amount of the losses (the “founder liability argument”). They stressed that the founding institutions had established, managed, and dominated the operation of the jusen companies, and thus should bear full responsibility for their downfall. Moreover, the agricultural institutions pointed to the memorandum exchanged in 1993 as proof that their loans to the jusen companies were guaranteed by the founding institutions and ultimately by MOF. The founder liability argument is a clear expression of the “responsibility” norm.

The founding institutions, standing to lose the most under straightforward application of the substantive norms of Japanese finance, sought to defect from the traditional arrangement and relied on common bankruptcy principles in staking out their position. The founding institutions countered that the jusen companies were separate legal entities, and there was no basis for treating some creditors more favorably than others. Thus, all lenders should share the losses in proportion to their loans to the jusen companies (the “lender liability argument”).
A third position, intermediate between the first two, held that the founding institutions' responsibility should be limited to the value of their own loans to the jusen companies. Under this “modified founder liability” theory, the founding
## Table 4.1 Possible loss allocation methods and their impact on lenders to the *jusen* companies (unit: trillion ¥)

<table>
<thead>
<tr>
<th>Lending group</th>
<th>Loans made to <em>jusen</em></th>
<th>Lender liability&lt;sup&gt;a&lt;/sup&gt;</th>
<th>Founderliability&lt;sup&gt;b&lt;/sup&gt;</th>
<th>Modified founder liability&lt;sup&gt;c&lt;/sup&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td>Founding institutions</td>
<td>3.5</td>
<td>2.1</td>
<td>7.5</td>
<td>3.5</td>
</tr>
<tr>
<td>Other lenders</td>
<td>3.8</td>
<td>2.2</td>
<td>—</td>
<td>1.7</td>
</tr>
<tr>
<td>Agricultural cooperatives</td>
<td>5.5</td>
<td>3.2</td>
<td>—</td>
<td>2.3</td>
</tr>
<tr>
<td>Total</td>
<td>12.8</td>
<td>7.5&lt;sup&gt;d&lt;/sup&gt;</td>
<td>7.5&lt;sup&gt;d&lt;/sup&gt;</td>
<td>7.5&lt;sup&gt;d&lt;/sup&gt;</td>
</tr>
</tbody>
</table>

Notes:

(a) All lenders to *jusen* companies bear losses in proportion to total losses/total loans.

(b) Founding institutions bear all losses.

(c) Founding institutions write off all loans to *jusen* companies. Agricultural cooperatives and other lenders bear remaining losses in proportion to their loans to *jusen* companies.

(d) Total losses include ¥6.27 trillion in unrecoverable loans and ¥1.24 trillion of nonperforming loans.
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institutions would write off all their loans to the jusen companies, and all other lenders would bear losses in proportion to their jusen loans.

As Table 4.1 illustrates, the loss allocation method chosen would have a profound financial impact on the three distinct groups of financial institutions involved in lending to the jusen companies—founding institutions, agricultural credit cooperatives, and other bank lenders. The negotiations, then, represented not posturing based on abstract theories of liability, but concrete and desperate attempts to avoid trillions of yen in losses.

The enormous sums of money at stake amplified the debate over who bore responsibility for the failure of the jusen companies. To take the most dramatic example, as Table 4.1 indicates, there is a ¥5.4 trillion ($54 billion) difference between the loss that the founding institutions would collectively bear under a “founder liability” theory of loss allocation, and the corresponding loss under a pro rata “lender liability” theory. Under a pro rata lender liability theory of loss allocation as would be applicable in a formal bankruptcy proceeding, the agricultural cooperatives, as the largest lenders to the jusen companies, would bear the largest share of the losses. Conversely, the founding institutions would bear the lightest burden in formal bankruptcy proceedings.

Negotiations to resolve the loss allocation controversy proceeded on several levels simultaneously. At the center of attempts to resolve the problem were the MOF-sponsored talks between the founding institutions and the agricultural cooperatives. The ruling coalition formed a Securities and Finance Project Team to monitor the negotiations. When consensus among the principals to the negotiations proved elusive, an LDP Jusen Problem Study Group was established to generate political momentum toward a solution. By November 1995, senior MOF officials had entered into full-scale bilateral negotiations with their counterparts (p.92) at MAFF on the issue of loss allocation. And beneath the surface, a battle by proxy was being fought on behalf of the agricultural cooperatives by the nōrinzoku politicians on the one hand, and by politicians aligned with MOF in support of the banks on the other. The associations representing the various agriculture-affiliated financial institutions visited MOF to report on the negotiations and to request that MOF guide the founding institutions toward accepting full responsibility for the jusen losses.37

These behind-the-scenes maneuvers prompted a public debate over the use of informal methods rather than legal procedures to resolve the jusen problem. Editorials began to appear in Japanese newspapers calling for an end to “regulation in secret rooms” and urging resort to the legal process to resolve the problem.38 Pressured by a chorus of founder liability arguments, representatives of the Federation of Japanese Bankers Associations began to issue public reminders that the founding institutions could force the jusen companies into bankruptcy.39 The suggestion brought protests from the agriculture-affiliated institutions, and was greeted unenthusiastically by MOF officials, who publicly
stressed the need for the interested parties to resolve the problem among
themselves.\textsuperscript{40} Less publicly, MOF was busy shaping the contours of its own plan
to resolve the problem.

The utter lack of agreement among the principals on the issue of loss allocation
during the MOF-sponsored meetings caused MOF to devise the basic outlines of
its own \textit{jusen} resolution plan\textsuperscript{41} and increased political involvement in the
policymaking process. On December 1, 1995 a policy coordination council of the
ruling coalition issued guidelines on the resolution of the \textit{jusen} problem. The
guidelines called for a simultaneous liquidation of all seven \textit{jusen} companies,
immediate write-offs of unrecoverable assets and the transfer of other assets to
a special purpose \textit{jusen} resolution vehicle. The guidelines stressed that the use
of public funds should be limited to “absolutely unavoidable circumstances” and
emphasized that “it is necessary to ensure transparency, and to clarify the
responsibility of each party” for the \textit{jusen} problem.\textsuperscript{42} Although the guidelines
were silent on the crucial issue of loss allocation, they suggested a heavy burden
for the founding institutions in recommending that “the financial strength of the
parties should be carefully considered” in crafting the final plan.\textsuperscript{43}

MOF officials quickly sought to capitalize on the political authority of the
guidelines. Finance Minister Masayoshi Takemura indicated that MOF would
respect the guidelines while working toward a final proposal. According to
Takemura, in issuing the guidelines the government was not “reaching a
conclusion” on the \textit{jusen} problem; rather, the regulators would play a mediative
role by standing between the parties if talks among the principals stalled.\textsuperscript{44}
Simultaneously, Yoshimasa Nishimura, the Director General of MOF’s Banking
Bureau, summoned the presidents of two major banks to MOF and requested
that the founding institutions accept the guidelines and assent to a version of the
modified lender liability allocation that would involve a ¥1.5 trillion ($15 billion)
contribution from the agricultural affiliates and some supplemental funds from
the founding institutions beyond the ¥3.5 trillion ($35 billion) in loan write-
offs.\textsuperscript{45}

\textbf{(p.93)} Once again, however, both sides rebuffed MOF’s initiatives. The
agricultural cooperatives refused to accept a loss of the magnitude required by a
modified lender liability formula. Founding institutions refused to consider
sustaining losses in excess of the amounts they had lent to the \textit{jusen} companies.

As the struggle to apportion losses dragged on, strategic bargaining “in the
shadow of the law” began to shape the pace and structure of the final outcome.
Restless politicians threatened resort to the legal system if a liquidation plan
including a loss allocation scheme were not finalized by December 18,\textsuperscript{46}
although it is unclear what standing the politicians would have had to initiate
legal proceedings. Continually pressed by MOF to bear a share of the losses
beyond their ¥3.5 trillion in loans, the founding institutions began to argue that
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sustaining any greater losses would invite shareholder derivative litigation.\textsuperscript{47} Similarly, the founding institutions rejected any suggestion that they cover secondary losses, again raising the danger of shareholder derivative litigation.\textsuperscript{48} Reacting angrily to MOF’s pressure on the banks, the chairman of the Federation of Japanese Bankers Associations issued an explicit threat to force the \textit{jusen} companies into bankruptcy if MOF continued to press the founding institutions to bear a larger share of the losses.\textsuperscript{49} MOF steadfastly rejected the idea of a legal solution, reiterating its position that a deal worked out among the parties was the best way to achieve a prompt resolution of the \textit{jusen} problem.\textsuperscript{50}

D. The Government’s \textit{Jusen} Resolution Plan

The confrontation over loss allocation came to a head on December 14, 1995. On that date, the agricultural cooperatives rejected MOF’s proposal for the cooperatives to cover ¥1.2 trillion ($12 billion) of first stage losses, and offered just ¥530 billion ($5.3 billion) as their maximum possible contribution. This would force the use of public funds to cover first stage losses, and probably led to a high-level rift within MOF between the Budget and Banking Bureaus. After all-night consultations among three high-ranking career MOF officials, it was determined that public funds would be needed to fill the shortfall in first stage loss coverage.\textsuperscript{51} Although the exact chain of events leading to the decision to use public funds in the first stage of the \textit{jusen} cleanup are uncertain to this day, press accounts suggest that only a high-level political decision could have altered MOF’s plan and forced the introduction of public funds to cover first stage losses.\textsuperscript{52}

A few days later, representatives of MOF, MAFF, and the ruling coalition adopted a document entitled “On the Resolution of the \textit{Jusen} Problem”\textsuperscript{53} in an attempt to lay the groundwork for the injection of public money into the \textit{jusen} resolution framework. Adoption of the document by these three parties indicates high-level coordination among the ministries and political leaders in the formulation of the final resolution plan. The document called for increased transparency through the publication of data on the operations of the \textit{jusen} companies, and for a clarification of regulatory and private-sector responsibility for the creation of the \textit{jusen} problem. The document skirted the issue of agricultural cooperative \textsuperscript{(p. 94)} responsibility, but did call for a major restructuring of the agricultural finance system.

The document set out for the first time an authoritative plan to allocate \textit{jusen} losses. First stage losses to be realized immediately would be limited to ¥6.4 trillion ($64 billion). The losses would be covered principally by the founding institutions and other lenders: Founding institutions would write off the entire amount of their loans to the \textit{jusen} companies (¥3.5 trillion, $35 billion), and make a capital contribution and low-interest loan to a \textit{jusen} resolution corporation (later officially named the Housing Loan Administration, HLA) that would assume and attempt to collect on the assets transferred to it. The other
lending banks would write off ¥1.7 trillion ($17 billion) and make a low-interest loan and capital contribution to the HLA. The agricultural cooperatives would be called upon to “cooperate in contributing ¥530 billion [$5.3 billion]” to the HLA and in making a low-interest loan to the HLA “premised on the repayment of all of their loans to the jusen companies.”\(^{54}\) The word “contribute” was used so that the agricultural cooperatives could publicly maintain that they were not responsible for the jusen problem and were voluntarily participating in the jusen resolution plan in a spirit of public service.

This loss allocation formula fell short of covering even the reduced first-stage loss of ¥6.4 trillion. Thus, the document called for the government to contribute ¥680 billion from the fiscal year 1996 budget into a newly established account at the Deposit Insurance Corporation (DIC) to fund the shortfall. An additional ¥5 billion ($50 million) of public funds would be used for a capital contribution to the DIC to strengthen its operations. In addition, the document provided that the new DIC account would be used to “cover a portion of any losses that result after the assets are transferred [to the HLA]. The government will take appropriate measures if a loss appears in this account.”\(^{55}\) As clarified by MOF officials later, this passage means that taxpayer money would be used to cover half of all secondary losses that arise in the future as the HLA disposes of assets.\(^{56}\) The cabinet adopted this resolution plan on December 19, 1995.

The final report of the Financial System Research Council, issued on December 22, offers perhaps the most thoughtful official perspective on the jusen resolution.\(^{57}\) After stressing the importance of a prompt solution to the problem, the report emphasizes the fundamentally private nature of the jusen problem, and thus the appropriateness of a solution worked out through discussions among the principals.\(^{58}\) But the report notes the difficulties experienced in resolving the problem through private consultations, and suggests that regulatory intervention was needed to address the jusen problem on a macro level and to restore confidence in the Japanese financial system. Thus the use of public funds, while exceptional, was unavoidable: “This Research Council,” states the report, “believes that the government has no choice but to decide upon these temporary and extraordinary measures, which include the use of public funds ... In order to obtain the understanding of the public, we believe it is indispensable to thoroughly clarify” responsibility for the jusen problem.\(^{59}\) (p. 95) The report calls for the regulatory authorities to “examine past regulatory policy in regard to the creation of the bubble and the bad debt problem ... and to construct a new and highly transparent financial system while improving future financial regulation.”\(^{60}\)

Thoughtful official perspectives notwithstanding, the government’s plan was promptly lambasted by the press and touched off a major public outcry against the use of public funds to resolve the crisis. An editorial in Nihon Keizai Shimbun captured the main criticisms of the plan and the process by which it was
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The editorial vented the suspicion that the final loss allocation formula was the product of a cynical political decision made under the influence of nōrinzoku politicians to rescue the agricultural cooperatives at taxpayer expense. The editorial criticized the back room deals involved, and called for a thorough vetting of responsibility for the jusen problem, starting with the regulatory authorities. Finally, it suggested that some of MOF’s conduct in shaping the resolution plan was inconsistent with the rule of law.

E. The Secondary Loss Dispute

After struggling for five months to obtain agreement on the division of the current losses on unrecoverable assets, the government immediately faced another hurdle: How to cover the secondary losses that would inevitably arise as the HLA attempted to recover on the ¥6.6 trillion ($66 billion) of assets that would be transferred to it for management and collection. MOF officials attempted to persuade the founding institutions to contribute capital and low-interest loans to a new fund to be established within the DIC to cover secondary losses. The founding institutions, however, attached conditions to their participation. They requested legal support for the plan, in order to shield their managers from shareholder litigation. They also wanted assurances that the loans would be guaranteed and that the agricultural cooperatives would participate.

MOF ultimately prevailed. On January 24, 1996, MOF published its final outline on coverage of secondary losses. That plan had two components. First, each of the three groups of lenders to the jusen companies would contribute ¥2.2 trillion ($22 billion) in the form of low-interest loans to the HLA. The ¥6.6 trillion would be used to purchase the assets of the jusen companies to be recovered by the HLA. The principal of these loans would be guaranteed by the DIC. Second, the plan called for legislation establishing a “Financial System Stabilization Fund” of up to ¥1 trillion ($10 billion) within DIC, funded by the institutions that had lent to the jusen companies. The fund would be managed by the DIC. Half of all secondary losses would be covered out of public funds and half out of earnings on the Financial System Stabilization Fund. If returns on the fund turn out to be insufficient to cover half the losses, then the remaining losses will be borne by the DIC as the guarantor of borrowings made by the HLA. The establishment of the Financial System Stabilization Fund would be codified legislatively to protect the contributing institutions against shareholder derivative litigation.

F. Diet Debate

Deliberations on the resolution package began in the Diet's Lower House Budget Committee at the end of January 1996. A principal focus of the discussions was the basis for the December 1995 loss allocation formula, which called for a ¥685 billion injection of taxpayer funds. Diet members were particularly interested in learning how the amount of the agricultural cooperatives' “contribution” had been determined. In testimony before the Diet, the Minister of Agriculture
provided two explanations. First, he claimed that the figure represented the maximum amount that the agricultural cooperatives could afford without suffering serious financial damage. He explained that ¥200 billion of the ¥530 billion total agricultural contribution would be made by the prefectural cooperatives, which would push twenty of the forty-seven such institutions into the red. Second, the figure was said to represent the unrealized portion of the agricultural cooperatives' loss on interest rate reduction from the 1993 restructuring plan. The leading opposition party criticized these explanations as inconsistent post hoc rationalizations.

The Agriculture Minister's reluctance to admit that the figure was simply the result of a political compromise has never been fully explained. No doubt it stemmed in part from a desire to avoid further criticism of the plan as a politically motivated bailout of the agriculture cooperatives. But it may also have stemmed from a deeper inclination to maintain at least the appearance that only "acceptable" models of dispute resolution had been followed in ending the crisis. It may have been important to be viewed as abiding by the norm against financial institution failure, and to rationalize the agricultural cooperatives' "contribution" in the context of the preexisting, consensus-based 1993 restructuring formula. Publicly admitting to an overt political deal may have stripped the plan of the internal logic and aura of legitimacy needed to hold the fragile consensus together.

G. Jusen Resolution and Financial Reform Legislation

In early June of 1996, after 137 days of Diet wrangling, which included an extraordinary sit-in by opposition parties, a special committee of the Lower House approved a package of bills to implement both the jusen resolution and other financial reforms. Following the committee's approval of the bills, the three coalition parties released a statement signaling their intent to secure additional contributions from financial institutions to reduce the public's burden, and calling for the establishment of a transparent system of financial regulation based on strict monitoring and market-based regulations, the early establishment of an organization to liquidate the jusen companies and recover loans, and a prompt restructuring of the agricultural cooperative system. The package of financial bills codifying the government's jusen liquidation plan, including the expenditure of public funds and the establishment of the HLA to carry out the liquidation of the jusen companies and the recovery of their assets, was passed just before the expiration of the Diet session in mid-June.

H. Supplemental Loss-Coverage Fund

Passage of the legislation capped the jusen debate but did not disarm public anger. No sooner had the legislation designed to heighten transparency and reduce MOF discretion been enacted than MOF began strong-arming the financial institutions into providing additional funds to lessen the burden on the Japanese taxpayers. The ministry's plan was to create yet another special fund
through contributions from the financial institutions and the Bank of Japan, the earnings on which would defray the ¥685 billion fiscal outlay required to cover first stage losses.

MOF and other government officials had begun laying the groundwork for convincing financial institutions to bear a larger share of the losses in the previous month. For example, Finance Minister Kubo stated “the [founding] banks should voluntarily consider additional contributions, also taking into account their social role.” The government also began considering steps to shield the banks from shareholder derivative suits that might be filed for contributing shareholder assets to the government fund. These measures included a formal request from MOF to the banks for additional funds, as well as a Diet declaration seeking contributions and pledging that the fund would be used to help preserve the stability of the Japanese financial system.

Although the financial institutions vehemently fought the proposal to make even further contributions toward the jusen resolution scheme, MOF ultimately prevailed. The financial institutions and the Bank of Japan agreed to contribute additional monies to a fund designed to offset the ¥685 billion in taxpayer money used to cover first stage losses.

The final cost of the jusen problem to the Japanese taxpayers, however, will not be known for another decade, when the HLA completes its work. Much more than the earnings from the Financial System Stabilization Fund may be needed to cover secondary losses, depending on land prices and interest rates.

The delay in final accounting is probably not an accident. By putting off the day of reckoning into the distant future, the actors on the political stage at the time were able to deflect the intense public criticism that would have come their way if the final tally had been estimated immediately, especially given Japan’s economic woes and the freshness of the jusen debacle in public consciousness. When the costs are finally known, things are likely to be different. A new generation of voters will have emerged for whom the jusen fiasco is an obscure episode in their economic history. While the final resolution costs may present a political problem for someone, those who face the problem will be different from the politicians, bureaucrats, and interest group leaders who crafted the resolution plan of 1995–96.

IV. INSTITUTIONAL REFORMS
Looking back, the jusen debacle was the beginning of a process of re-engineering Japanese financial regulation—a process that gathered momentum with subsequent “Big Bang” reforms (discussed below). Legislation passed in the immediate aftermath of the jusen problem sought to decrease the discretion of MOF in dealing with ailing financial firms and increase the effect of the market on financial industry participants. This legislation appears to have been
formulated, at least in part, on the initiative of the Bank of Japan, which was waiting for an opportune moment to press for broad financial reforms.

These reform measures include two major changes relating to the treatment of failing financial institutions. First, a system of “prompt corrective action” based on objective criteria was instituted to deal with financial institutions in failing health.\textsuperscript{71} Similar to US legislation enacted in the wake of the S&L crisis,\textsuperscript{72} this law is designed to prevent politically palatable but economically costly regulatory “forbearance.” Under the law, when the soundness of a financial institution, as measured by objective criteria such as capital adequacy ratios, deteriorates beyond certain benchmarks, financial regulators are required to undertake increasingly stringent measures to minimize the danger to depositors. Second, another bill confers upon regulators the authority to petition the initiation of corporate reorganization or bankruptcy procedures with respect to financial institutions.\textsuperscript{73}

With the introduction of these measures, in a major departure from past Japanese financial practices, some financial institutions would be allowed to fail. To prepare for this eventuality, another bill was designed to make systemic improvements in the deposit insurance system.\textsuperscript{74} In the event of a financial institution’s failure, the DIC would be able to provide depositors with a cash payment, outside of court procedures, of an amount equivalent to their estimated return in bankruptcy. A similar bill was enacted to strengthen the deposit insurance system for agricultural credit cooperatives. Ostensibly to provide time for the public to assess the financial health of particular depository institutions, however, the government guaranteed all deposits (including those above the statutory payoff cost limit of ¥10 million ($100,000)) for five years. As the guarantee was about to expire in 2001, the financial system had still not recovered, so the blanket guarantee was extended, and a phased withdrawal over a period of several years was instituted.

In addition to deposit insurance reforms, the politics surrounding the government’s handling of the \textit{jusen} crisis rekindled long-simmering debates on two institutional reforms: Removing financial inspection and supervisory responsibilities from MOF and increasing the independence of the Bank of Japan. Reform in both areas was accomplished in 1997.

In December of 1996, the LDP and its non-cabinet allies approved a plan that transferred financial inspection and supervisory authority from MOF to the Financial Supervisory Agency (FSA), a body established under the Prime Minister’s (p.99) office. This agency has supervisory authority over all financial institutions. The former Banking and Securities Bureaus of MOF were consolidated into a single unit of the Finance Bureau. Management of crises in
the financial sector is shared by MOF and the FSA. Thus, Japan’s current supervisory structure is a direct outgrowth of the jusen problem.

Simultaneously, the jusen matter lent momentum to a movement to reduce MOF’s influence over the Bank of Japan. Critics had maintained for some time that the Bank of Japan enjoyed less independence than the central banks of the United States and western European countries, and that MOF’s influence over the Bank was behind the easy monetary policies that helped to create the bubble economy in the late 1980s.

The task of recommending specific legislation to revise the Bank of Japan Law was delegated to a subcommittee of the Financial System Research Council. The Council’s report concluded that many provisions of the then-current Bank of Japan Law were inconsistent with “today’s economy and finance given the progress of marketization and globalization.” The report noted that public interest in monetary policy had increased as a result of the bubble economy and subsequent nonperforming loan problems, and concluded that “[i]n these circumstances, for the Bank of Japan to gain credibility from the public and financial markets, it is indispensable to reform the entire policy making framework with emphasis on securing central bank independence and the transparency of policy making.” Legislation to implement the recommendations of the Council was enacted in 1997, and the Bank of Japan gained formal independence from MOF.

V. ANALYSIS AND CONCLUSIONS

The rise and fall of the jusen companies illustrates both the operation of the traditional (informal) norms of Japanese public–private ordering which we have described as a “regulatory cartel,“ as well as the beginning of a process in which these traditional norms began breaking down and being replaced by more explicit, transparent, and legally oriented rules of the game.

Several salient features of Japanese financial regulation were prominently represented in the jusen controversy. The jusen problem arose in part because of limited competition. Indeed, the jusen companies were created explicitly to serve a narrowly defined market share that was not being met by other financial institutions. The problems these institutions encountered were also partly due to constraints on market entry: The jusen companies were given dispensation to engage in real estate finance at a time when other financial firms were being administratively dissuaded from doing so; and agricultural cooperatives were allowed to lend to the jusen companies without restriction at a time when other financial institutions faced regulatory constraints on such lending. The entire negotiation process followed from the institutional design of Japanese finance discussed in Section I, and the interaction among interested groups was carefully calibrated to influence the relevant decisionmakers within MOF and MAFF. Convoy-style “survival of the weakest” regulation and avoidance
of failure were the hallmarks of each of the three jusen rescue or resolution plans. These plans displayed remarkable concern for the agricultural cooperatives, which themselves were cleverly manipulating the convoy system by claiming to be financially strapped, unsophisticated dupes of the commercial banking industry. The process displayed a high degree of informality, even at great cost to the participants, as evidenced by the fact that the founding institutions accepted a nonlegal jusen resolution process that cost them over a trillion yen ($10 billion) more than, in theory, they would have had to pay under formal bankruptcy procedures.\textsuperscript{78} MOF relied exclusively on nonlegal measures, such as pressuring bank executives to resign and securing nonbinding contributions to special loss-coverage funds, in response to the crisis. As critics of the process pointed out, legal procedures and rules played little role in the resolution of what was essentially a private insolvency matter. Yet, the influence of legal norms was not absent: When the negotiations turned unfavorable to the banks that had founded most of the jusen companies, their industry representatives repeatedly threatened to place the jusen companies in legal bankruptcy proceedings, and argued that the banks could not accept the traditional approach of founder liability because of the risk of shareholder derivative litigation. Despite pervasive resort to informal processes, the banks were bargaining in the shadow of the law.

It is also evident that those charged with resolving the jusen problem attempted to follow the traditional rules of the game as outlined in Section I. The bargaining process, for example, followed well-established norms. By 1991, when the jusen problem first surfaced, it was too late for the individual jusen companies to resolve their problems alone. They, therefore, turned to MOF, which provided brokerage and facilitation services to devise five-year recovery plans for each institution. As losses continued to mount, it became evident that major lenders, including the agricultural cooperatives, might be asked to incur losses as part of a rescue effort, and a second restructuring was attempted. Here, the conflict increasingly spilled across industry and jurisdictional boundaries, as the agricultural cooperatives (under the principal jurisdiction of MAFF) sought to distance themselves from the founding institutions (all of which fell under the jurisdiction of MOF) and to emphasize their supposedly more limited role as unsophisticated investors in the jusen companies. These spillover effects triggered the bargaining norm of negotiated inter-jurisdictional resolution. Because two industries—banking and agriculture—were involved, MOF entered into discussions with MAFF in which the ministries acted as representatives of their respective industries. When even this proved inadequate, the fourth norm of channeled political intervention came into play. The ruling coalition formed a project team to monitor the negotiations, the LDP organized a Jusen Problem Study Group to press for a solution, and zoku legislators lobbied on behalf of banks or agricultural interests. There is speculation that even the Prime Minister eventually entered the picture as
negotiations reached an eleventh-hour phase. As the matter approached a crisis, negotiations were underway in one form or another at all levels of the bargaining hierarchy. In the end, a resolution plan developed through administratively brokered negotiations among private parties was jointly endorsed by MOF, MAFF, and the ruling coalition—the expected outcome of a bargaining process involving a complex, wide-ranging problem.

The resolution generated by this process was, in general, consistent with the substantive norms we identified in Section I. Above all, the principle of survival of the weakest was maintained. The agriculture cooperatives were extremely nimble at casting themselves in the role of the weakest party. Consistent with this norm, the cooperatives used their alleged weakness to give credibility to a threat of defection: They threatened to withdraw their money from the 
jusen
 companies, and thus plunge these institutions to a chaotic insolvency that would cast a cloud on the entire Japanese financial system. The no-exit policy was maintained, to a degree, although the 
jusen
 companies had to be sacrificed. There was simply no way that these institutions could have been rescued, given the enormous losses on their balance sheets. But the agricultural cooperatives were saved at the expense of the banks and the Japanese taxpayers, even though many argued that the cooperatives should have been required to bear their pro rata share of the losses, regardless of the financial impact. Taxpayer funds were allocated to cover first-stage losses, and much more may be required to cover second-stage losses. The government also explicitly committed to ensure all bank deposits for a period of five years, and the Bank of Japan reduced interest rates to virtually unheard of levels, in part in an attempt to prop up the nation's sagging banking industry. Thus, responsibility and equitable subordination—norms applicable even to the government—were a hallmark of the resolution plan.

In an extreme disaster such as the 
jusen
 debacle, the responsibility and equitable subordination norm can conflict with the principle of survival of the weakest: MOF, in pushing the major banks to accept full founder liability to rescue troubled institutions, might have unduly weakened the pillars of the Japanese financial system. Indeed, this was the major concern underlying the Japan Premium imposed on Japanese banks by the international financial community. By allocating losses among the three principal groups of lenders to the 
jusen
 companies roughly according to financial strength, the regulatory cartel arrived at a solution that enabled all players—other than the 
jusen
 companies themselves—to survive.

Although the 
jusen
 resolution plan, thus fit quite well within the framework of traditional Japanese public–private decisionmaking, severe strains in the system were evident. Every bit of effort the regulatory cartel could muster was needed to achieve a rough form of consensus on the 
jusen
 resolution plan. The enormity of the losses simply precluded a cooperative ex ante agreement. While the
agricultural cooperatives were satisfied to proceed under the traditional substantive norms of Japanese finance, the major banks balked at the obligation to shoulder the enormous losses dictated by adherence to those norms. As noted above, the founding institutions used the threat of legal process against the other players repeatedly as a sword to gain bargaining advantages in the negotiations, and the specter of shareholder derivative litigation as a shield to deflect pressure to accept full founder liability. While the banks may not have intended to carry out their threats, the very fact that they were made suggests that resort to formal legal resolution proceedings was a credible solution to the jusen problem. Enormous cracks in the foundation of governance by consensus were revealed in the bargaining process.

Equally significant is the public outrage over the underlying causes and resolution of the jusen problem. This outrage, fueled by an increasingly critical media, was directed toward the nonlegal, non-transparent “back room deals” and favoritism towards politically powerful groups that characterized both the operation and demise of the jusen companies. Japan observers may be hard pressed to recall a comparable display of public disenchantment with the modus operandi of political, bureaucratic, and business leaders.

As a result, the jusen issue provoked serious reconsideration of the traditional norms by thoughtful Japanese, both within and outside of the government. Indeed, the jusen problem is illustrative of the process of transition currently underway in Japan. Traditional substantive norms were applied in modified form, and a partial foundation was laid to reorient Japanese financial regulation toward greater transparency and procedural integrity. To be sure, these changes, like subsequent developments, have been incremental, gradual, and painful. In fact, it is interesting to note that the MOF and Bank of Japan reforms implemented in the wake of the jusen problem were carried out according to the traditional preclearance style of lawmaking, in which committees of experts were selected to reach consensus on the legislation, and no revisions were made to the bills by the Diet. Japan's financial problems may not presage a "comforting convergence with an American economic model," but the jusen episode does indicate the willingness of international financial markets to punish players who adhere to the traditional norms of Japanese financial regulation over more widely accepted and accessible standards of regulation. In this sense, Japanese finance is slowly converging with more internationally recognized rules of the game. “Big Bang” reforms subsequent to the resolution of the jusen problem have moved Japanese finance further away from the regulatory cartel model. For example, market segmentation eroded, leading in 2001 to the complete elimination of restrictions that separated the banking, securities, and insurance industries. Corporate fund raising options were expanded with the introduction of new bond products, new stock exchange listing and initial public offering standards, and the promotion of asset-backed securities. Disclosure and enforcement were improved through a variety of measures. Deregulation of this
sort hastens the breakdown of the old system by reducing the incentive for banks and other regulated firms to negotiate on a continuous basis with MOF, and eliminating many of the benefits of abiding by the regulatory cartel.

The regulatory cartel did have the appearance of working well in the era of high economic growth and stable expectations. In those times, the primary role (p. 103) of the cartel was to divide up an expanding pie. Persons outside the cartel may not have received their share of the increase, but because their lot was also improving public anger remained muted. Groups within the cartel found it relatively easy to bargain over the spoils when the pie was increasing. It was possible to give in a little to a competing interest when all groups were profiting handsomely in any event. Moreover, given the repeat nature of dealings within the cartel, a group whose interests were slighted somewhat in one round could rest assured that there would be other occasions in which it would come out ahead.

Many groups benefited from the governance-by-consensus model epitomized by the regulatory cartel in Japanese finance. This mode of decisionmaking and dispute resolution helps to account for the growth—for a time, at least—of remarkably powerful financial institutions in Japan, and the appearance (if diminishing reality) of an extremely stable financial system guided by an able bureaucracy. At the same time, governance by consensus was efficient in a period of rapid economic growth; and it freed Japanese financial and corporate actors from the concern that heavy reliance on formal legal rules and procedures might hinder economic growth and beneficial modes of industrial organization.

In times of low economic growth, however, the traditional Japanese methods of governance do not operate well. Those outside the framework for consensus-building become disenchanted by the privileges enjoyed by those with influence. And even those who enjoy a seat at the bargaining table find themselves hard pressed to reach agreement on the allocation of a stable or shrinking, rather than an expanding, pie. These problems were evident in the jusen controversy and succeeding rounds of financial crisis, where the actors had to divide up “bads” such as economic losses and political opprobrium. Although the process did result in a resolution of the jusen problem, the extreme difficulties faced along the way were the first signs that continued operation of the regulatory cartel was untenable.

Regrettably, however, public anger over the jusen debacle caused Japanese policymakers to become even more timid in their response to the country’s mounting nonperforming loan problems. Thus, some of the regulatory forbearance that has stalled resolution of Japan’s financial problems to this day can be traced to backlash from the episode recounted in this chapter.
As of this writing, it is still not possible to say that market-oriented financial oversight and norms have fully replaced the regulatory cartel, although recent episodes of bank failure have been handled in a manner that differs markedly from the *jusen* resolution. Ultimately, the *jusen* problem and its aftermath will be seen as the beginning of the end of the regulatory cartel—the watershed moment in the complete transformation of Japanese finance—whenever that day finally arrives.

Notes:
(1.) See, for example, Takeo Hoshi and Anil K. Kashyap, Corporate Financing and Governance in Japan (2001).
(3.) The term “regulatory cartel” was coined in Curtis J. Milhaupt and Geoffrey P. Miller, Cooperation, Conflict and Convergence in Japanese Finance: Evidence from the “Jusen” Problem, 29 L. & Poly. Int. Bus. 1 (1997), on which this chapter is based.
(8.) An exception exists where a weak firm is merged into a stronger firm.
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(12.) Kashi kingyō no kiseitō ni kansuru hōritsu [Lending Business Law], Law No. 32 of 1983, Appendix, art. 9.

(13.) Kashi kingyō no kiseitō ni kansuru hōritsu shikōrei [Lending Business Law Enforcement Order], Order No. 181 of 1983, art. 1(4) (giving MOF authority to “investigate” the business and finances of all registered firms engaged in the lending business).

(14.) Jusen Data, *supra* note 11, at 159.

(15.) Id.

(16.) See id.

(17.) Jūsen mondai “kisō kōza” [“Basic Course” on the Jusen Problem], Kin'yū bijinesu, April 1996, at 30, 32.

(18.) Jusen Data, *supra* note 11, at 5.

(19.) Id.

(20.) Id.

(21.) Id., at 40.

(22.) Id.

(23.) Compare the similarly disproportionate political power of American farmers, who share similar characteristics. See, for example, Geoffrey P. Miller, Public Choice at the Dawn of the Special Interest State: The Story of Butter and Margarine, 77 Calif. L. Rev. 83 (1989).


(25.) Id.
(26.) MAFF took the position that the *jusen* companies were fundamentally home mortgage lenders and therefore loans to the *jusen* companies did not constitute real estate loans of the type covered by the administrative guidance. This interpretation, of course, fails to acknowledge that by 1990, a large percentage of *jusen* loans were being made to real estate companies, not individual home buyers.


(28.) *Jusen* Data, *supra* note 11, at 50.

(29.) See id., at 51.

(30.) Reprinted in id., at 14.

(31.) See “Ganpon hosho” no kaishaku tairitsu [Conflicting Interpretations of “Guarantee of Principal”], Nihon keizai shimbun, Feb. 16, 1996, at 1 (reporting Diet testimony of former MAFF official asserting that the memorandum was a guarantee of agricultural cooperatives' principal, and testimony of former MOF official asserting that it did not constitute a guarantee).

(32.) Jūsen furyō saiken, ’91 nen ni 67% [*Jusen* Bad Loans: 67% in ’91], Nihon keizai shimbun, Feb. 6, 1996, at 1.

(33.) *Jusen* Data, *supra* note 11, at 41. Of the total, ¥8.74 trillion in loans had been made to corporate borrowers and ¥1.98 trillion in loans had been made to individuals.


(35.) Id. at 3.

(36.) Id. at 8.

(37.) Jūusen shori de ōkurashō ni bōtaikō e no shidō wo yōsei [(Agricultural Affiliates) Request that MOF Give Guidance to the Founding Institutions in the *Jusen* Workout], Nihon keizai shimbun, Nov. 18, 1995, at 4.

(38.) See Jūsen mondai wa misshistu gōysei yame hōteki shōri wo [Stop the Secret Room Regulation, Resolve the *Jusen* Problem Legally], Nihon keizai shimbun, Nov. 21, 1995 (criticizing the handling of the *jusen* problem as symbolic of Japan's non-transparent methods of financial regulation).


(40.) See id.
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(41.) Under MOF’s plan, losses on nonperforming loans would be divided into two stages: “First-stage losses” would be realized immediately when the performing assets of the jusen companies were separated from the nonperforming assets and transferred to a newly created vehicle established for the purpose of assuming and collecting the loans. The financial institutions involved would cover all of the first-stage losses. Losses that arose from the subsequent efforts to dispose of the assets transferred to the jusen resolution vehicle (“secondary losses”) would be covered in part by the lending institutions, and partly from public funds.

(42.) Cited in Jusen mondai no shōri ni tsuite [On the Resolution of the Jusen Problem], reprinted in Jusen Data, supra note 11, at 15.

(43.) Id. There is no question that the founding institutions were the strongest group financially.


(45.) “Shusei bōtai” kyōryoku wo bōtaikō shunō ni ōkurasho yōsei [MOF Requests the Heads of Founding Banks to Cooperate in “Modified Founder” (Liability)], Nihon keizai shimbun, Dec. 1, 1995, at 1.


(47.) Okura, nōsuishō de saishū chōsei [MOF and MAFF Enter into Final Adjustment], Nihon keizai shimbun, Dec. 2, 1995, at 3.


(49.) Kashutsu zandaka kosu futan mitomezu [(Founding Institutions) will not Accept a Share of Losses in Excess of the Loan Amount], Nihon keizai shimbun, Dec. 6, 1995, at 7.

(50.) Hōteki seiri ni shinchō shisei [Cautious Stance on a Legal Solution], Nihon keizai shimbun, Dec. 14, 1995, at 3.


(52.) Id. (concluding that the agricultural affiliates originally planned to cover ¥1 trillion of losses, but that a high-level political decision was made to reduce the burden to ¥530 billion at some point between Dec. 4th and 14th).
(53.) On the Resolution of the *Jusen* Problem, *supra* note 41.

(54.) Id. (emphasis added).

(55.) Id.


(58.) Id. at 45.

(59.) Id. at 46.

(60.) Id.

(61.) See, for example, Rūru itsudatsushita jūsen no seiji ketchaku [A Political *Jusen* Decision Lacking in Rules], Nihon keizai shimbun, Dec. 20, 1995, at 2.


(63.) Jūsen saishū shorian no yōshi [Main Points of the Final *Jusen* Resolution Plan], Nihon keizai shimbun, Jan. 23, 1996, at 5.

(64.) Kamiawanu jūsen rongi [Frictionless *Jusen* Debate], Nihon keizai shimbun, Jan. 31, 1996, at 3.

(65.) ¥530 billion is roughly the amount of interest to be forgiven over the seven years that had remained on the agricultural cooperatives' restructured loans to the *jusen* companies, discounted to present value.


(67.) Tokutei jūsen kin'yū kikan senmon gaisha no saimu saiken no shori no sokushintō ni kansuru tokubetsu sochihō [Special Measures Law to Promote the Resolution of the Assets and Liabilities of the *Jusen* Companies], Law No. 93 of 1996. A related bill suspends prescription on loans made by *jusen* companies. Tokutei jūsen kin'yū kikan senmon gaisha ga yūsuru saiken no jikō no teishito ni kansuru tokubetsu sochihō [Special Measures Law to Suspend the Prescription of Loans Held by *Jusen* Companies], Law No. 98 of 1996.

(69.) Id.


(71.) Kin’yū kikantō no keiei no kenzensei kakuhō no tame no kankei hōritsu no seibi ni kansuru hōritsu [Bill to Implement Measures for Ensuring the Sound Management of Financial Institutions], Law No. 94 of 1996.

(72.) See Federal Deposit Insurance Corporation Improvements Act §131 (codified at 12 U.S.C. § 1831o(a)(2)).

(73.) Kin'yū kikan no kōsei tetsuzuki no tokureitō ni kansuru hōritsu [Bill to Implement Special Procedures for Reorganizing Financial Institutions], Law No. 95 of 1996. The bill also amends the Corporate Reorganization Law so that it can be applied to the resolution of failed cooperative-type financial institutions, and empowers the DIC to act as the agent of depositors whose rights will be represented and exercised by the DIC in court procedures.

(74.) Yokin hokenhō no ichibu wo kaisei suru horitsu [Bill to Amend the Deposit Insurance Law], Law No. 96 of 1996. For an analysis of Japan’s deposit insurance system, see Curtis J. Milhaupt, Japan’s Experience with Deposit Insurance and Failing Banks: Implications for Financial Regulatory Design?, 17 Monetary & Econ. Stud. 21 (1999).


(76.) Id.

(77.) See Nihon ginkō hō [Bank of Japan Law], Law. No. 67 of 1942, as amended.

(78.) See supra Table 4.1. Accepting the informal resolution plan over formal bankruptcy proceedings cost the founding institutions approximately ¥1.4 trillion ($14 billion), less the legal costs of the proceedings.

(79.) The reduction in the agricultural cooperatives' share of the losses from ¥3.2 trillion ($32 billion) under a pro rata formula (theoretically possible though not formally considered) to ¥530 billion ($5.3 billion) under the resolution plan adopted caused a corresponding increase in the losses sustained by the founding institutions, other lenders, and the Japanese taxpayers, and necessitated deferring ¥1.24 trillion ($12.4 billion) of losses to the second stage, where once again taxpayers and non-agricultural lenders will bear most of the burden.
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(81.) For a thorough analysis of the Big Bang and its impact, see Hoshi and Kashyap, supra note 1, at 289–98.