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### Analysis of the financial system of Japan

*Abstract:* Japan is a unitary state with a constitutional monarchy. The emperor is a symbol of the state, but his activities are performed in coordination with the parliament. Japan is a unitary state that consists of 47 prefectures. Many researchers also highlight the democratic and national features of the Land of the Rising Sun. At the present time, Japan is a highly developed country of technological progress and innovation. Japan's rapid growth after World War II is due not only to its technical innovations, but also to the complex interaction of technology and technology, economic, and socio-political factors. The majority of public investments were directed to the development of industrial infrastructure, and only a small part of them was directed to the social sphere. New construction and modernisation of production capacity contributed to GDP growth. The relevance and problematics of the study is due to the emerging controversial issues in legal science. The study subject was the norms governing the relations developing in financial activity, as well as the theoretical developments of scientists on this issue. The study object was legal relations arising in financial activity in Japan and in international financial relations with the participation of the named country. The study's purpose was to identify the main components of the Japanese financial system, the relationship between them, and the legal regulation of financial activity in this country. The methodological basis is the dialectical method, as a general scientific method of cognition, and separate private scientific methods: logical, formal-legal, comparative-legal, and historical-legal. This study contains the main theoretical provisions, reasoned on the basis of Japanese legislation and scientific literature, arguments, and conclusions that can be applied in practice. The author concludes that the financial crises of 1998 and 2008 forced the Japanese government to switch to strict regulation of the country's financial system. In Japan, the concept of an integrated approach to the regulation of the financial system was retained. In 2014, a special mechanism for managing financial crises was created in Japan. The peculiarity of Japan's financial model is the relationship between public financing and significant private capital in the implementation of national programs. Interaction and interpenetration of state and corporate financial planning contribute to coordinated economic development and ensuring the stability of the economic system.

*Keywords:* Japan, Japan's financial system, international financial relations, financial regulators, financial crises.



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## Анализ финансовой системы Японии

*Аннотация:* Япония является унитарным государством с конституционной монархией. Император – символ государства, но его деятельность осуществляется по согласованию с парламентом. Япония представляет собой унитарное государство, которое состоит из 47 префектур. Многие исследователи выделяют ещё демократические и национальные особенности Страны восходящего солнца. В нынешнее время Япония – высокоразвитая страна технологического прогресса и инноваций. Стремительный рост Японии после Второй Мировой войны обусловлен не просто ее техническими инновациями, но и сложным взаимодействием техники и технологий, экономическими и социально-политическими факторами. Преимущественная часть государственных инвестиций направлялась на развитие промышленной инфраструктуры и лишь незначительная их часть – в социальную сферу. Новое строительство и модернизация производственного потенциала способствовало росту ВВП. Актуальность и проблематика исследования обусловлена возникающими спорными вопросами в юридической науке. Предметом исследования были нормы, регулирующие отношения, складывающиеся в сфере осуществления финансовой деятельности, а также теоретические разработки ученых по данной проблематике. Объектом исследования были правоотношения, возникающие в сфере осуществления финансовой деятельности на территории Японии и в международных финансовых отношениях с участием названной страны. Целью исследования было определение основных компонентов финансовой системы Японии, взаимоотношения между ними, правовое регулирование финансовой деятельности в данной стране. Методологической основой являются диалектический метод, как общенаучный метод познания, и отдельные частно-научные методы: логический, формально-юридический, сравнительно-правовой, историко-правовой. Данная работа содержит основные теоретические положения, аргументированные на основе законодательства Японии и научной литературы рассуждения и выводы, которые можно применить в практической деятельности. Автор приходит к заключению, что финансовые кризисы 1998 г. и 2008 г. заставили правительство Японии перейти к жесткому регулированию финансовой системы страны. В Японии была сохранена концепция комплексного подхода к регулированию финансовой системы. В 2014 г. в Японии был создан специальный механизм по управлению финансовыми кризисами. Особенностью финансовой модели Японии является взаимосвязь государственного финансирования и значительного частного капитала в реализации общегосударственных программ. Взаимодействие и взаимопроникновение государственного и корпоративного финансового планирования способствуют согласованному экономическому развитию и обеспечению стабильности экономической системы.

*Ключевые слова:* Япония, финансовая система Японии, международные финансовые отношения, регуляторы финансовой деятельности, финансовые кризисы.



### Introduction

Japan is a unitary state with a constitutional monarchy. The emperor is a symbol of the state, but his activities are performed in coordination with the parliament. Japan is a unitary state that consists of 47 prefectures. Many researchers also highlight the democratic and national features of the Land of the Rising Sun (*Balashov & Belova, 2019*).

At the present time, Japan is a highly developed country of technological progress and innovation. Japan's rapid growth after World War II is due not only to its technical innovations, but also to the complex interaction of technology and technology, economic, and socio-political

factors. The majority of public investments were directed to the development of industrial infrastructure, and only a small part of them was directed to the social sphere. New construction and modernisation of production capacity contributed to GDP growth.

The relevance and problematics of the study is due to the emerging controversial issues in legal science.

The study subject was the norms governing the relations developing in financial activity, as well as the theoretical developments of scientists on this issue.

The study object was legal relations arising in financial activity in Japan and in international financial relations with the participation of the named country.

The study's purpose was to identify the main components of the Japanese financial system, the relationship between them, and the legal regulation of financial activity in this country.

Based on the study purpose, the following tasks were developed:

- determine the path of formation of the modern Japanese financial system based on the study of literature;
- determine the structure of the financial system of Japan, as well as the mechanism for regulating financial crises in the country using the analysis of special economic and legal literature and the provisions of legislative and by-laws.

The methodological basis is the dialectical method, as a general scientific method of cognition, and separate private scientific methods: logical, formal-legal, comparative-legal, and historical-legal.

This work contains the main theoretical provisions, reasoned on the basis of Japanese legislation and scientific literature, arguments and conclusions that can be applied in practice.

### **Formation of the modern financial system of Japan**

Before World War II, the Japanese economy was dominated by large family conglomerates called Zaibatsu. Zaibatsu, meaning “money clan” or conglomerate. It was used from the 19th to the first half of the 20<sup>th</sup> century to name large families controlling banking and industrial associations (cartels, syndicates). The four main zaibatsu began their history back in the Edo period. These are Mitsubishi, Mitsui, Sumitomo, and Yasuda. The controls remained in the family holding company, and the financing was performed internally. During the American occupation, attempts were made to reform Zaibatsu. However, civic support and the need for rapid reindustrialisation of the war-torn country left most of these companies untouched, although control passed from families to shareholders. Today, companies like Mitsubishi and Sumitomo can trace their history.

The Japanese yen was created according to the New Currency Act of 1871, and in 1882 the Bank of Japan was formed to centralise the issue of currency. The Bank of Japan initially acted as the government, implementing economic policy, controlling the pace of economic growth through quotas for the growth of lending to commercial banks.

It is generally accepted in science that the financial and banking system of Japan has gone through several major stages in its development in less than a hundred years: from 1882 to the present (*Drysdale & Gower, 1999, p. 32*). In total, four such stages can be distinguished, each of which is unique in its own way and important for understanding the current situation in the legal regulation of banking in the country (*Karpov, 2017*).

The first stage from the second half of the 19<sup>th</sup> century to 1930 became a turning point for the future fate of Japan and its banking law. So, only in 1858, Japan was forced to open its ports to foreign countries by signing trade agreements with Russia, the United States and other countries. Emperor Mutsuhito (Mei ji), who took the throne in 1867, paid special attention to bringing the country out of isolation and joining the Western legal system.

In 1882, on the basis of the law on the Bank of Japan, which entered into force on October 10 of the same year, the central bank of this country was established. This decision was necessary for the Japanese authorities, since further industrialisation and economic development are impossible without the available money that went to support entrepreneurs.

At the second stage of the formation of the financial system (from 1930 to 1945), financial resources are being mobilised to support wars.

The third, so-called post-war stage (from 1945 to 1997), began with the surrender of the Japanese Empire on September 2, 1945. This period in the history of Japan was accompanied by reindustrialisation and lending to enterprises, a new round in the development of the economy, liberal reforms of the 1970s, the integration of the national banking system into the world banking system.

The fourth stage (from 1997 to the present century) characterises the development of the Japanese banking system in the modern historical period of time. The beginning of this stage can be counted from 1997, when a new law on the Bank of Japan was adopted, which proclaimed two new principles of the central bank: independence from the Ministry of Finance and transparency of the Bank of Japan.

*Thus*, the formation of the financial system of Japan took place through the reform of the banking system, the definition of the competence of the central bank of this country, the reorganization of enterprises, various actions in finance (mobilisation of financial resources, lending to enterprises, integration into the world banking system, etc.).

## **Structure of Japan's financial system**

### ***1. Competence of financial activity regulators***

Before revealing who are the regulators of financial activities in Japan and their competence, it is worth mentioning the regulatory framework of financial activities and the financial system.

The main source is the Constitution of Japan. There are more than thirty tax laws in force in Japan, as the country itself is interested in creating the most elaborate system of tax legislation (*Karpov, 2019, pp. 2-7*). The modern legal regulation of Japan's financial system began with the adoption of the New Currency Act of 1871, and the Bank of Japan was formed to centralise the issue of currency in 1882 (*Ermakova, 2018*). In 1948 In Japan, the Law No. 25 (*On Securities and Stock Exchanges, 1948*) was adopted, which was based on the US securities legislation. In the following decades, numerous amendments were made to this law, and in 2006 the law was adopted under a new name – the Law *On Financial Instruments and Stock Exchanges* (*Rusakova, 2017*). The main source of banking regulation is the Banking Law No. 59 of 1981, as amended in 2006 (*On Banks, 1981*). The Law on Banks also regulates the activities of holding companies whose subsidiaries include banks. Investment banking (as opposed to commercial banking) is regulated by Law No. 25 of 1948 (*On Investment Banking, 1948*).

Among other laws it should note:

- Law on Insurance Activities No. 105 dated June 7, 1995 (*On Insurance Activities, 1995*);
- Law on Deposit Insurance No. 34 dated 1971 (*On Deposit Insurance, 1971*);
- Law on Electronic Registration of Monetary Claims No. 102 dated 2007 (*On Electronic Registration..., 2007*);
- Law on Certified Public Accountants No. 99 dated 2007 (*On Certified Public Accountants, 2007*).

After the global financial crisis of 2008 and the catastrophic scale of regulatory violations, governments began to pay great attention to various concepts of regulation of financial systems. Of the four currently existing concepts of financial regulation, Japan has a concept of an integrated approach. The Japanese financial regulatory structure is headed by the Financial Services Agency, while the Ministry of Finance and the Bank of Japan continue to play an important role. The Japan Deposit Insurance Corporation is responsible for implementing practical measures such as reimbursement of insured deposits and financial assistance for the reorganization of insolvent banks.

It is necessary to consider the role of each financial regulator separately. The Ministry of Finance is responsible for managing the government's budget and maintaining confidence in the Japanese currency and the stability of foreign exchange markets. The Ministry's supervisory role is limited as a result of the creation of the Financial Services Agency, although the Ministry retains its role within the Crisis Management Council. In addition, the Ministry of Finance is responsible for the budgets of all state bodies of the country, including the previously named agency.

The Financial Services Agency is a Japanese government agency responsible for overseeing banking, insurance, securities and exchanges (*Frolova, 2018*). The agency's role is to ensure the stability of Japan's financial system; to protect depositors, insurance policy holders and securities investors; and to inspect and oversee the transparency of the financial system. It was established in July 2000 under the jurisdiction of the *Financial Reconstruction Commission* by reorganising the *Financial Supervision Agency*. After the reorganisation of the ministries of the central Government of Japan, the Agency became an organ of the Cabinet of Ministers. The functions of the Agency include:

- planning and policy development for the Japan's financial system;
- supervision of private sector financial institutions;
- development of trading rules in the markets;
- development of accounting standards;
- supervision of certified auditors and audit firms;
- supervision of compliance with the rules in the financial markets.

Part of the Agency's powers has been delegated to the *Securities and Exchange Commission* in relation to on-site and off-site monitoring of investment banking and other securities transactions. She is authorized to conduct inspections, but not to take administrative measures. Fines are imposed by the Agency based on the recommendations of the Commission. The Commission is governed by a chairman and two commissioners who are appointed by the Prime Minister of Japan for a three-year term.



The Bank of Japan is a legal entity established according to the Bank of Japan Act of 1882. The organisational principles of the Bank of Japan represent a set of fundamental values that it must adhere to as the central bank of Japan (*Gorchakova, 2020*). The main task of the bank is to contribute to maintaining the stability of the financial system by:

- issuance of banknotes and implementation of currency and monetary control;
- ensuring uninterrupted settlements between banks and other financial institutions.

He controls the money supply mainly by controlling the discount rate. The government owns 55% of the bank's shares, the remaining 45% belong to private investors. However, supervision of banks is seen as the role and responsibility of the country's government. The Bank of Japan is not a government agent and has no right to control the activities of banks. However, as a lender of last resort, it can support banks in the event of their insolvency. At the same time, the Bank of Japan may enter into agreements with banks to audit banks.

The *Deposit Insurance Corporation of Japan* is a quasi-governmental organization established according to the Deposit Insurance Act of 1971, as amended in 2014, in order to control the deposit insurance system in Japan (*Deposit Insurance Act, 1971*). If the bank becomes insolvent, the main role of the Corporation is to protect the rights of depositors and the entire financial system of the country. Its governing council consists of a chairman, four deputies, an auditor and eight members. The heads and members of the Corporation's Board are appointed by the Prime Minister of Japan. It may provide for the payment of insurance claims on bank deposits for the principal amount of ten million yen per depositor.

Thus, in Japan there are four regulators of financial activity, among which two are state authorities of Japan, and the other two are quasi-governmental structures that are formed by specific legislative acts.

## ***2. Elements of Japan's financial system***

The main components of the Japanese financial system are financial institutions (banks and non-bank financial institutions) and the financial market. Today, Japan's banking system is dominated by Mitsubishi UFJ Financial Group, Mizuho Bank and Sumitomo Mitsui Financial Group; these three banks can trace their roots to Zaibatsu (*The Japanese Finance System, 2012*). There are 12 city commercial banks operating in Japan, which accumulate the savings of the population and use them to provide medium-term financing for business, industry and agriculture. City banks are not allowed to manage trusts or pension funds. Most of the other city banks were created according to the Zaibatsu concept, e.g., the banks Mitsui Bank (1876), Fuji Bank (1880), Mitsubishi Bank (1880) and Sumitomo Bank (1895). There are also 63 regional local banks in Japan. About two-thirds of the lending of these banks is performed in the prefecture in which they are located.

The first Industrial Bank of Japan was established by the Meiji government in 1902 to provide long-term financing for heavy industry. After the Second World War, this bank became private. At that time, two more industrial banks were created – the Bank of Long-term Loans of Japan and the Nippon Credit Bank. There are also seven trust banks in the country, which are allowed to manage trusts, pension funds, etc. Trust banks receive about half of their funds by selling trust certificates for a period of two to five years. The rest is income from trust management. The largest trust banks are Mitsubishi Trust & Banking and Sumitomo Trust &

Banking. A specific type of savings bank in Japan is the *Postal Savings Bureau*, which is serviced by the postal service through 23,000 post offices of the country. At the end of the 1980s, this bank had a deposit of more than 500 billion US dollars and was the largest savings institution in the world. The Japanese Postal Bank is in the process of privatisation. Norinchukin Bank is a bank owned by workers of farming and fishing cooperatives in Japan. It is a major supplier of funds for city banks.

The group of non-bank credit and financial institutions in Japan includes 71 savings and credit institutions: they are mainly designed to serve small retail, wholesale and construction firms. Insurance companies in Japan have the largest life insurance market in the world, because Japanese people buy significantly more insurance policies than residents of other countries. There are 41 insurance companies operating in the life insurance industry, of which 12 are foreign companies and four are branches of foreign companies. The total assets owned by 25 Japanese insurance companies (excluding reinsurance companies) amount to about 35 trillion yen. Six insurance companies, called the *Big Six*, control about 90% of all assets.

Japan's financial system also includes stock markets. The Tokyo Stock Exchange is the largest stock exchange in the world, handling over 80% of stocks in Japan. The Osaka Stock Exchange ranks third in the world, just behind the New York Stock Exchange. One of the most popular indices in the world is the Nikkei 225, compiled by the Japanese daily economic newspaper Nihon Keizai Shimbun. The Nikkei 225 index is one of the most important Asian indices. It is calculated based on the shares of the 225 largest companies by capitalisation of the Tokyo Stock Exchange. The Nikkei 225 index was first calculated in 1949.

Historically, securities companies in Japan operate primarily as dealers (including retail stock subscriptions and transactions). In the 1980s, the Big Four Japanese securities firms – Nomura, Daiwa, Nikko, and Yamaichi accounted for 80% of the operations of the Tokyo Stock Exchange. The market value of the assets of these firms was greater than that of most banks.

*Thus*, the structure of the Japanese financial system is represented by financial regulators, the banking system, non-bank financial institutions and stock markets. The banking system of Japan, in fact, reflects the administrative and territorial division of this country.

### **Financial crisis management**

In 2014, a special mechanism for managing financial crises was created in Japan. The Deposit Insurance Law No. 34 of 1971, as amended in 2014, authorises the Deposit Insurance Corporation to take measures to rescue financial institutions if the insolvency of a financial institution may cause systemic risks (*Deposit Insurance Act, 1971*). The Corporation is obliged to take these measures not only in case of international and national financial crises, but also in case of bankruptcy of regional banks. Amendments to the 1971 Law entered into force on March 6, 2014, and they introduced a regime for making orderly decisions in case of insolvency of financial institutions. The regime comes into effect if its introduction is considered necessary to prevent serious market shocks. These financial institutions are considered as de facto systemically significant financial institutions.

The *Financial Stability Board of Japan* has identified a group of 30 global systemically important banks to which amendments to the 1971 Law on the introduction of an “orderly decision-making regime” should apply. As of November 2016, these systemically significant banks include three

Japanese banks: Mitsubishi UFJ FG, Mizuho FG, and Sumitomo Mitsui FG. The Financial Services Agency is authorised to require these banks to submit their recovery plans at least once a year.

The mechanism of financial crisis management in Japan is truly a unique phenomenon focused on eliminating the risks of bankruptcy of systemically important financial institutions to avoid a systemic financial crisis.

### Conclusion

Currently, Japan is the country that still actively preserves its political traditions in decision-making (*Pashikhina & Tyurina, 2021*). For example, until the end of World War II, a number of ministries in the Cabinet of Ministers were subordinate to the emperor himself, and at the moment these ministries have some independence. In the process of forming the budget process during those years, the main role was played by the peculiarity in which power was constantly in the hands of one party. This phenomenon revealed the process of pressure of the deputy corps and, on the contrary, revealed the peculiarities of coordinating complex issues while maintaining parity between the opposition and the party that was in power.

The financial crises of 1998 and 2008 forced the Japanese government to switch to strict regulation of the country's financial system. In Japan, the concept of an integrated approach to the regulation of the financial system was retained. There are three main financial regulators in the country: the Financial Services Agency, the Ministry of Finance and the Bank of Japan. In 2014, a special mechanism for managing financial crises was created in Japan.

The peculiarity of Japan's financial model is the relationship between public financing and significant private capital in the implementation of national programs. Interaction and interpenetration of state and corporate financial planning contribute to coordinated economic development and ensuring the stability of the economic system.



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