Impediments in the Japanese Banking Industry

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7.1 Definition of Banking Service

The twelve items classified from 7ba to 7bl as found in the PECC Report, correspond directly to the section titled, "Banking and other Financial Services" (excluding insurance and insurance related services) in 5a of the Annex on Financial Services. These items are as follow:

1 Acceptance of deposits and other repayable funds from the public

2 Lending of all types

3 Financial leasing

4 All payment and money transfer services

5 Guarantees and commitments

6 Trading for own account or for customers' account on exchange over the counter

7 Participation in the issuance of all types of securities

8 Money brokering

9 Asset management

10 Settlement and clearing services for financial assets

11 Advisory and other auxiliary financial services

12 The providing, processing, and transfer of financial information

7.2 Evaluation

Through the one-on-one application of the Tom Warren (1995) method of evaluation, the exclusionary nature of Japan's banking industry in regards to foreign competitors can be concluded in Table 7-1.

Table 7-1 Evaluation of Trade Barrier

Classification		Evaluation	Market Access				National Treatment			
PECC	WTO		*1*	*2*	*3*	*4*	*1*	*2*	*3*	*4*
7ba	1	PECC	0.5	0.5	0.5	0.5	1.0	1.0	0.5	0.5
		WTO	0.5	0.5	0.5	0.5	1.0	1.0	0.5	0.5
		Actual	0.5	0.5	0.5	0.5	1.0	1.0	0.5	0.5
7bb	2	PECC	0.5	0.5	0.5	0.5	1.0	1.0	0.5	0.5
		WTO	0.5	0.5	0.5	0.5	1.0	1.0	0.5	0.5
		Actual	1.0	1.0	1.0	0.5	1.0	1.0	0.5	0.5
7bc	3	PECC	0.5	0.5	0.5	0.5	1.0	1.0	0.5	0.5
		WTO	0.5	0.5	0.5	0.5	1.0	1.0	0.5	0.5
		Actual	1.0	1.0	1.0	0.5	1.0	1.0	0.5	0.5
7bd	4	PECC	0.5	0.5	0.5	0.5	1.0	1.0	0.5	0.5
		WTO	0.5	0.5	0.5	0.5	1.0	1.0	0.5	0.5
		Actual	0.5	0.5	0.5	0.5	1.0	1.0	0.5	0.5
7be	5	PECC	0.5	0.5	0.5	0.5	1.0	1.0	0.5	0.5
		WTO	0.5	0.5	0.5	0.5	1.0	1.0	0.5	0.5
		Actual	1.0	1.0	1.0	0.5	1.0	1.0	0.5	0.5
7bf	6	PECC	0.5	0.5	0.5	0.5	1.0	1.0	0.5	0.5
		WTO	0.5	0.5	0.5	0.5	1.0	1.0	0.5	0.5
		Actual	0.5	0.5	0.5	0.5	1.0	1.0	0.5	0.5
7bg	7	PECC	0.5	0.5	0.5	0.5	1.0	1.0	0.5	0.5
		WTO	0.5	0.5	0.5	0.5	1.0	1.0	0.5	0.5
		Actual	0.5	0.5	0.5	0.5	1.0	1.0	0.5	0.5
7bh	8	PECC	0.5	0.5	0.5	0.5	1.0	1.0	0.5	0.5
		WTO	0.5	0.5	0.5	0.5	1.0	1.0	0.5	0.5
		Actual	1.0	1.0	1.0	0.5	1.0	1.0	0.5	0.5
7bi	9	PECC	0.5	0.5	0.5	0.5	1.0	1.0	0.5	0.5
		WTO	0.5	0.5	0.5	0.5	1.0	1.0	0.5	0.5
		Actual	0.5	0.5	0.5	0.5	1.0	1.0	0.5	0.5
7bj	10	PECC	0.5	0.5	0.5	0.5	1.0	1.0	0.5	0.5
		WTO	0.5	0.5	0.5	0.5	1.0	1.0	0.5	0.5
		Actual	0.5	0.5	0.5	0.5	1.0	1.0	0.5	0.5
7bk	11	PECC	0.5	0.5	0.5	0.5	1.0	1.0	0.5	0.5
		WTO	0.5	0.5	0.5	0.5	1.0	1.0	0.5	0.5
		Actual	1.0	1.0	1.0	0.5	1.0	1.0	0.5	0.5
7bl	12	PECC	0.5	0.5	0.5	0.5	1.0	1.0	0.5	0.5

		WTO	0.5	0.5	0.5	0.5	1.0	1.0	0.5	0.5
		Actual	1.0	1.0	1.0	0.5	1.0	1.0	0.5	0.5

Mode	Form	Definition	WTO
1	Cross-border activities	through cross-border flows, in which neither the supplier nor the producer moves physically, relying instead upon an intermediate service	Article 1- 2(a) Specific Commitments 7B(1)
2	Consumption abroad	through the movement of a consumer to the supplier's economy	Article 1- 2(b) Specific Commitments 7B(2)
3	Commercial presence	through the movement of a commercial organization to the consumer's economy	Article 1- 2(c) Specific Commitments 7B(3)
4	Presence of natural person	through the movement of an individual supplier to the consumer's economy	Article 1- 2(d) Specific Commitments 7B(4)

Evaluation of Trade Restrictions in Reference to WTO Agreements

The most important trade restriction as cited in the WTO Agreement, is the restriction based on "maintaining financial order." On the basis of this clause, restrictions on the legal form of commercial presence, as well as regulations designed to restrict new entry into the financial service sector are justified. Other restrictions also apply. In the Specific Commitments for example, individual business forms are required for each and every type of financial services. Forms (1) to (4) correspond to Modes 1 to 4 in the attached table.

Looking at "national treatment" for instance, there is no restriction in regards to Mode (1) and (2), and thus, restriction is evaluated to be 1.0. Regarding Mode (3), since some restriction are applied to foreign suppliers, restriction is evaluated to be 0.5. The restriction regarding Mode (4) is identical between different industries; hence, the restriction is evaluated to be 0.5, the same value given to other industries.

Market access. Regulations for keeping financial order can be adopted for all banking services when necessary. Taking this fact into consideration, all banking services can be assumed to be partially restricted and be evaluated as 0.5. However, when examining the extent of restriction regarding individual modes, the evaluation differs. First, for Mode (1), only discretionary investment management services are the objects of restriction. For Mode (2), partial restriction is placed on a wide range of banking services thereby making the

evaluation to be 0.5. For Mode (3), the evaluation point for trust business which is explicitly restricted, is 0.5 but for all other services 1.0. Mode (4) is also evaluated to be 0.5 for the same reason as explained above. The evaluation for all services is 0.5. In general, when the score for PECC is compared with the WTO score, frequency is much better for WTO regulations than it is for PECC.

Evaluation of Actual Market Circumstances

When the "national treatment" clause is scrutinized, there is no evidence to suggest that the restrictions are applied in a manner which violates WTO agreements. Thus, the degree of restriction in actual market circumstances is evaluated to be at the same level as those in the WTO agreements. Next, when market access is studied, it is recognized that the restriction with regard to Mode (4) is appropriately evaluated to be 0.5 for all kinds of banking services.

Other business operations are evaluated as follow: 1.) since 7bl is not the object of restriction in actual business, the evaluation is 1.0. 2.) Non-residents cannot open their demand-deposit accounts and deposit-taking businesses are strictly regulated by authorities, under the directive of sustaining financial order. Therefore for 7ba, the evaluation is 0.5. 3.) Taking simply the business operation 7bb to be loan business, the evaluation point is 1.0, since there is no restriction on lending business. 4.) Letting the business operation 7bc to be unrestricted financial lease operations the evaluation becomes 1.0. 5.) Regarding 7bd, since remittances must be made through banks with official admissions and because regulation on banking and financial institutions are restrictive, the evaluation is 0.5, reflecting the partial restriction. 6.) For the same reason, the evaluation for 7bj is also 0.5.

7.) With regard to 7be (i.e. guarantee business), there is no special restriction. Therefore, the evaluation is 1.0. 8.) While there is no direct restriction on the businesses classified in 7bf, some services traded in the foreign exchange markets are subject to trading regulations. Hence, its evaluation is 0.5. 8.) Since all banks are allowed to issue their bank bonds to the non-financial public, the evaluation is 0.5. 9.) There is no direct restriction on brokering business in 7bh, and the evaluation is 1.0. 10.) Some services in category 7bi are offered in the form of trust business operations and are subjected to restriction under the

WTO agreements. Therefore, the evaluation is 0.5.

The extent to which services classified in 7bk and 7bl are legally restricted can not be evaluated here. It is concluded that there is no restriction on the provision of these services. The evaluation points for the two are 1.0.

Calculation of Frequency Measure

Applying the same formula as used by Tom Warren (1995), frequency is calculated in the following manner. Here for instance, the frequency value based on the evaluation of PECC is calculated by this formula: if 0.5 terms are not counted, frequency is given by 100 -{24 /(8 • 12)} • 100＝75. If 0.5 terms are counted, frequency is given by 100 -{(24+36 /(8 • 12)) • 100＝37.5.

Table 7-2 Frequency

	Frequency	
	if 0.5 terms are not counted	if 0.5 terms are counted
PECC	75	37.5
WTO	75	37.5
Actual Circumstances	56.25	28.125

7.3 Measuring the International Price-Gap in Banking Services

7.3.1 What are the services provided by the banking industry ?

1a. Definition of the Banking Industry

Like other industries, one can think of a bank as an organization that uses factors of production as inputs and produces financial services as outputs. Recognizing the production process of the banking industry in an economics framework, basic factors of production can be listed as such: 1.) funds raised through various methods (bank deposits), 2.) physical capital such as branch office buildings and computers, and 3.) labor as provided by bank employees. Its products include a wide range of financial services in the form of loans, deposits, and foreign exchanges.

For the sake of simplification, financial services can be divided into two types: the first type being those that accompany traditional bank "loan businesses." The second type, all other services including investment in securities as well as the so-called "fee businesses". The former group of services earns interest income by intermediating funds from the lenders to borrowers. This group of services is categorized in 7ba and 7bb under the CPC classification. The latter group of services have diversified in recent years under financial liberalization, and corresponds to the services covered in the categories from 7bc to 7bl under the CPC classification.

1b. Pricing Banking Services

The production activities of a bank can be summarized by the production function $F: R_3 \rightarrow R_2$. The total market value of financial services produced by a bank is measured by the current income, and the market value of financial services accompanying loan business is measured by the income from loans and deposits. Although the physical amount of financial services is not measurable, if the unit prices of these services are assumed to be constant, various "income" would correspond to the physical indices based on divisia indices. It is assumed that Y1 is measured by the interest income from loans and deposits and Y2 is measured by total non-interest income that is, current income minus interest income. In the production process, Q1, Q2 and Q3 are measured respectively by the total amount of raised funds: the total market value of physical capital such as buildings and equipment, and the number of workers.

$$(1) \qquad (Y_1, Y_2) = F(Q_1, Q_2, Q_3)$$

Letting P1, P2 and P3 represent the individual prices for each factor of production, total production cost C is given by equation (2), where P1Q1, P2Q2 and P3Q3 are expenses for raising funds, physical capital, and workers. These roughly correspond to total interest expense, equipment expense, and payroll expense respectively.

$$(2) \quad C = G(Y_1, Y_2, P_1, P_2, P_3) = P_1Q_1 + P_2Q_2 + P_3Q_3$$

Assuming perfect competition, the prices of individual banking services are identical to the marginal cost of producing these services. Therefore, differentiating equation (2) with respect to each individual service, the cost of producing these services can be calculated.

If the differences in the quality of banking services and market structure of banking sector between countries are ignored in order to measure the international price discrepancy of banking services, only a simple study comparing the difference in the marginal cost of producing banking services among different countries is necessary[1]. If the aforementioned conditions are satisfied, and as long as the cost function of banking industries differs between countries, such differences in cost function will corresponds to the differences in the efficiency of banking industries. If international trade barriers in the banking industry exist due to legal regulations, this type of technical inefficiency may be partly attributable to the trade barrier on international service trade.

7.3.2 Barriers on Service Trade and International Price Discrepancy

2a. Market Structure and International Price Gap

Assuming international price discrepancies in banking service are caused by trade barriers, possible cases may exist. First, consider one case where the Japanese banking sector is not competitive and enjoys excess profit due to the restrictive entry of foreign competitors into its banking sector. In other words, this is the case where the bank-lending market is oligopolistic and where banks enjoy a superior position over their borrowers. Negotiated conditions of lending will be favorable towards the banks, and the end result will be lending

[1] However, this computation of marginal costs is almost meaningless. This methodology is appropriate, only if (1) all countries' banking sectors are perfectly competitive (i.e. there is no excess profit), (2) production technology adopted in all banking industries are identical among different countries (i.e. the same management strategy is adopted in banking industry in all countries), and (3) there is no intimate relationship between the development of banking industry and other industries (the development of

rates higher than the rates charged in the competitive market. Under this circumstance, the interest rate gap between the competitive level and the actual level will lead to price discrepancy in the banking service market (here being lending service). Similarly, in the bank-deposit market, if banks can drive down the deposit interest rate by using their market controlling power, domestic price of providing bank deposits will become higher than foreign prices, as measured by the amount of excess profit gained by banks.

2b. Technical Efficiency and International Price Discrepancy

The second case. Despite the fact that the Japanese banking sector is competitive and individual banks face mutual competition, the price of producing banking services will be higher than abroad. This is due to the fact that production technology in the Japanese banking industry lags behind foreign banks. For instance, if the installation of ATMs is limited and domestic banking industry is labor intensive, the personnel expense of providing the teller service will be larger than in other countries. This would result in higher domestic price for banking services. Another example deals with inefficient use of human resource. Domestic banks employ too many workers and too many branch offices for their size of operation. The result: higher operation cost and expensive price for providing such services. In other words, inefficiency occurs in the business operations of banks on the side of the management as well as in the lack of technology. This production inefficiency pushes the domestic price above the foreign level price that provides the same kind of quality and service.

However, in the actual banking business, the story is not so simple. In order to discuss international price discrepancy in actual business operations, I will focus my arguments on two basic and main business operations by banks: the “deposit-taking” and “loan-extending” businesses.

7.3.3 International Price Discrepancy and Market Structure

3a. Problems to be noted

It has often been stated that Japanese banks exploit excess profit in the domestic

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financial system does not affect the development stage of whole economic system).

market through the use of the in-competitive market structure. In the case of Japanese banks, excess profit is a result of international price-gap in banking service. To examine this fact, supporting evidence of lack of competition in individual banking services must be found[2]. However, because of the reason below, international price differentials can not simply be argued as solely being caused by Japanese banks' excess profits.

First, in general for banking businesses, there is a tendency that the market penetration by foreign banks is far less than by domestic banks. This tendency is frequently observed for large-sized economies. For instance in the loan business, since foreign banks have more difficulty in collecting and analyzing local business information, local large-size corporations (such as companies listed in the stock market) are not usually the customers of foreign banks' lending businesses. It may be further said that no foreign bank relies solely on targeting their lending business in Japan on local small and medium-sized companies. Therefore, regardless of the question whether or not the banking sector is competitive, foreign banks are less capable than domestic banks in handing customers' information. Local market penetration by foreign banks is consequently limited.

Secondly, observing only the bank-lending market, the customer profile of banks varies widely and banks' bargaining power on lending interest rates differs between different groups of customers. Hence bargaining power of banks can only be judged on a case-by-case basis. It is difficult to say whether banks require their borrowers to pay excessively high interest rate by exploiting their superior position in the market.

If the borrowers are good-performing large corporations listed on the exchange, these corporations have the alternative to raise capital through stock or bond issuance in Japan or abroad. Therefore, competition exists in the lending market for these companies. On the other hand, if the customers are small and medium-sized companies without alternative means to tap funds, banks may have superior bargaining position in dictating the loan conditions. As financial liberalization has progressed in recent years, even Japanese city banks, which have previously

[2] There has been a lot of arguments discussing whether Japanese financial markets were constantly in in-equilibrium before financial liberalization started with intensity in the 1980s. However, since a series of financial liberalization measures have been in progress in Japanese financial markets since the 1980s, it is generally recognized that today's financial markets in Japan are competitive ones.

only focused on lending to large companies, now also eagerly extended loans to small and medium-sized companies. Under this new market condition, small and medium-sized companies are now able to choose the most competitive borrowing terms.

Thirdly, because the "main-bank" system in Japan fosters a long-term relation between banks and companies, banks are expected to share risks with the companies over a long period of time. The added responsibility for the banks being of course, to monitor the substance and business functions of the corporation. Once this unique bank-and- client nature is understood, the observation of interest rates being temporarily higher than abroad does not automatically imply that Japanese banks require excessively higher interest rate in the long-run.

3b. Evaluation of the Banking Sector in Japan

Here, I would like to evaluation the competitiveness of the banking sector in Japan. Since the 1980s, foreign exchange controls have been deregulated in Japan and new market entry by foreign financial institutions has continued. Thus, there is little evidence to show that legal restriction substantially segments Japanese banking sector from abroad. Even though the Japanese banking sector can be seen as oligopolistic judging from the number of operating banks, it nonetheless does not conclude that banks exploit their excess profit due to their bargaining power in trading.

Consider the financial intermediary business - the most principal operation of banks, as a simple example. If the difference in the quality of borrowing customers is neglected, the major tools that can be used by banks in market competition are the lending and deposit interest rates. The higher the deposit interest rate is and the lower the lending interest rate is, the easier it will be for banks to raise their loanable capital and to extend their raised funds. This implies that unless interest rates are not legally regulated, the interest rate margin will become narrower as market competition becomes severe[3]. Table 7-3 compares the interest rate margin among Japan, the United States and Germany. Interest rate margin is shown to be

[3] This is equal to the difference of the interest rate of lending minus the interest rate of borrowed , which does not include the operational costs.

the lowest in Japan. When the rate of return and profit margin of banks between Japan and the United States are compared (as in Table 7-4), the rate of return and lending, as well as deposit interest rate differential are both substantially lower.

Table 7-3 International Comparison of Interest Rate Margins

	1989	1990	1991	1992	1993
Japan	1.23	1.03	1.18	1.32	1.30
U.S.	2.59	2.76	3.14	3.63	3.71
Germany	1.95	1.96	2.08	2.14	2.15

(source) Bank of Japan, *Comparative Economic and Financial Statistics Japan and Other Major Countries*, various issues.

Table 7-4 Comparison of the Rate of Return of Banks in Japan and the U.S.

Ratio of Net Income to Own Capital(1994 Statements of Account)		Average Lending and Borrowing Interest Rate Differential (1992)	
Japan	13.6%	Japan	0.9%
U.S.A.	20.5%	U.S.A.	1.2%
Germany	17.1%	U.K.	1.3%
Switzerland	19.0%	Hong Kong	2.3%

(Source) Yasuda(1996)

7.3.4 International Price Discrepancy and Operational Inefficiency

4a. Problems to be noted

Now, the question of whether Japanese banks are inferior to foreign banks in operational efficiency shall be examined. Operational efficiency is linked to the price of providing banking services in Japan. In order to investigate formally this question, cost structure study of banking operations and econometric analysis (for instance, estimation of cost function of banks) must be done. Although there have been many econometric studies examining the business operations of banks, these studies have serious limitations[4].

First, given the fact that banking services have diversified in the face of financial liberalization, the choice of banks' business strategies have widened. While Japanese banks have been providing almost identical services among each other so far, U.S. banks have chosen their business operations based on their business strategies to achieve operation efficiencies[5]. Therefore, when comparing banks between Japan and the U.S., the object of comparison must be selected carefully. In this example, the selection of samples used in international comparison of banking operational efficiencies is quite sensitive.

Secondly, if banks put pressure on their business operations based on their operational

[4] Beside the reasons mentioned below, in the mid 1990s, the most serious problem for Japanese banks had been the so-called "bad loans" problem. Huge amount of non-performing assets damaged the confidence people had of Japanese banks. These bad-loans restrict the business operations of banks and as a results deteriorate their operational efficiency.

[5] For instance, there is a tendency in U.S. banks that they should specialize their business operations to minimize cost and maximize the income: they have to make a choice between retail business and wholesale business, or between commercial banking business and investment banking business.

advantage to improve efficiency, only a limited number of customers may enjoy the realized merits. If banks specialize their business operations for certain selected customers, the price of services banks specialize will become less. For the non-targeted customers, the reverse is true.

Incidentally, for commercial banks specializing in retail business, the share of the most important depositors (also the most profitable customers) is only 20% of all depositors. If these banks pursue profit maximization, it is reasonable to make the best efforts in satisfying the demands of rich customers. Other customers may be neglected, however. In this case, only 20% of all bank customers - those most favorable to the banks, will be able to enjoy the lower costs realized through cost-minimization. On the other hand, the remaining customers unfavorable to the banks will face harder banking access and higher banking service charges. In this situation, how should the reduction of the price of providing banking service be made possible by the improvement in operational efficiency be evaluated?

Thirdly, it is widely recognized that there are economies of scale and economies of scope in the banking industry. If economies of scale and economies of scope exist, the larger banks with wider business operation would be able to minimize their operational costs and dominant the market. This in theory implies natural monopoly. Thus, in the banking industry, there is a trade-off relationship between the improvement of efficiency caused by expanding the size and scope of business. There is also "x-inefficiency" caused by the monopoly. In this case, the evaluation on the effect of economies of scale and economies of scope can not be done easily.

4b. Evaluation

Neglecting the problems mentioned above, I would like to evaluate the efficiency of Japanese banks[6]. When the ratio of total operational costs to total assets is examined and taken as a simple index representing the efficiency of business operations, Table 5 can provide us with some insight into Japanese banks' performance. Judging from the Table 5, the averaged operational cost per total assets is clearly lower in Japan than other countries, which

[6] More strictly speaking, the operational efficiency of banks are classified into "purely technological efficiency" and "efficiency in allocation of managerial resources." This classification is ignored here.

means that Japanese banks are good at increasing the cost efficiency of their operations.

Table 7-5 International Comparison of Administrative Expenses to Assets

	1989	1990	1991	1992	1993
Japan	0.85	0.85	0.90	0.96	1.00
U.S.	3.45	3.49	3.73	3.86	3.94
Germany	1.94	1.95	1.99	1.97	1.92

(source) Bank of Japan, *Comparative Economic and Financial Statistics Japan and Other Major Countries*, various issues.

However, although the ratio of operational cost to total asset is low, this does not mean that the low ratio of operational cost contributes to the value-addedness of the banking business. First, banking management strategies differ between Japan and the United States. This contributes to the different structure of income between the two. In comparison with Japanese banks, U.S. banks have the lower portion of interest income to their total income, while Japanese banks have the higher portion of fee-based income to their total income. This implies the following: in comparing banks with similar levels of income between Japanese and the U.S., the amount of U.S. banks' total asset is smaller than those of Japanese banks, as the share of fee-based income is added to the total income of U.S. banks. As shown in Table 7-3 and Table 7-4, the profit margin and differential between lending and deposit interest rates are both smaller in Japan and in the U.S. If the same amount of lending is extended by banks, interest income of Japanese banks would be smaller than those of the U.S. banks.

In summary, as long as it is recognized that the major business operation of banking industry is to 1.) raising funds in the form of deposits and intermediating them in the form of loans, and 2.) that the amount of production of financial intermediation is measured in terms of the amount of loans extended, it can be concluded that Japanese banks produce banking services at lower cost, when compared with foreign banks abroad. In this sense, Japanese banks business operation is efficient and the price of their service is low.

Japanese banks' ability to expand the provision of funds at low cost in a highly efficient manner can be attributable to Japan's high and sustainable economic growth. On the side of raising funds, since per capita amount of financial assets in Japan has expanded rapidly over the decades, Japanese banks can easily collect these funds at low cost. On the side of

extending loans, since Japanese companies have experienced rapid growth, banks have had little difficulty in finding good customers who demand large loans. Under these circumstances, Japanese banks have been able to intermediate capital from depositors to companies at low cost.

Moreover, in comparing Japanese banks with banks in other advance countries, Japanese banks are more advanced in the installation of high quality ATMs. The computer network covering banks is also extensive. These efforts for modernization contribute to the minimization of the number of bank employees and branch offices. This in turn contributes to the reduction in operational costs. Thanks to the advance banking service infrastructure, automatic public utility payments system are commonly used and credit cards are widely distributed[7].

Judging from the above arguments, there is only a small possibility that the new entry of foreign banks into the Japanese market will introduce financial technology that would substantially reduce the cost of intermediating financial resources.

7.3.5 Deregulation and Banking Service

Arguments made in the previous sections do not imply that the current Japanese banking industry is the most efficient in providing various banking services, nor that the current state of the Japanese banking industry will remain unchanged.

Comparison of banking industries in Japan and the U.S. is summarized in Table 7-6. Comparing with American banks, Japanese banks lag behind in financial structure development, business diversification, and new technology. In the coming years, when it becomes necessary for the Japanese banks to improve their rate of earnings similar to their U.S. counterparts, they may have to squeeze their business operations. If that is the case, then there is a possibility that the features which characterizes today's Japanese banks (such as low profit margin and small differentials between lending and deposit rates) will change.

[7] Some appreciate the high learning ability of Japanese bank employees.

Table 7-6 Banking Industries in Japan and the U.S.

		Japan	U.S.
Rate of Return	Net Income/ Own Capital Ratio	4.2	20.5
	Net Income/Total Assets Ratio	0.2	1.6
Financial Robustness	Own Capital/Total Assets Ratio	4.7	7.8
Diversification of Operations	Non-interest Income Ratio	26.3	39.1
Financial Technology	Score of Interest Rate Swap	21.5	6.0
	Score of Currency Option	10.0	7.0
	Score of Swap Option	13.0	3.0

(Source) Yasuda(1996)

I would like to close this memorandum by pointing out two questions. First, when the operating cost of banks rise due to changes in their banking customers or new services demanded, might it also be appropriate to say that such a rise in operating cost would automatically lead to a rise in the price of banking services? In order to answer to this question, we may be required to define the scope of banking services.

Secondly, is the lifting up service-trade barriers helpful in changing the Japanese banks' management style to a more profit-oriented one? Perhaps. In addition to opening up banking sector to foreign competitors, overall domestic financial deregulation is also essential in promoting a new profit-oriented mentality in the Japanese banking industry.