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Financial Liberalization and Japan's Agricultural Cooperatives

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Poster paper prepared for presentation at the International Association of Agricultural

Economists Conference, Gold Coast, Australia

August 12-18, 2006

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1. Introduction

The system of agricultural cooperatives in Japan is called JA.¹ This name comes from the combination of “Japan” and “Agriculture.” JA plays a pivotal role in Japan's agricultural sector. JA holds an influential position in political dynamics and a strong economic power in rural areas.

JA has a hierarchical, nationwide network and organizes a large majority of farmers. Based on its strong ties with the Liberal Democratic Party (LDP), which has been in power for almost the entire postwar period, JA has been putting great pressure on the government to protect farmers' interests.

JA is a mammoth economic entity. JA provides various kinds of services, not only to farm households, but also to non-farm households. JA has supermarkets to sell daily necessities to farm and non-farm households. In addition, JA is active in collecting deposits from and selling insurance policies to them. These banking and insurance businesses earn a major portion of JA's profit. Based on the profits from the banking and insurance businesses, JA forms farmers into a solid voting group.

Up until the early 1990s, the profitability of JA's banking and insurance businesses had been stable because of the government's heavy intervention policies in financial markets.

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¹ The name of JA has been used since 1993. Before that, Japanese agricultural cooperatives call themselves *keito* (its literal meaning is ‘system’). For simplicity, this paper uses JA for the entire postwar period.

However, the government abandoned most of these interventions and introduced fierce competition to financial markets in the early 1990s. This deregulation policy seriously undermined the profitability of JA's banking and insurance businesses. The mid-1990s can be regarded as the turning point of the political dynamics of Japan's agricultural sector. Since then, JA has been losing its economic power and therefore its organizing ability. As a result, the political pressure for agricultural protection also has been weakening

In spite of its importance, information on JA's banking and insurance businesses has been limited for foreign researchers. This is probably because the JA system is so unique and complicated. The purpose of this paper is to provide a clear understanding of JA's activities and to explain the political dynamics in Japan's agricultural sector. Following this introduction, Section 2 discusses the system and characteristics of JA. Further details of JA's banking and insurance businesses are explained in Section 3. Section 4 reviews how financial liberalization damaged JA. Section 5 offers a conclusion.

2. Overview of the JA System

The basic structure of the JA system was established in the mid-1950s. JA had maintained a simple three-tier structure till 1997. Unit cooperatives in the villages, towns and cities make up the first level. Each unit cooperatives has its own jurisdiction which does not overlap with those of others. Unit cooperatives provide not only agricultural services but also almost every service related to daily life. Farmers are regular members of unit cooperatives and non-farm residents can join as associate members if they express sympathy with the principles of the JA movement. Both regular and associate members can use all the services of unit

cooperatives, but only regular members are entitled to commit the management of unit cooperatives.² The election for the president of a unit cooperative is also only among regular members.

Above the unit cooperatives are agricultural federations. Federations had formed two tiers at the prefectural and national levels till 1997. Since then, JA has been restructuring these federations by merging prefectural-level federations into national-level federations. Among various types of agricultural federation, credit federations and mutual insurance federations and economic federations are particularly important. They support unit cooperatives' banking and insurance activities. All the federations and unit cooperatives belong to and are supervised by the National Central Union. The National Central Union also organizes JA's political activities.

JA also functions as a de facto sub-governmental body of the Ministry of Agriculture, Forestry and Fisheries (MAFF). Many MAFF policies would not have been executed without JA's assistance. A typical example is the acreage control program, the rice production cartel led by the MAFF, which continued 35 years from 1969 to 2003. Under this program, the MAFF first set the national target for the acreage that should be diverted from rice planting, and allocated this target among the cities, towns and villages. In both setting and allocating the target, the MAFF considered JA's opinion. JA monitored whether member farmers accomplish the allocated target acreage.

The government provides various vested interests on JA's economic activities, which should be regarded as 'reward' to JA's functioning as a de facto sub-governmental body. In

² To promote their non-farming-related businesses, unit cooperatives have encouraged non-farm households to join JA as associate members. However, associate members are not allowed to participate decision making. Although farmers allow non-farm households to contribute to JA's profits, they keep non-farm households away from the various pork-barrel benefits obtained from LDP politicians.

particular, the Ministry of Finance's (MOF) favorable treatments on JA's banking and insurance activities ensured stable profits to JA, as will be discussed to detail in the next section.

JA has still kept a dominant position in the market shares in the distribution of farm products and supply of farm inputs.³ This is because JA's farming-support services are so wide and convenient for small-scale farmers, who retain farmland with the expectation of future capital gains but not so enthusiastic about making profits from farming. Although entrepreneurial large-scale farmers make efforts to develop their own channels of farm product distribution and farm input procurement, the traditional small-scale farmers, who are still in the majority, have become more and more dependent on JA's services.

The collusion among farmers (in particular, small-scale farmers), politicians, the MAFF and JA has helped maintain farmers' income level. While the average income of farm households fell behind that of urban households in the 1950s, the gap rapidly diminished in the 1960s. From the mid-1970s to the mid-1990s, farmers' income level constantly exceeded their urban counterpart by nearly 15 percent.

3. JA's Financial Activities

Japanese financial institutions were often compared to 'armed convoys' up till the early 1990s.⁴ This is because the MOF's regulations and protections were so heavy. For example, the MOF's permission was needed for such activities as the location of branches and creation

³ Godo (2001) provides estimates of JA's market share.

⁴ Teranishi (1994) gives a concise review on MOF's armed-convoy-style financial intervention policies.

of new financial instruments. Moreover, interest rates of deposits and premiums of insurance were controlled at below-market levels. Since the entry of new financial institutions was restricted, stable profits were ensured for existing financial institutions.

The MOF provided particularly favorable treatments on JA's financial activities. For example, The MOF allowed JA greater freedom to set insurance premiums, which means a clear advantage over private insurance companies. JA was given more freedom than ordinary commercial banks to set up branches. JA's term-deposit interest rates were allowed to be 0.1 percent higher than the rate set by the ordinary commercial banks. Because of these heavy interventions by the MOF, JA's federations for banking and insurance businesses could build up profits simply by lending through the inter-bank money market to city banks which chronically faced a huge financial demand from large enterprises.

Unit cooperatives themselves have little ability to manage funds – they consign these operations to the upper federations. Most of deposits collected by unit cooperatives are redeposited into the upper federations. The profit margin between the redeposit and deposit interest rates was high until the early 1990s⁵. Unit cooperatives also obtained stable profits from commission charges by placing insurance funds into the upper federations.

The presidents of unit cooperatives, who are respectful keypersons in rural communities, are better politicians than businesspeople. However, lack of business experience was no great barrier thanks to the privileges of banking and insurance businesses. The president simply set a target amount of deposits and insurance policies, towards which all the employees work. Then, using JA's organizational power, JA employees persuade

⁵ Before 1992, the margin between redeposit and deposit was stable at over 1.0 percent. However, the margin decreased to less than 0.5 percent thereafter. Godo (2001) gives the details of redeposit and deposit interest rates.

farmers to put more money on JA's banking and insurance accounts. A typical example of such efforts is the 'deposit promotion week,' when JA employees visit farmers after regular office hours and on weekends to ask for new deposits, appealing to a sense of obligation in their rural communities.

Unit cooperatives became more and more dependent on the profits from banking and insurance in the 1970s and 1980s. Ironically, these two decades were when unit cooperatives expanded the scope of their activities under the slogan of 'not only farming but also rural living overall'. Unit cooperatives started up various new businesses such as housing development and travel ticket services in the 1970s and 1980s, but these new businesses were not particularly profitable. However, because unit cooperatives were providing a wider variety of services and offered greater convenience, they became more attractive to farmers. This helped unit cooperatives attract new deposits and sell new insurance policies. In other words, the real purpose of these new activities was the promotion of JA's financial services.

Because the president of a unit cooperative is elected by a majority of regular members, JA policies favor the larger body of traditional, small-scale farmers rather than the smaller number of innovative, entrepreneurial farmers. Farmers find it difficult not to rely on JA's services because JA's scope of business is so wide. Even those who are critical of JA do not like to defy the organization for fear of retaliation from JA and other farmers. The only resistance they can make is to reduce their reliance on the organization.

4. Financial Liberalization and JA

The financial liberalization in Japan has proceeded gradually since 1979 when the MOF liberalized interest rates on large deposit accounts of over 100 million yen. However, the speed of liberalization was so slow that the business conditions of JA's financial activities were relatively stable throughout the 1980s.

However, the MOF's liberalization of interest rates on small deposit accounts, which began in 1989 and was completed in 1994, threw JA into severe market competition with other financial institutes. In addition, the MOF removed various regulations and protections to introduce fierce competition in the banking and insurance businesses in the 1990s. This sequence of the MOF's financial liberalization eliminated various privileges from JA. JA's profitability in banking and insurance business fell drastically in the mid-1990s and has never recovered since then. The presidents of unit cooperatives no longer were able to count on stable profits from their financial businesses.

JA has been coping with this harsher business environment in three ways. First, JA started to reduce its staff. Second, JA started merging prefectural-level federations with national-level federations, aiming to change the former three-layer structure into a two-layer structure.⁶ Third, in order to seize the economy of scale, the consolidation of smaller unit cooperatives also sped up.⁷

In spite of these countermeasures, JA could not avoid weakening its economic power. While the profitability of the financial businesses has been decreasing, JA still relies on profits from the financial businesses because profitability of JA's other businesses is still low.

⁶ In 2000, all the prefectural mutual insurance federations were merged into the National Mutual Insurance Federation. By April in 2005, 36 prefectural economic federations were merged into the National Federation and 1 prefectural credit federation was merged into the Norinchukin Bank (there are 47 prefectures in Japan).

⁷ The number of unit cooperatives decreased into less than one-fourth between 1990 and 2005.

This means that JA's economic position is now like 'trading on thin ice.' Since financial liberalization will irreversibly go on, JA's more drastic restructuring will be also inevitable.

As a result of the descent of JA's economic power, its organizing ability as well as voting power became less strong. Since the mid-1990s, it has become not rare that JA suffers unexpected defeats in election. A typical example is the 2004 upper house election: while the representatives from JA had constantly kept two seats as proportional representation till the previous 2001 upper house election, they won no seats then.

Since JA has played a pivotal role in the political dynamics in agricultural policies, JA's losing power brings significant changes in MAFF's policy making. The cozy relationship among farmers, politicians, the MAFF and JA is slowly but steadily decaying. For example, the MAFF is now considering abolishing the acreage control program, whereby the MAFF and JA have collaborated so as to support small-scale rice farmers. The MAFF's resistance against agricultural trade liberalization is also becoming less strong.⁸

The mid-1990s can be seen as the turning point of the political dynamics in the Japanese agricultural sector.⁹ Since small-scale farmers have reduced their political power, it is now a prime occasion for the Japanese government to cease the long-lasting supports for small-scale farmers and promote innovative, large-scale farmers. By doing so, international competitive power of Japan's agriculture will be drastically strengthened.¹⁰

⁸ In the current trade negotiations, the MAFF keeps urging trade protection for agricultural commodities (Honma 2003). However, MAFF's resistance is becoming less subsistent.

⁹ Besides weakening of JA's power, there are two more factors that hurt farmers' political power in the mid-1990s. First, in 1996 when the new election system was employed (changing from the multi-member constituency system to a single-member constituency system), the disparity in the number of registered voters per member of the Diet between rural and urban areas was rectified to some extent (for more details, see Mulgan, 2000). Second, the percentage of farmers became too small (farmers' share in labor market went down less than 4% in the 1990s) to maintain a politically influential position.

¹⁰ MAFF (1992) estimated that the production cost can be halved by concentrating farmland to large-scale farmers which show high productivity. Similar views have been announced occasionally by the MAFF.

5. Conclusion

In the international trade negotiations in the 1980s and 1990s, the Japanese government repeatedly showed strong resistance to liberalization of agricultural market. This stubborn attitude exposed Japan to risk of failing to join the Final Agreements of the Uruguay Round. The government's strong resistance was backed by JA which represented the small-scale farmers' benefits only. Since JA had been one of the most influential voting groups, the government could not neglect strong claims from JA.

However, as shown above, financial liberalization undermined JA's income resources. Losing its economic power, JA has been decreasing its organizing ability as a voting group since the mid-1990s. Because of this decrease in political pressure, there is now a prime opportunity for the Japanese government to reform its agricultural policies. On the surface, the Japanese government is still against the trade liberalization on agricultural products in the current WTO negotiations. In practice, the government is less likely to make such stubborn resistance as it made in the previous Rounds of international trade negotiations.

Noticeably, it is not agricultural market and/or trade liberalization that is providing the opportunity to undergo a fundamental reformation of agricultural policies. Instead, financial liberalization is providing this opportunity. Financial liberalization referred to all the financial institutes inclusively and was supported by the general consensus. Thus, JA could not resist when the MOF abandoned its favorable treatments on JA as a part of financial liberalization. Financial liberalization may not have direct impacts on agricultural policies. But, through damaging JA's economic power like a "body blow," financial

liberalization is gradually but mightily inducing the Japanese government to renounce traditional agricultural protectionism.

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