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A study of the modern Japanese financial system, focusing on the "overdraft" phenomenon

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I. INTRODUCTION

This paper presents a study of modern Japanese financial institutions, especially the central bank and city banks, focusing on "overdraft" problems.

The uniqueness of central banking is the interdependency among the governmental sector, the central bank and other financial institutions. The resulting phenomenon, city banks' overdraft, has become one of the crucial issues in the Japanese economy. The strategy of the interdependency seemed to create an absence of proper central banking policies, so that the growing economy, accompanied by the low interest rate policy, has forced the central bank to loan to city banks without proper restrictions. Thus city banks have turned out to be an overgrown sector accompanied by many overgrown enterprises; and that was also caused by the underdevelopment of the capital market. This speculation seems to form the basis for the modern structure of the Japanese financial system.

The books which I studied and used in this paper were written by several economists and critics in Japan. Following the historical movement of this financial system in recent years, various facts and definitions they made can be analyzed into two stages subject to the Japanese financial structure. In order to compare and clarify the "overdraft" problem, the two-stage analysis presented in the paper is one of the best ways to derive the nature of the Japanese financial system. These two stages are focusing on the period that the low interest policy performed and the period that the recent continuous surplus of the international balance.

Finally, the above studies on the modern Japanese financial system are mostly based upon researched statistical data which were provided by the Bank of Japan and related governmental institutions.

II. THE BANK OF JAPAN

A. Its institutional movement and interdependency

The most crucial factor which makes Japan so strongly and specially different from other developing countries is the interdependency between the Bank of Japan and the Japanese government. The chain for the relationship is caused by the law of the Bank of Japan.

The law of the Bank of Japan was primarily issued by the government in 1882. The validation for it was renewable every 30 years. But during World War II, the validation of the law expired and was renewed by the militarily established government which adopted the main idea from the Nazis.[1] Thus the law of the Bank of Japan has been changed in a militaristic controlling fashion and the validation has been set up for an infinite period of time. After World War II, gradually criticism toward the amendment of many parts of the law arose. Moreover, the policy board was established as a supreme decision-making committee in 1949, composed of the president of the Bank of Japan as the chairman, a representative from the Finance Ministry, a representative from the Economic Planning Authority, a representative from the City Bank, a representative from the Industrial Association, a representative from Agriculture, Forestry and Fishery, and a representative from Finance Circles.

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[1]Who adopted governmental sovereignty in central banking.

Since then, the committee makes most of the decisions about central banking problems. However, as was mentioned before, the law of the Bank of Japan has been a great disturbance to the committee and has been argued about constantly since the following articles in the law clearly provide a serious governmental intervention into central banking.

1. The 42nd article in the law states, "The...Bank of Japan is under the supervision of the competent minister."
2. The 43rd article in the law states, "The...competent minister may order the Bank of Japan to carry out any changes in the articles of association or to carry out other necessary items in order to reach the object of the Bank of Japan under the confirmed special necessity.

Therefore, the above two articles in the law are, by all means, described as the failure of the independence of the central bank.

For this controversial issue, there were several monetary system investigation committees established from 1949 to 1957. Their purposes were to discuss the four major problems in the central banking criticism at the time:

1. The degree of the competence of the Finance Minister in central banking;
2. The limitation of the Bank of Japan notes;
3. The acceptance of the national debt by the Bank of Japan;
4. Special emergency financing of the Bank of Japan.

The complete amendment of the law of the Bank of Japan requested by those committees was submitted to the Finance Minister at that time, but it simply broke out after a different interpretation in the degree of the independence of the Bank of Japan.

In 1964, the Japanese economy started to break into the international level and began to harmonize its economy through IMF,[2] OECD,[3] and BIS.[4] The international trend forced the Japanese central banking policies to be amended in order to meet international standards. Thus, in 1965, "The Finance Ministry Original Plan" was issued with a new item. The item emphasized the promotion of the credit system. That is to say, the Bank of Japan, as well as the government, would gain its controlling power in central banking more than ever before.

More specifically, Table 1.1 shows the comparison of those arguments concerning the law of the Bank of Japan. From this table, we may conclude the following facts which would clearly explain the existence of interdependency of the Bank of Japan with the government.

1. Fifty-five percent of the capital of the Bank of Japan is provided by the government in the existing situation. This shows the government has absolute power in central banking.
2. The staff members in the Bank of Japan are mostly controlled by the government (because the appointing power is directly and indirectly held by the government).
3. Central banking policies have to be approved by the finance minister or the cabinet.

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[2] International Monetary Fund.

[3] Organization of Economic Cooperation and Development.

[4] Bank for International Settlement.

Table 1.1. The comparison of arguments concerning the amendment of the Bank of Japan's law

	Existing Case	Investigation Committee Plan	Finance Ministry Plan
Principal target proposed	Currency control Financial control Maintain and promote credit system	Absolute power to issue bank note Currency credit control	Bank note issue Currency credit control Maintain and promote credit system
Distribution of capital	55% are governmental property	Juridically recognized enterprises with no capital	Juridically recognized enterprises with no capital
Designation	President and vice-president are appointed by Cabinet Director (trustee) is appointed by Competent Minister	President is appointed by Cabinet Vice-president is recommenced by president and is appointed by Cabinet	Minister Finance Minister House and Senate (designator)
The degree of governmental relation	Supervised by Competent Minister The 43rd item in Bank of Japan's law	Recognition of governmental directing right toward the Bank of Japan's policies Recognition of governmental rights to postpone resolution toward the Bank of Japan's policies	Cooperative with government. For necessity, government can order the Bank of Japan's operation to maintain government's policy

Debt system	Competent Minister decides the issuing limitation through Cabinet and announces publicly The same amount of guarantee should accompany the issuing amount	Eliminate the regulations for issuing limitation No restrictions for the issuing amount of debt	Eliminate both issuing limitations and guarantee
Reserved fund system	Establishment, alteration and abolition are necessarily recognized by the Competent Minister	Abolition of the need of approval of the Competent Minister	Abolition of the recognition of minister toward the reserved fund system

Clearly, item 1 appears to be the most powerful governmental intervention and items 2 and 3 are obviously the supplementary issues about the governmental intervention.

B. Its system and the role it plays

The major financial policies in Japan are discount-rate policy, debt balance control and the operation for the rate of the reserve fund.

Discount rate policy is performed when there is a necessity for changing the loan interest rate of the central bank against commercial banks in order to balance business fluctuations. Debt balance control is needed when the central bank makes the debt transaction with commercial banks in order to achieve a balanced distribution of money flow in the the financial system, and the operation of the deposit rate for reserve fund is indirectly related to the central bank's duty of keeping commercial banks' deposits in it in order to influence commercial banks' lending behavior.

Therefore, before going into the analysis, the substantial duties of the central bank should be introduced.

First of all, we may look over the principal account of the Bank of Japan, as shown in Table 1.2.

The major items in the property account are discount draft and loan, bonds (including government debt) and foreign currency (overseas property account).

Bank notes occupied most of the debt account. If we look at Figure 1.1 bank notes seemed to have a constant rate of increase each year in the system. On the other hand, those three major items in the property account

Table 1.2. The principal account in 1971[a]

Property		Debt and capital	
Unit: One hundred million			
Gold and metal	308	Bank note	64,077
Discount draft and loan	6,808	Financial institution	- 2,947
Government debt and bond	15,631	Deposit	980
Overseas property account	47,979	Governmental deposit	4,612
Others	6,467	Capital, reserve fund	4,576
Total	77,195		77,195

[a]Source: (10).

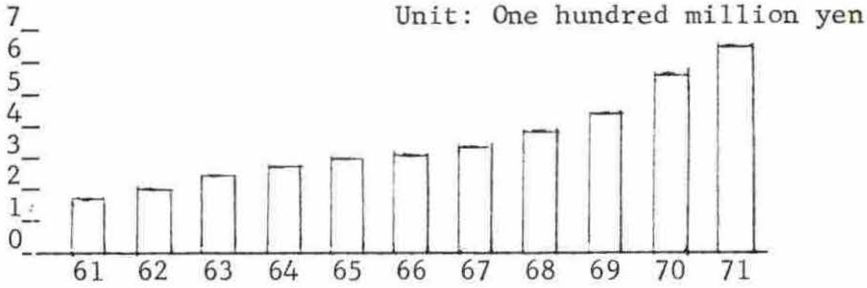

Figure 1.1. Bank Note

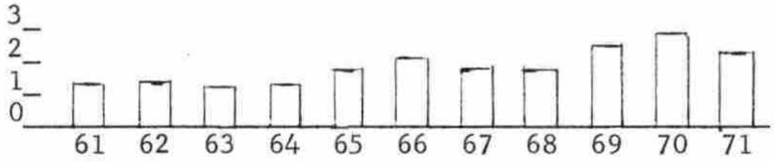

Figure 1.2. Loan

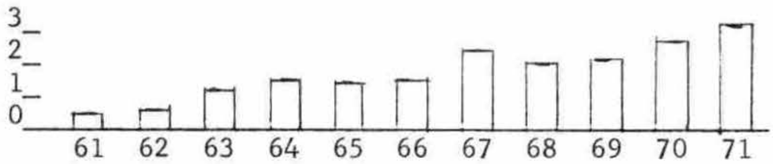

Figure 1.3. Bonds

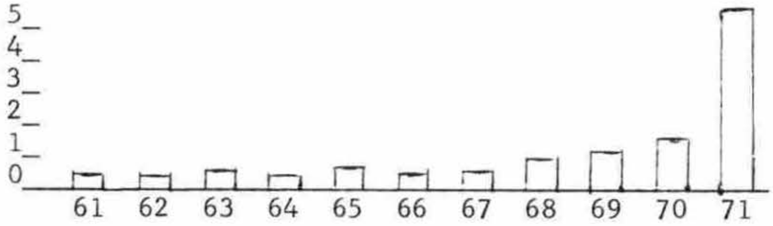

Figure 1.4. Foreign Currency

are largely fluctuating.[5] The transaction partners for those accounts would be either government or financial institutions (mainly bank). For instance, Case I: If the Bank of Japan buys government debt from commercial banks, then an increase in the amount of government debt in the Bank of Japan will result in an increase in the commercial banks' deposit in the Bank of Japan for exchange, since the banks' deposit in the Bank of Japan yields no interest. It also results in a decrease in the commercial banks' debt to the Bank of Japan.

Case II: If the international balance's surplus continues, the government buys foreign currency from commercial banks. Thus an increase in the government's foreign currency reserve will force the government to sell foreign currency to the Bank of Japan. Then the Bank of Japan will increase its foreign currency reserve and the government's deposit in the Bank of Japan also increases. Reciprocally, when the government buys foreign currency from commercial banks, a decrease in the amount of government's deposit in the Bank of Japan will result. Meanwhile, an increase in the commercial banks' deposit in the Bank of Japan will result in a decrease in the amount of the commercial banks' debt to the Bank of Japan.

This shows that if we neglect the fluctuations in the government's deposit and the financial institutions' deposit in the central bank, then the foreign currency which the government bought will possibly result in a reduction of the Bank of Japan's loan to financial institutions and so weaken the Bank of Japan's controlling power over them.

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[5] See Figures 1.1 - 1.4.

The balance sheet of capital would probably be the best figure to explain the central banking policies.

We may notice that the difference between the principal account and the balance sheet of capital are as follows:

Table 1.3. Principal account

Assets	Liabilities & Stockholders
(B) Loans against financial institution	(A) Bank notes against financial institution
(C) Debt against institution	
(D) Debt against government	
(E) Foreign currency against government	

Table 1.4. The balance sheet of capital[a]

	Year
Bank note	(A)
Financial capital[b]	(D) + (E)
The Bank of Japan's credit[c]	(B) + (C)
Loan	(B)
Debt operation	(C)

[a]Financial capital includes tax and government debt assume government's deposit; balance is unchanged.

[b]Accurately, "Financial Capital" is the difference of financial capital against civilian revenue and expenditure.

[c]"The Bank of Japan's credit" is "The Bank of Japan's capital supply against financial institution".

From Table 1.3:

$$A \cong B + C + D + E$$

then

$$A - (D + E) \cong C + B$$ [6]

where

D + E is financial capital

B + C is the Bank of Japan's credit.

For an extreme case, if

$$(D + E) < 0 \quad \text{and} \quad (D + E) > A$$ [7]

then

$$(B + C) < 0.$$

This implies that the Central Bank withdraws its capital from money market institutions.

Furthermore, the balance sheet of capital can be used to describe financial institutions. For example, an increase in bank notes will be viewed to mean that financial institutions become tense, and vice versa when a large amount of excess payments of financial capital occurs. In other words, if financial institutions are lacking capital, then the Bank of Japan will be forced to provide the capital for them. It also means that the surplus of the Bank of Japan's credit will be the parameter for financial institutions' money flow movements.

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[6] For simplicity, I have ignored the fluctuations of deposits and others. In fact: $A - (D + E) \neq (B + C)$.

[7] $(D + E) < 0$ is the case that financial capital's balance against civilian is in an excess revenue situation.

Now, we seem to reach a point that the Bank of Japan's credit is a conditional parameter for the money flow of financial institutions. Hence, in order to have more understanding of the Bank of Japan's credit, other factors which appear with it in balance sheet account should be introduced.

1. Bank notes: Its movement during recent years in Japan has been stabilized at a constant rate of increase as mentioned in Figure 1.2. It implies that long-term economic growth is being substantially achieved in Japan without considering the problem of the financial system. Thus, basically, the Bank of Japan's credit is surplus.

2. Financial capital's revenue and expenditure against private sources.

When government excess outgo results in a lack of capital, then the government will let the Bank of Japan accept a short-term government debt in exchange. If the government is in an excess income position, it will reduce the short-term government debt.

3. Special account for foreign exchange (the account for foreign currency balance).

If foreign currency increases, foreign exchange banks will sell foreign currency to the special accounts. Thus the increase of foreign currency in the special account will force the government to sell its short-term government debt to the Bank of Japan in order to offset the payment.

But recently, under the contract of issuing the foreign exchange bond,[8] if the government buys foreign currency which goes over the limitation, there exists a difficulty of keeping all foreign currency in the special account. Since the foreign exchange bank's interest rate is higher than the rate of return of operating foreign currency, this will put foreign currency stock above a certain degree in the special account. The result: the foreign exchange special account will sell foreign currency to the Bank of Japan, and the special account will buy foreign currency using the capital which was obtained from selling foreign currency.

C. Its major and supplementary policies

Now, we may turn to analyze those major policies of the Bank of Japan which I mentioned at the beginning of Section B.

1. Discount rate policy   In general, the standard discount rate is represented by the commercial draft discount rate in Japan.[9] There are two normal effects of changing the discount rate as follows:

a. Cost effect: An increase in the discount rate will result in a higher bank capital cost. This contains the Bank of Japan's loan which would cause a bank's business activities to go down. For example:

1. An increase in the cost to banks borrowing from the Bank of Japan will result in a decrease in the amount borrowed by

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[8] Short-term government's bond.

[9] It's different from the prime rate in U.S.A.

banks from the Bank of Japan, and so diminish the bank's loan to enterprise.

2. An increase in the bank's capital cost will result in an increase in the bank's loan rate to enterprise in order to retain the profit.

b. Announcement effect: This effect is based upon the psychological movements of money market institutions focusing on the announcement of the central banking discount rate policy.[10]

From the statistical data[11] we can observe that during 1964-1969 the discount rate is very low compared to the bank's loan interest rate to enterprise. Moreover, an interesting thing to observe is that the call rate is equal to or higher than the discount rate. In tight-money situations, call rates exceed official rates. This phenomenon is caused by the restriction in borrowing from the Bank of Japan at discount rates. Clearly we see from the following chart that even though there is an increase in banks borrowing from the call market, the discount rate policy will not affect the bank's borrowing from the Bank of Japan as long as the call rate is above the discount rate.

Thus, changes in the discount rate wouldn't have any direct impact on banks' behavior of borrowing. In order to reduce banks borrowing from the Bank of Japan the Bank of Japan needs to increase the discount rate to apply a tight-money policy and must also increase the loan interest rate at the same time in order to achieve control of city bank's lending.

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[10]It is also necessary to consider time lag.

[11]See Appendix B.

Therefore an increase in the discount rate is important to the increase in the loan interest rate in Japan.

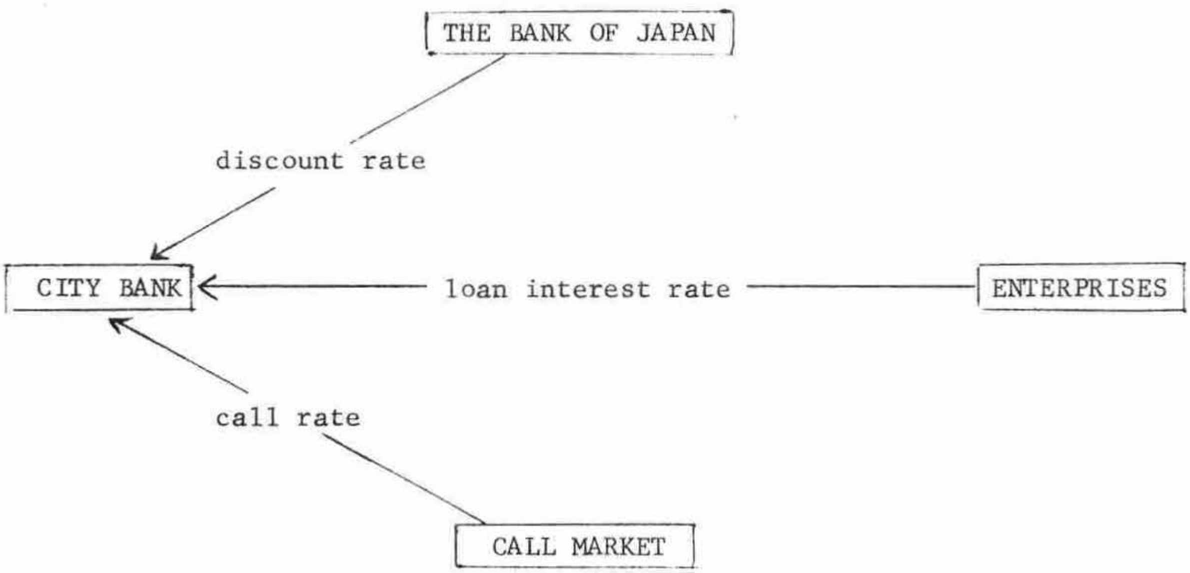
We may note here that the banks' loan interest rate may not be the decisive factor for granting loans to enterprises, because credit-rationing is performed a great deal in the Japanese financial system.

Since the Bank of Japan controls the city bank's loans it forces the city bank to acquire loans from the call market if the city bank chooses a "little more cost" but "free" money source.

<u>2. Debt operation (open market operation)</u> The debt operation hasn't been successful in the Bank of Japan during the period 1964-1969. One of the reasons is the underdevelopment of the capital market.

Short-term government debt has no circulating market because the call rate is larger than the short-term government debt interest rate. The transaction of the short-term debt is simply between the Bank of Japan and certain enterprise at the fixed rate. Thus there is no way to establish a suitable market at that time.

The Bank of Japan's transaction debts are mainly long-term government debts and government guaranteed debts. But these long-term debt transactions are scarce. Most of them are held by the financial institutions. They expect the Bank of Japan to buy those bonds at a better price than in the circulating market, since they are forced to accept those debts by the Central Bank. Therefore, a long-term debt is simply an exchange with the Bank of Japan's loan credit circulated between the Bank of Japan and other financial institutions. And, in fact, no market existed for it before the early 60's.



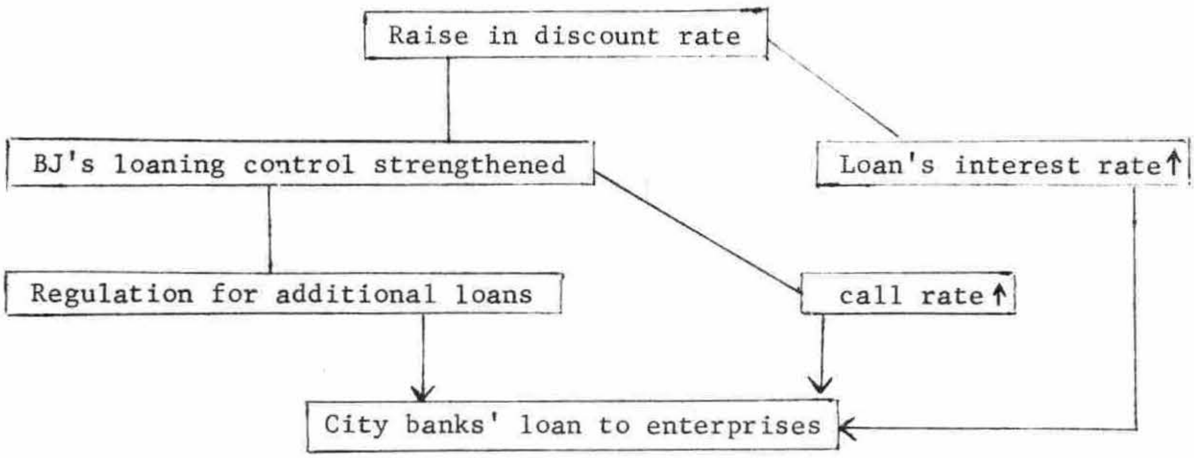
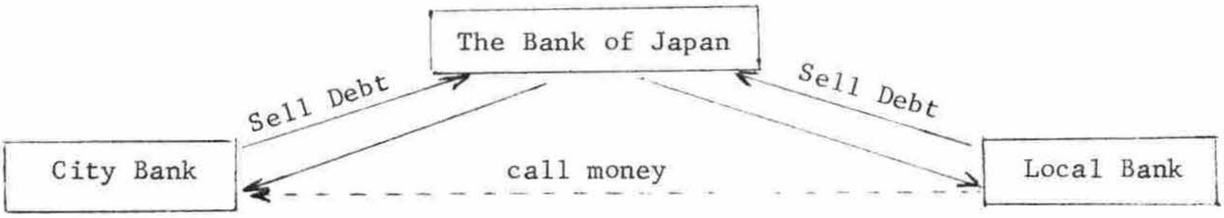


Figure 1.5. Monetary control and the Bank of Japan

For convenience, the graph below shows the circulation of the debt operation.



Thus, the Bank of Japan's debt operation becomes a buying action only in the early 60's when the low interest rate policy was performed.[12]

D. The rate of reserved fund operation

This is considerably more effective when compared to the above two policies since it's determined by the law. The only problem that can be argued is whether the finance minister has the right to prove the rate of reserve. This also shows the problem of intervention by the government of central banking.

In recent years, the operation is as follows: In tight-money situations the rate of reserve is increased and vice versa in easy-money cases. But the rate of reserve was low and the fluctuation was small, thus the real effect of it had not been reached during the past years.

The reason for that was because of the different situation between city banks and local banks. From the data given in Appendix B, Table B.4, we can see that city banks were overdrafted from the Bank of Japan, but

[12] New development of the capital market will be explained later.

local banks had no noticeable loans from the Bank of Japan. Indeed, local banks had spare money most of the time.

Therefore, an increase in the rate of reserve will substantially influence city banks but will not affect local banks as long as there is a poor debt operation. Reciprocally, local banks become the supplier of call money.

III. THE COMMERCIAL BANKS AND BANK-RELATED ENTERPRISES

A. The commercial banks

The commercial bank in Japan can be divided into four groups.

1. City bank
2. Local bank
3. Foreign exchange bank
4. Foreign bank

Since city banks[13] play a vital role in this paper, I am going to concentrate on them rather than entire commercial banks.

In principal, city banks accept demand deposits in order to facilitate the settlement of checking accounts.

The role they play is to not only reduce the circulation of currency but also to use the temporarily isolated capital flow to invest in industrial activities. Moreover, city banks create lending capital by extending credit and bring it to activate the city's money-flow operation which will develop the capital circulation in the society. Thus their social responsibilities are quite important.

From the data given in Appendix B we can observe that city banks played an extremely vital role in the Japanese financial system, because various governmental policies and the existing economic situation encouraged them to direct financing to the industries with the full support from

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[13] It is defined as "commercial banks which are in metropolitan cities, mainly in Tokyo, Nagoya, Kyoto, Yokohama, Osaka, Kobe, and Hiroshima, but exclude foreign exchange banks".

Some local banks changed into city banks during this period 50's-70's, such as Japan Mutual Bank changed into City Bank in 1971.

the Bank of Japan. If we look through their historical movements, we can see that their behavior towards the growing economy was really the key factor to observe in Japanese economic movements and may force some potential movements of the economy. We may look at Tables 2.1 and 2.2 for a simple comparison between the city banks' principal accounts in 1961 and 1971.

There are several points which should be noticed from the data provided.

1. In the debt account, the loans in 1961 were 21.2 percent of the total deposits and only 3 percent in 1971. We may notice that the government in 1961 was operating under a low interest policy. The loan was mostly from the Bank of Japan since it was more liquidable. Therefore, this seems to explain that the city banks' overdraft problems were serious factors in 1961 but not in 1971 since only 3 percent of the total deposit was the loan. Moreover, only 1.7 percent of the loan was from the Bank of Japan.
2. A decrease occurred in the percentage of owned capital against total deposits (from 5.4 percent down to 1.4 percent). It is caused considerably by an exponential increase in the banks' lendings and the restrictions on the distributions of their own stocks. It seems to point out that even though a restriction on their own reserve fund exists, city banks were likely to forget their own responsibilities for the guarantee of deposits because they believed the Bank of Japan would bear most risks from the industrial protection plan which was encouraged by the government

at that time. We may notice that the city banks' lending capacities are grown from the derivative deposit[14] which comes from the banks' creditableness with full support of the Bank of Japan's credit. Indeed, because of the underdevelopment of the capital market in the early 60's, city banks became the major supporter and began to take care of enterprises' long-term fund as well as the short-term fund. Most of the city banks' lendings toward enterprises were concentrated by the banks' free discretion[15] which encouraged lending competition among city banks. Therefore, a few large scale enterprises seemed to receive most of the circulation. At the same time, city banks accumulated the circulation of huge amounts of deposit through those enterprises and created more reliability of their credit.[16] On the other hand, because of concentrated investment competition, enterprises were seeking their capital which was supplied only by city banks. Hence, the business of enterprises became a disturbing element toward the scale of business fluctuation.

From the account of city banks' lending from the central bank, we find that the yearly increment was 2 billion[17] in 1965 and 5 billion in 1970. The reason for this exponential increment wasn't only caused by the fast

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[14]The derivative deposit made higher banks' profitabilities and bank's lending capacities.

[15]The reason for this is the failure of the discount rate policy.

[16]See various tables in Appendix B.

[17]Unit: Japanese Yen.

growing economy but also by city banks' unclassified pipe lines[18] through the direct financing.[19]

Going back to its origin, it was caused by the delayed improvement of enterprises with its capital fulfilled through the bond market. Hence, those enterprises' capital were substantially relied on by city banks and the degree of dependability was increased every year. Thus it ought to be concerned that there exists a certain tightened relationship between the fast growing economy and the city banks lending. Politically, the increment was caused by the low-interest rate policy[20] of the government in the early 60's which ignored the fact that enterprises at that time owned only 2 percent of the actual capital against total deposits. Because of the intervention by the government toward central banking, city banks creditableness, which was supported by the Bank of Japan's credit, is fully used and developed rapidly. This phenomenon also happened to bank-related enterprises. A low discount rate and a low tax to the banking finances provided an almost unlimited fund supply to the banks by the government. Of course, unlimited lendings to enterprises also occurred.

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[18]Without considering long-term or short-term fund supply, commercial banks were free to engage in any industrial investments. If there is any restriction for banks themselves to engage such activities, then they will use their connected financial institutions to do the job.

[19]Because of the complicated Japanese wholesale and retail market structure.

[20]Minister Ideda believes that a highly growing economy requires a full support by government.

Table 2.1. City Banks' principal account in 1961[a]

Assets		Debt	
Total Deposit	62,930 (100)		
Unit: 100 millions			
Cash (the reserve fund in BJ is included)	11,259 (17.9)	Debt	--
Interbank deposit and call loan	360 (0.6)	Loan	13,320 (21.2)
		Capital stock	3,380 (5.4)
Securities	5,670 (15.8)		
Short-term government debt	--		
Long-term government debt	90 (0.2)		
Lendings	55,530 (88.2)		
Others	11,170 (17.8)		

[a]Source: (13).

Table 2.2. City Banks' principal account in 1971[a]

Assets		Debt[b]	
	Total Deposit 314,308 (100)		
	Unit: 100 millions		
Cash	29,820 (9.4)[c]	Loan	9,212 (3.0)
Deposit	6,293 (2.0)	Call money	15,370 (5.0)
Call loan	720 (0.2)	Foreign exchange account	12,920 (4.1)
Securities	48,402 (15.4)	Capital	4,518 (1.4)
Discount draft	79,532 (25.3)	Others	80,189 (25.5)
Lendings[d]	188,964 (60.1)		
Foreign exchange account	21,669 (7.0)		
Others	61,117 (20.0)		

[a]Source: (13).

[b]Loan from the Bank of Japan was 5,386 (1.7) in debt account.

[c]Numbers shown in parentheses are the percentage against total deposit.

[d]Draft lendings 162,281 was included in lendings.

If we look over the city banks' lending contents, we find that most of them are concentrated on a few large enterprises. As mentioned before, the tendency was caused by the management of the mixed bank policy.[21] City banks' lendings are especially concentrated on safe and excellent credit owners (such as large enterprises) and credit is examined carefully on those enterprises. This selective lending is identical to the credit rationing described in a later chapter. In the details shown on city banks' lending, draft lending is more proportionate than commercial drafts' discount. Commercial drafts' discount diminished from the Bank of Japan's loan and import draft of settlement or export pre-lending draft, etc. are treated as draft lending. The contents for those draft lendings mostly are fixed long term investment for accommodation. Practically, the amount of investment for accommodation should absorb from issuing bond and debenture in nature. But the underdevelopment of the capital market has caused enterprises to depend on city banks' in absorbing their accommodation fund.

Furthermore, other funds would have been used for accommodation. The fund actually invested for the purpose of accommodation should have been more proportionate than the amounts shown in the statistical data.

The basis for city banks' expansion was the huge amount of personal savings which were caused by the fast-growing economy.[22]

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[21] Mixed bank policy means that a commercial bank can operate not only a short-term finance but also a long-term finance as well.

[22] More specifically, the existence of the huge amounts of excess distribution of government funds, caused by the exponential economic development.

If we consider the actual personal deposit's increment in a year, 1957 was 0.5 billion, 1965 was 2.5 billion and 1970 was 4.7 billion. Indeed, those deposits included many long-term deposits.[23] It's quite different from other developing countries. Reciprocally, it did emphasize the failure of the capital market.

The net profit for city banks is not known, since there is no standard calculation for it. But we may examine their gross profits and costs[24] in order to find out what their net profit would roughly look like.

First of all, the interest rate on deposits is limited by the Bank of Japan's guideline.[25] On the other hand, the increase in lending and the bond rate will be the main item for these growing banks profit. Of course, the most important factor is the low and established interest rate of deposit and the Bank of Japan's loan. Thus, the banks' profit will be influenced by the difference between the rate of interest of lending and deposit. For profit maximization, city banks need only to increase their capacities in business circles through pipe line activities, as long as there exists an excess demand of funds. The larger city banks get, the more profit they gain. Subsequently, the profit which city banks' earned from the currency operation has been a conditional parameter of efficiency in banking management. Therefore, the gross profit of city banks is combined with the profit from currency operation and the profit from the credit supply.

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[23] Long-term deposit makes the suggestion to let city banks go into the long-term investment plan.

[24] Gross profit (lending interest + bond interest); Cost (deposit interest + loan interest + outlay).

[25] It contains several.

B. The relationship between city banks and local banks

If we look over Appendix B, one of the crucial things we may notice is the existence of local banks. Their financial movements are very close to city banks.

Compared to local banks, other financial institutions except city banks have no significance for the analysis in this paper. Thus, its desirable not to discuss their movements except by necessity.

Now we turn to study the role that local banks play in the paper.

The role local banks play is quite different from one which city banks play, because, city banks were and are demanders of the Bank of Japan's loan. But local banks were and are the supplier of call money. Indeed, local banks do not receive the Bank of Japan's loans which makes them free to act as the call money suppliers. They earn their profit through call market and sometimes earn profit from interbank financing to city banks.

Because of the geographical disadvantages, local banks' deposit seemed to decline compared to city banks. But there is independence in local banks concerning the Bank of Japan's restrictions and adherence to overborrowing enterprises. In fact, local banks have their healthy banking structures such as balanced financing to all kinds of enterprises without concentrated investment. Certainly, because of its independence from the Bank of Japan's credit and loan, the effective central banking policies toward local banks or other related banks are quite questionable. The only relationship that exists between the Bank of Japan and local banks is the transaction of government debt. Since the circulation of those debt operations does seem to be well worked out, the Bank of Japan still can't reach its control to those local banks.

IV. BANK-RELATED ENTERPRISES

A. Its structure and the role it plays

There are many data provided by the Bank of Japan's statistical lab to indicate that the Japanese financial system is become more systematized than ever before. More specifically, enterprises to which were loaned 20 percent of bank-owned capital in 1973 were as follows:

Mitsui group: Mitsui Bank, Mitsui Products Company

Mitsubishi group: Mitsubishi Bank, Mitsubishi Trading Company

Sumitomo group: Sumitomo Bank, Ito-chu Trading Company, Sumitomo Trading Company

Fuji group: Fuji Bank, Mitsui Products Company, Marumemi Company

Daiichi group: Daiichi Kangyo Bank, Itochu Trading Company, Mitsubishi Trading Company

Sanwa group: Sanwa Bank, Nissho Iwai Trading Company

Tokai group: Tokai Bank, Mitsubishi Trading Company, Tomen Company, Mitsubishi Trading Company.

From the yearly report of the statistical bureau of the Bank of Japan, the first listed companies are 746 excluding financial institutions.

Concerning the proportion of loaning and the mutual exchange of stocks,[26] 60 percent out of 746 companies which qualified as large enterprises are systematized in the above six groups.

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[26] See Table D.1 in Appendix D.

Tracing back to the early 60's, the enterprises' capital mostly depended on banks' borrowings, but not collecting, through public bond market or by issuing their stocks.

As mentioned in the previous section, this phenomenon was caused by two major factors.

1. The central bank's low interest rate policy.

2. Underdevelopment of the capital market.

These were the first steps toward their systematized structures. Since then, even though there was partial development of the capital market and reformed central banking policies, systematized structures have been built up. The financial chain between city banks and enterprises is exclusively tightened. There were several reasons for this.

The main reason was that the investment competition between large enterprises became the competition between their systematized city banks. The attitudes of city banks toward the investment competition seriously obstructed central banking policies.[27] Indeed, there was an excess circulation of money flow throughout 1970-1973[28] which was caused by the continuous surplus of international balance in Japan, during which period most large enterprises made large profits.[29] It provided many opportunities for them to improve their own capital proportionate to their total assets. In reality, the spare money was not returned to city banks but was reinvested in bond and land purchases. It is interesting to observe

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[27] The whole interpretation will be presented in the next chapter.

[28] It is caused by the enormous increase in foreign currency.

[29] See Appendix B.

that since city banks did not prefer enterprises to pay money back in order to tighten their relations with them, it was also more profitable if they kept it that way. If city banks received those returning funds it would decrease the amount of loans shown in its property account. The Bank of Japan would try to absorb them up to certain appropriate degree.[30]

Besides investments in land and bonds some large enterprises did finance some middle or small enterprises with spare money. It seemed to form another systematized structure in the whole business circle. Of course, this relation can not be determined numerically through the existing public statistical data or by the Bank of Japan's published data. But it can be analyzed by the derivation of this special economic structure, where the pipe lines are really complicated in both their wholesale and retail aspects. If the share of some profitable field can not be controlled by those large enterprises, they will try to absorb those enterprises which historically shared the field. Once they got into part of it, they most of the time get all of it.

If we look over the constitution of enterprises' financial assets, we will find that the property of trust, insurance and bonds are only one-fifth or one-fourth of the whole. Indeed, it is stabilized in that way despite the tone of the market. On the other hand, personal financial assets increased fifteen times from 1954 to 1969. Saving deposits were 60 percent to 70 percent against total deposits before 1964. Bonds were only about 20 percent before 1964 and only 10 percent in 1965.

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[30] Because the Bank of Japan concerns its effecting power toward city banks.

For enterprises, their assets' constitution was more than 60 percent from outside capital. Own capital proportions were going down every year. It was only 10 percent to 20 percent in the 60's. Of course, we also shouldn't ignore that between large enterprises and their satellite enterprises, or between large enterprises and their systematized city banks, there exists a mutual bearing of stocks. If we subtracted this figure[31] then the actual proportion of self-owned capital will be much lower. Included in the outside capital, only a small proportion is made of debts and long-term loans and most of it is occupied by short-term loans.

B. The horizontal and vertical integrations of city banks

From the following tables, we may see that there exists various complicated structures for the whole business circle.

From Table 3.1, we can easily see that most city banks, trust banks and insurance companies are closely related to six major systematized financial groups. It shows the horizontal integrations of city banks. From Tables 3.2 through 3.5, we can see that city banks supplied their capital not only by direct financing to enterprises but also supplied money through their satellite companies. This shows the vertical integration of city banks.

There are no statistics which can be obtained concerning the degree of those financial groups' expansion into the business circle. Even so, we can infer that the degree of the expansion into the business circle

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[31] Of course, it can't actually be subtracted since there is no such data provided.

would be enormous. Moreover, the legal or illegal political contributions from those financial groups would also effect the governmental policies as well as the central banking policies.

Table 3.1. The ratio of financing in major financial systems[a]

Financial Institutions	High Ranked Company		Second Ranked Company	
	No. of Co.	The ratio of Finance	No. of Co.	The ratio of Finance
Mitsubishi Group Mitsubishi Bank Mitsubishi Trust Bank Meiji Life Ins. Co. Tokyo Marine Ins. Co.	85	34.89%	53	44.00%
Mitsui Group Mitsui Bank Mitsui Trust Bank Mitsui Life Ins. Co. Taisho Marine Ins. Co.	79	24.18	46	37.47
Sumitomo Group Sumitomo Bank Sumitomo Trust Bank Sumitomo Life Ins. Co. Sumitomo Marine Ins. Co.	80	34.37	36	31.26
Fuji Group Fuji Bank Yasuda Trust Bank Yasuda Life Ins. Co. Yasuda Marine Ins. Co.	78	26.28	68	31.53
Daiichi Group Daiichi Bank Asahi Bank Asahi Life Ins. Co.	41	20.63	27	28.71
Sanwa Group Sanwa Bank Toyo Trust Bank Daido Life Ins. Co.	53	28.93	23	39.39

[a]Source: (3).

Table 3.2. Bank-related lease industry's company[a]

Bank	Lease Co.	Date of Establishment	Capital (unit: 100 mill. yen)
Fuji	Fuyo Sogo Lease Co.	April 1969	1.0
Sumitomo	Sogo Lease Co.	Sept. 1968	1.0
Sanwa	Orient Lease Co.	April 1964	4.5
Daiwa	Orient Lease Co.	April 1964	4.5
Kobe	Orient Lease Co.	April 1964	4.5
Tokai	Central Lease Co.	May 1969	1.0
Daiichi	Central Leasing System	July 1969	5.0
Kangyo	Tokyo Lease Co.	Aug. 1964	2.0
Kyowa	Showa Lease Co.	April 1969	1.2
Fudosan	Showa Lease Co.	April 1969	1.2
	Universal Lease Co.	April 1969	0.5
Nihon-Kogyo	Universal Lease Co.	Dec. 1969	5.0

[a]Source: (18).

Table 3.3. Bank-related credit card company[a]

	Date of Establishment	Capital (Unit: 100 million yen)	Related banks
Japan Diners Club	Dec. 1960	1.0	Fuji
Japan Credit Bureau	Jan. 1961	6.0	Sanwa, Mitsui, Kobe Kyowa
Diamond Credit Co.	Dec. 1967	2.0	Mitsubishi
Sumitomo Credit Service Co.	Dec. 1967	2.0	Sumitomo
Million Card Service Co.	April 1968	2.0	Tokai
Union Credit Co.	June 1969	1.8	Daiichi Kangyo, Fuji Saitama, Taiyo, Mitsubishi

[a]Source: (18).

Table 3.4. Bank-related information industry's company[a]

Bank	Company	Date of Establishment	Capital (Unit: 100 million)
Daiichi Kangyo Bank	Daiichi Kangyo Management Center	Dec. 1967	0.5
	Century Research Center	Oct. 1971	5.0
Fuji Bank	Fuyo Information Center	May 1970	5.0
	Fuji National City Consulting Co.	July 1970	0.8
Mitsubishi	Diamond Computer Service	July 1970	0.5
Sumitomo Bank	Nihon Information Service	Feb. 1969	2.0
	Sumitomo Business Consulting Co.	Mar. 1971	2.0
Sanwa Bank	Toyo Computer Service	Mar. 1967	5.0

[a]Source: (18).

Table 3.5. Bank-related house-financing company[a]

Company	Establishment	Capital (Unit: 100 million)	Major Stock Holders
Nihon House Financing Co.	June 1971	7.38	Kyowa, Kobe, Sanwa, Chiba, Toyo Trust, Hokutaku, Mitsui, Mitsui Trust, Yokohama
House Loan Service	Sept. 1971	6.00	Fuji, Mitsubishi, Daiichi Kangyo, Saitama, Taiyo, Tokai
House Coordinate Center	Oct. 1971	5.00	Mitsui, Mitsubishi, Sumitomo, Yasuda, Toyo, Chuo
Mutual Bank House-Loan Center	July 1972	5.00	Mutual Banks

[a]Source: (2).

V. TWO STAGES FOR "OVERDRAFT" PROBLEM

A. The "overdraft" definition and measurement

For the special character of the Japanese financial system, Japanese economists usually called it "overloan" rather than "overdraft".

The definition for it is rather difficult, because it is defined in many ways by various economists. Nevertheless, most economists seem to agree with the following definition: "Banks, especially city banks, are in overdrafted situation to their undertakings; and the resulting financial difficulty was compensated by the borrowings from the central bank (The Bank of Japan)." In other words, we may define "overdraft" as "bank's excess credit over a long period which is mainly depended on the debt from the Bank of Japan."

The measurement for "overdraft" is again rather a difficult one. Basically, we may consider it through the degree of the ratio between loan and deposit in Table 4.1. But it's not possible for us to define which part of the ratio will be met from the "overdraft" phenomenon. However, we may measure banks' owned reserve, which is defined as follows: Banks' owned reserve = cash + deposit at the Bank of Japan - loan from the Bank of Japan.

Then overdrafted condition can be observed when banks' owned reserve is negative.

More specifically, owned reserve can also be expressed into the following measurement.
Owned reserve = cash - (check and draft + deposit + call loan) - (loan + call money).

Table 4.1 lists the owned reserve statistics during 1954-64, based upon the above formula.

Table 4.1. The balance sheet for owned reserve, 1954-1964[a]

Year		City Bank	Local Bank
		Unit: One million yen	
1954	First half	- 3,333	279
	Second half	- 2,343	453
1955	First half	- 1,578	528
	Second half	- 987	759
1956	First half	- 1,684	659
	Second half	- 3,336	758
1957	First half	- 5,595	777
	Second half	- 6,210	958
1958	First half	- 5,858	1,181
	Second half	- 4,751	1,109
1959	First half	- 5,488	1,361
	Second half	- 5,863	1,493
1960	First half	- 6,027	1,875
	Second half	- 6,634	1,511
1961	First half	-10,310	1,844
	Second half	-12,412	1,883
1962	First half	-15,579	2,338
	Second half	-13,998	2,503
1963	First half	-14,450	3,020
	Second half	-14,592	3,219
1964	First half	-19,488	3,791
	Second half	-20,002	4,180

[a]Source: (13).

Clearly, there was always a negative owned reserve existing between 1954-1964. So the overdraft phenomenon can be identified during these years.

We may turn to see how the overdrafted situation can damage the central banking policies.

In general, an "overdraft" situation exists. It means there is a deficiency in city banks' reserves. This results in pressure from the Bank of Japan to increase their reserves. In order to diminish the pressure from the Bank of Japan, city banks will turn to get call loans from the call market for additional reserves, in order to meet the Bank of Japan's requirement on reserve funds. Obviously, such action taken by city banks will result in an increase in the call rate, since there is an increase in demand for call money. If the increase in call rate offsets the increase in long-term interest rate, then there exists a difficulty for money flow to get into the debt market. Then the short-term financial market becomes an investment market and the interest rate's adjustment toward money supply and demand is weakened. It causes limitation to the market operation and the rate of reserve fund operation. Finally, it will force the Bank of Japan's financial policy to be only a lending policy.

If we look at Table 4.3, it indicates that despite a stabilized ratio of lendings, the "overdraft" from the Bank of Japan decreased substantially in 1971 and 1972. In the meantime, there was also a decrease in the ratio of external debt but not so substantially decreased compared to the ratio of the Bank of Japan's loan. That is because some of the debt which decreased from the Bank of Japan had gone to other money suppliers, especially from the call market.

Table 4.2. The ratio of loan against total deposit during 1954-1962, between city banks and local banks[a]

Year	City Bank %	Local Bank %
54	95.1	83.0
55	78.6	81.2
56	75.4	79.2
57	84.2	80.3
58	82.0	78.2
59	85.3	78.9
60	84.7	78.9
61	86.9	79.5
62	90.7	78.9

[a]Source: (24).

Table 4.3. The indicator for city banks' "overdraft" phenomenon, 1960-1972.[a]

Year	Ratio of Lendings[b] %	Ratio of External Debt[c] %	Ratio of the Bank of Japan's Loan[d] %
60	98	14	8
61	103	22	18
62	105	22	16
63	102	19	12
64	104	21	9
65	99	19	9
66	97	17	10
67	99	16	8
68	96	15	8
69	97	16	8
70	99	18	9
71	93	8	2
72	93	8	5

[a]Source: (24).

[b]The ratio of lendings $= \dfrac{\text{lendings}}{\text{actual deposit + debt issued}}$

[c]The ratio of external debt

$$= \frac{\text{credit money + call money - call loan}}{\text{actual deposit + debt issued + loan + call money - call loan}}$$

[d]The ratio of the Bank of Japan's loan

$$= \frac{\text{the Bank of Japan's loan}}{\text{actual deposit + debt issued + the Bank of Japan's loan}}$$

B. A brief introduction to the capital market and the call market

1. The capital market The existing capital market in Japan is mainly divided into public bond market, long-term deposit market, long-term lending market and consumption housing financing markets.

I pointed out that there was a partially developed capital market in the previous chapter where I was talking about the development of the stock market and the discount draft market. The debt market is still facing a lot of difficulty of the following nature:

First of all, the Japanese stock market started in 1949. In 1969, its trading amounts became the second in the world. It seemed to be operating very stably in Japan. The scale for it isn't big enough to influence the tendency of the economy. That is because the cost for capital absorption in the way of issuing bonds is considerably more expensive than the cost for capital absorption through banks' borrowing. Thus, the Bank of Japan supplies funds through the stock market in order to circulate bond and debt transactions.

Secondly, the most crucial issue of the Japanese capital market was the underdevelopment of the debt market, because it influenced both monetary and fiscal policies. The failure of the market in the early 60's deeply disturbed the Japanese financial organization while the economy was growing very fast. The debt operation first started in 1956, and was operating substantially in 1966.

How it failed was because most debt transactions were between financial institutions. The seller was mainly city banks and the buyer was mainly local banks and other middle-small financial institutions which held spare money. Thus, concerning money flow circulation, the debt circulating market is just playing the same role as the call market. Debts which are dealt in the market were mostly financial debts and industrial debts. Government debts, local debts and government guaranteed debts' transactions were scarce. Especially, the issued government debts mostly went to financial institutions. The Bank of Japan absorbed them through open market operation, so that the amount of the government debt held by financial institutions wouldn't increase. Thus financial institutions wouldn't have to sell government debts to others. The amounts of government debt transactions are still small even though the amount of government debt is large. Because of the governmental policy, the financial institutions (mainly city banks) are forced to accept those government debts and government guaranteed debts. However, those debts will be absorbed by the Bank of Japan. So there is no necessity for them to sell those debts. There was an increase in the amount of debt held by individuals. But most debts such as industrial debts and financial debts are still mainly held by financial institutions.

Financial institutions would buy newly issued debts if they had spare money. In a tight money situation, those financial institutions who have no spare money would rather take a slight loss to sell debts to the other financial institutions who have spare money. Obviously, those financial institutions without spare money are mainly city banks and those who have spare money are mainly local banks or long-term financial institutions.

Finally, the discount draft market was established in 1970 in order to meet the emergency expansion of the Bank of Japan's debt operation through the highly developed economy. The success of the market really led to real open market operations.

<u>2. Call market</u> The call market is quite important, since it's the main money supplier of the financial institutions other than the Bank of Japan to city banks.

Call money in the market is supplied by financial institutions, mainly local banks, trust banks, and mutual financing banks. Call loans are mostly demanded by city banks.

The uniqueness existing in this market is the phenomenon that the call rate is never lower than the discount rate in the Japanese economy.

Consider the normal situation where the discount rate ≥ call rate ≥ short-term government debt.[32] This means banks will either supply call money into the call market or buy short-term government debt or securities in order to meet their payment. When in tight money situations, they can sell these things above in order to collect their capital. If, indeed, the collected capital is still not enough, they will be forced to borrow from the central bank at a higher interest rate.

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[32]The reason for keeping call rate ≥ short-term government debt is that if a call rate is lower than short-term government debt, then the money supplier in the financial institution will buy short-term government debt, since it's more profitable and reliable. Thus, call money will be scarce.

But in fact, city banks in Japan have no intention of keeping their reserves up to a certain appropriate degree since they consider the risk bearing will be shared by the Bank of Japan and it's more profitable to maximize their lending to large enterprises. Thus, in order to maximize their lending capacities, they borrow from call market and the Bank of Japan technically.

The reason for call rate $\geq$ discount rate was because call loans had become the source of city banks' short-term lendings and also for use of the city banks' reserve payment.

C. Two-stage analysis

Now, we may turn to approach a simple analysis using various facts which are presented in the paper and the interpretations which I made from various aspects of the statistical data in order to clarify the relationships among those financial institutions, especially the central bank, city banks, local banks and related financial markets.

For the convenience of the analysis, I divided the period of those financial movements into two stages. The first stage was focusing on the period where the low interest policy was performed. The second stage was mainly concentrated on the inflow of a large amount of excess foreign currency which was caused by the big surplus of international balance in 1971-1972.

There are four factors in the first stage.

1. The Bank of Japan's interdependency with the government;
2. Governmental policy (the low interest rate policy);

3. City banks' "overdraft" from the Bank of Japan;

4. Enterprises' overborrowings.

The basis for the second stage was really caused by the low interest rate policy in the early 60's in the first stage.

From Figure 4.1, we can see the degree of mutual intervention on financial support.

First of all, the government, at that time, believed that in order to have a fast-growing economy, full support from the government was needed.[33]

Thus, the performance of the low interest rate policy[34] led most financial institutions, especially city banks, to activate their lendings toward the enterprises by the Bank of Japan's loan at low discount rate. Both the call market and the capital market's money flow were not very active.

Thus, under the full support from city banks, both large and middle-small enterprises in cities were fully operated even over their capacities of business on many fields including export. The growth of large enterprises, the close relationship between city banks and enterprises and city banks "overdraft" from the Bank of Japan were substantially established at this time, which really form the basis for the Japanese financial system.

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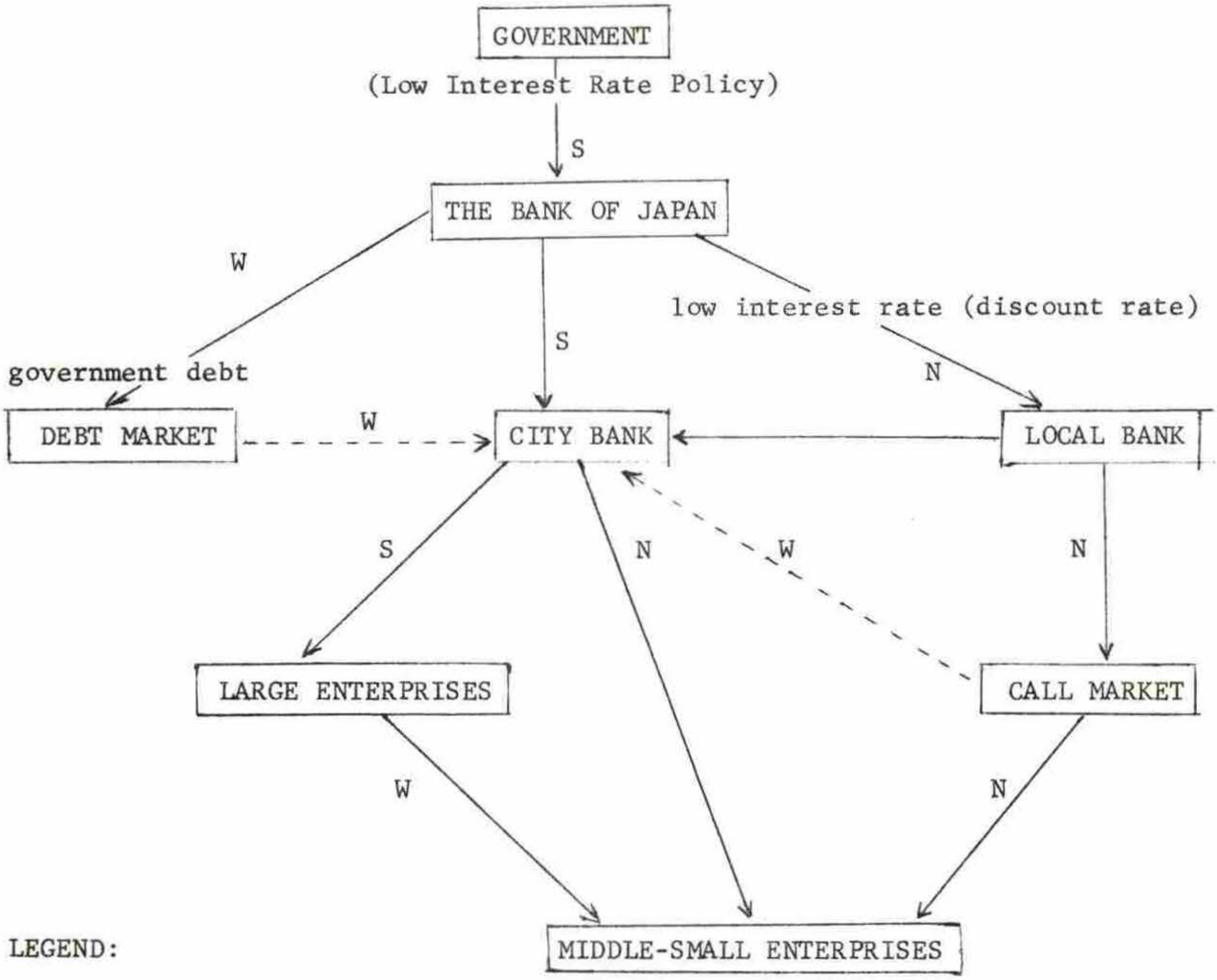
[33] In fact, without considering the failure of the good financial system, the policy did result in the Japanese economy growing very fast. One of the reasons for the success was because the economy, which had not been noticeable before, broke into the international level in 1964.

[34] Tax reduction on enterprises investment on accommodations is also included.



LEGEND:

S = The degree of influence is strong
N = The degree of influence is normal
W = The degree of influence is weak
U = The degree of influence is uncertain

Figure 4.1. The relationships among government, financial institutions and enterprises in the first stage

We may switch to the second stage to see what happened to the phenomenon which occurred in the first stage. There are four factors in this stage.

1. The Bank of Japan's interdependence with the government;
2. City banks' "overdraft" from the call market;
3. City banks' interdependence with the enterprises;
    a. credit rationing by city banks
    b. mutual exchange of stocks between city banks and the financial groups;
4. The relationship between the powerful financial groups and the government.

Because of the improvement in the economic growth and the expansion of foreign trade, the Japanese economy broke into the international market. The governmental policy toward the financial system was dramatically changed in a liberal manner to meet the international level and a better financial system which has been criticized constantly since the decampment of the government which had the low interest rate policy.

From Figure 4.2, we can observe that the relationships among those financial institutions and enterprises did change but didn't get better in the way of a healthy financial system.

In the second half of 1971 and the first half of 1972, there was an enormous increase in the amounts of foreign currency, which was caused by profitable foreign trade.

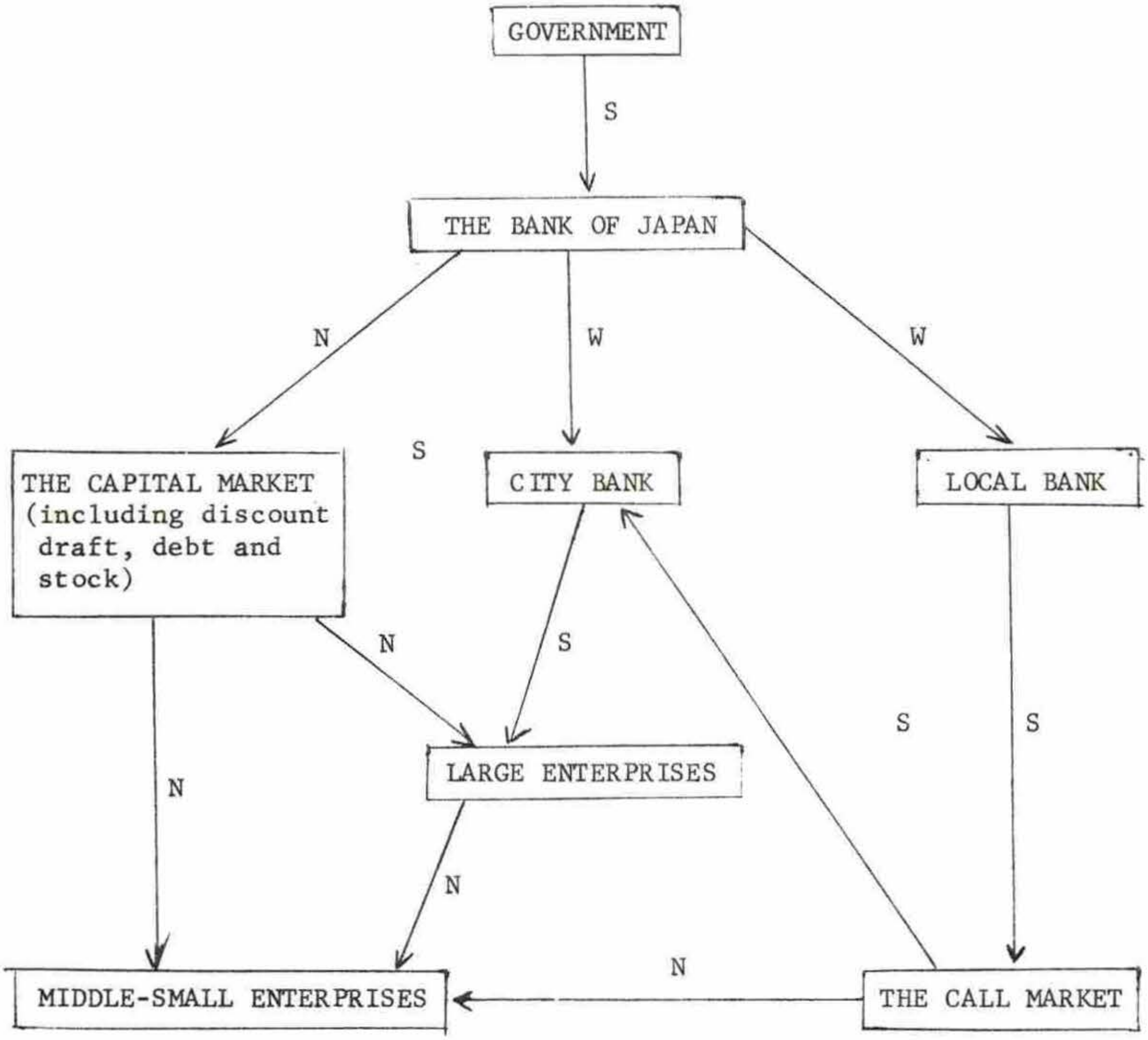


Figure 4.2. The relationships among government, financial institutions and enterprises in the second stage

The phenomenon[35] seemed to solve city banks' "overdraft" from the Bank of Japan for the time being. But actually on the one hand there was a substantial decrease of city banks' debt in the Bank of Japan's loan but on the other hand, there still was a substantial city bank debt in the call market. Two reasons can explain this matter:

1. In order to meet the competition among financial groups, city banks wanted to keep their excess money flow.[36]
2. Considering the unity of the financial group, city banks did not request enterprises to return their lendings since it was not profitable to do so.[37] The profits which enterprises obtained from the profitable exports were simply re-invested in many profitable businesses such as land and stock investment.

Indeed, city banks used their creditableness and followed the good tone of the market. They again kept their debt in the call market and the discount draft market for a better relation between the suppliers of call money and themselves.

From Figure 4.3, we can see the structure for the so-called "financial group".

The horizontal integrations of city banks are those financial institutions such as trust banks and insurance companies. Besides their general responsibilities, their policies are mostly parallel to the city banks' policies.

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[35] Because city banks took care of most foreign trade. Thus the amount of foreign currency inflow resulted in excess money circulation in city banks.

[36] Except for those turns to the Bank of Japan's loan. In order to relax the Bank of Japan's restrictions toward them.

[37] The reason has been explained in a previous chapter.

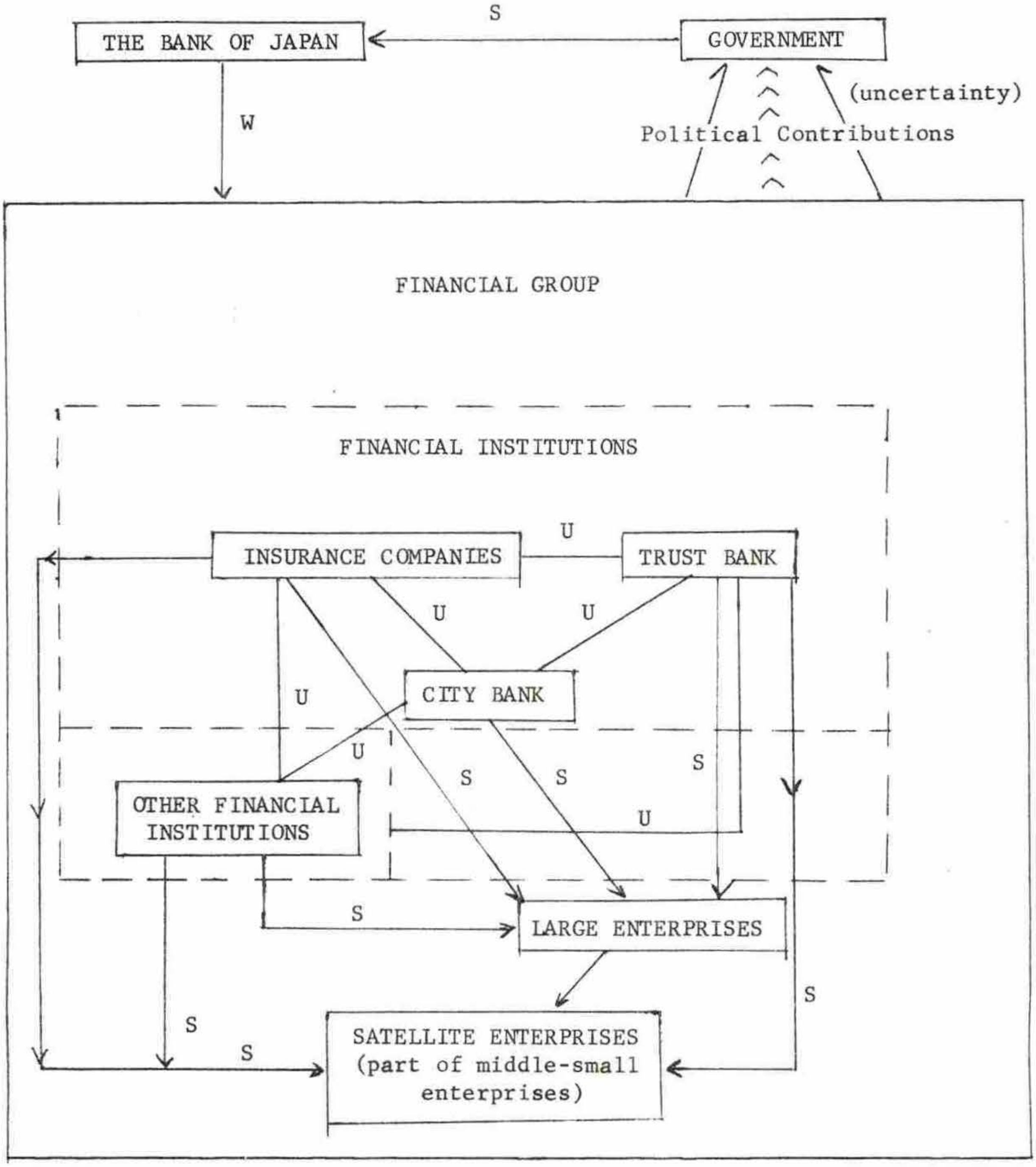

Figure 4.3. The mechanism of financial groups in recent years

The vertical integrations are (a) other small financial institutions which provided many different forms of money flow or credit supply in the business circle for which city banks can not serve directly; (b) large enterprises which were surrounded by many of their satellite enterprises in many major industries. The role that those satellite enterprises play is simply as a camouflage of their multi-approaches toward the same kind of industries seemingly for the prevention of monopoly, and sometimes, because of the political considerations toward the communist countries.

Finally, considering the financial groups as a whole, the governmental intervention[38] has become very common in the country. The derivation of the governmental intervention by the financial groups could have become a disaster for the central bank which is so dependent on the government.

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[38]Mainly, political contributions toward the general election and government officers.

VI. SUMMARY AND CONCLUSION

The main idea of this paper is to present the basic understanding of the Japanese financial system. Thus, the introduction of each individual financial institution is needed.

Chapter I, describes the role and the system for the Bank of Japan following the movement of the amendment of the law of the Bank of Japan.

It showed the linked relationship between the government and the bank which so strongly affected the smoothness of the reform in the law of the Bank of Japan. The resulting situation showed the strange phenomenon that 55 percent of the whole central bank's capital is financed by the government. Without any explanation, the whole system inside the bank appears to be just part of the governmental institutions.

Next, I turned to describing the general role which the central bank played and used this to explain the major financial policies along with the existence of the interdependence with the government. This should give a basic understanding of central banking and related policies.

The city banks' behavior and the positions in which they stood relative to the central bank under the "overdraft" situation, and the related movement of other financial institutions, especially local banks, is also introduced in Chapter II.

To the best of my knowledge, the important contribution of the thesis is the disclosure of the existence of the financial group which includes systematized financial institutions and systematized enterprises. This disclosure is presented in Chapter III.

The original reason for their growth was caused by the low interest rate policy in the early 60's.

The more basic reason for the growth was caused by the mutually inclusive relationships.

These financial groups are the major disturbing factors in the Japanese central banking. The contents of these financial groups are precisely introduced by either vertical or horizontal integrations in this chapter.

Chapter IV combines all the facts which I have introduced in previous chapters, in order to clarify the problem of "overdraft" and its results.

I divided the stages into two major parts. The purpose here was to analyze two different financial systems and policies through two time periods of interest.

As a necessary part of the analysis, the capital and the call market are also introduced in this chapter.

Thus, we may conclude that this is a basic study of the Japanese financial system during the 60's and 70's. The governmental interventions in the central bank had resulted in an "overdraft" condition for city banks and the "overborrowing" condition for enterprises, especially in the early 60's. Because of the expansions of city banks and enterprises, in the later 60's and early 70's, the relation between city banks and enterprises have been tightened. The financial groups have been built up by the over-competition of both city banks and enterprises in many industrial areas.

Thus, city banks as well as some financial institutions became part of the financial groups.

Because the large proportion of the economy was dependent on export, the financial groups, including city banks and several of the enterprises, are getting bigger and bigger. This phenomenon was and is happening now in Japan.

We can conclude that their political influences toward the government as well as toward the central banking are significant.

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IX. APPENDIX A: THE DATA CONCERNING THE BANK OF JAPAN

Table A.1. Substantial capital banance of the Bank of Japan during 1960 to 1972 (Unit, 100 million yen)[a]

			FINANCIAL CAPITAL				
Year	Bank Note	Total	General	Food Control	Foreign Exchange Capital	New Long-term Government Bond	Others
60	2,003	51	-2,659	323	2,387	--	-181
61	2,171	-4,909	-2,725	25	-2,209	--	-543
62	2,343	2,033	- 118	538	1,613	--	-719
63	2,465	614	580	69	-35	--	-238
64	2,475	4,394	2,960	1,379	55	--	-1,654
65	2,580	2,662	2,073	1,609	65	-1,085	-275
66	3,635	-2,220	2,218	2,615	-397	-6,656	-1,443
67	4,618	-752	484	5,235	-655	-5,816	-1,527
68	5,306	3,478	-1,763	5,477	4,434	-4,670	-2,536
69	6,895	1,312	-3,481	4,333	4,286	-3,826	-2,362
70	6,490	-1,447	-7,077	2,047	6,755	-3,172	-2,960
71	7,114	30,282	-3,771	-331	43,556	-9,172	-1,261
72	15,350	474	-2,184	1,690	17,870	-16,902	788

[a]Source: (12 and 24).

Table A.1. Continued.

Year	Reserve Deposit	Total	The Bank of Japan's Credit: Lending	Debt Balance	Short-Term Debt Balance	Short-term Government Debt Balance	Others
60	-73	2,206	2,205	1	--	--	--
61	-602	8,225	6,860	1,365	--	--	--
62	286	743	122	621	--	--	--
63	-1,233	3,322	-1,520	4,842	--	--	--
64	552	-817	1,346	-2,163	--	--	--
65	-927	1,120	2,975	-1,855	--	--	--
66	597	6,701	930	5,624	--	--	147
67	-893	7,790	-1,371	8,850	--	--	311
68	272	4,092	-169	4,098	--	--	163
69	-1,855	9,800	4,269	4,526	908	--	97
70	-567	11,464	4,385	8,102	1,525	-3,000	452
71	-227	-21,680	-17,780	-1,501	-2,433	3,000	-2,966
72	-6,412	-20,499	-10,795	-135	--	--	9,842

Table A.2. The derivation of currency supply and demand by regional groups between 1956 and 1963 (Unit: 100 million yen)[a]

	Financial Balance (A)		Bank Note Balance (B)		Currency Supply and Demand (A-B)		The Bank of Japan's Credit[b]		
Year	Major Five Cities	Other Areas	Major Five Cities	Other Areas	Major Five Cities	Other Areas	Lend-ing	Debt Operation	Total
56	-2,787	1,153	-81	995	-2,706	158	2,491	34	2,525
57	-4,228	1,631	-396	621	-3,832	1,010	3,118	17	3,135
58	-211	2,721	-68	744	-143	1,977	-1,759	-4	-1,796
59	-2,267	3,600	293	910	-2,560	2,590	134	--	166
60	-4,224	4,178	992	1,020	-5,216	3,166	2,205	--	2,206
61	-9,995	5,022	1,826	342	-11,824	4,680	6,860	1,365	8,225
62	-5,699	7,660	1,696	647	-7,395	7,013	122	621	743
63	-7,839	8,337	2,020	444	-9,859	7,863	-1,520	4,842	3,322

[a]Source: (25).

[b]Computation of The Bank of Japan's Credit is adopted from "Japanese currency and food price" by Yoshio Suzuki, 1964, P. 32.

Table A.3. The distribution of the Bank of Japan's property (1956-1962)[a]

Year	Lendings[b] To Private %[d]	Gold and Foreign Currency %	Government[c] Bond %	Others %
56	12.7	23.4	57.0	6.9
57	62.0	8.3	22.5	7.2
58	55.1	11.9	22.8	10.2
59	42.8	19.3	31.5	6.4
60	39.8	23.0	32.3	4.9
61	71.0	21.6	2.9	4.5
62	80.4	15.4	1.3	2.9

[a]Source: (24).

[b]Lendings included foreign exchange lendings.

[c]Government debt included governmental lending.

[d]Unit is the percentage against total property.

Table A.4. The principle account of the Bank of Japan in the end of 1962[a]

Debt	Unit: 100 million yen	Assets	
Bank Note	17,460 (100%)[b]	Gold and Foreign Currency Reserve	7,840 (16.3%)[b]
Financial Institution's Deposit	410 (2.3%)	Lendings in Cities	12,850 (73.6%)
Governmental Deposit	200 (1.2%)	Government Debt (included government lending)	3,780 (21.7%)

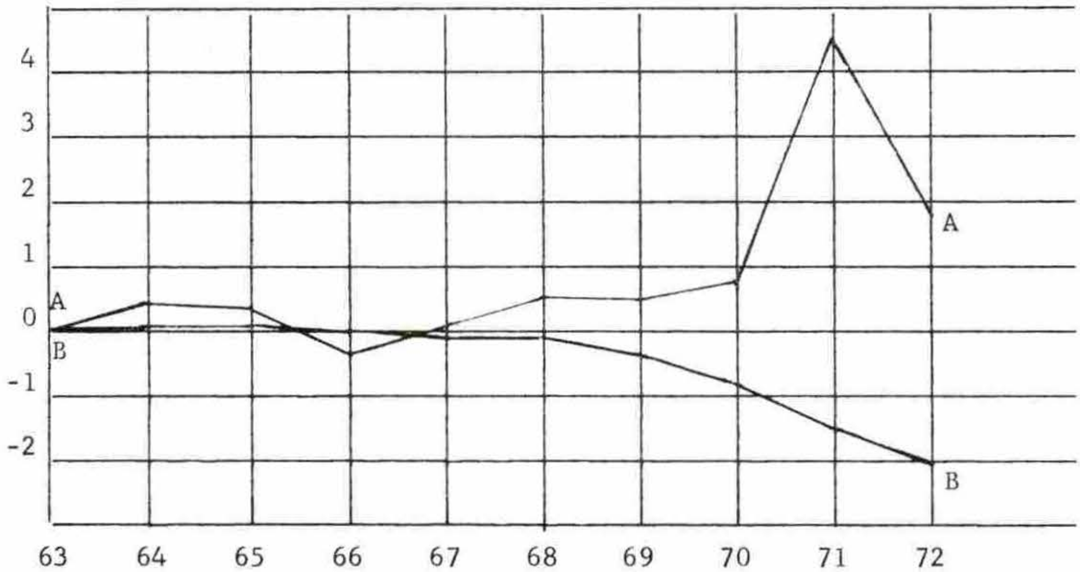
[a]Source: (24).

[b]Numbers in parentheses are the percentage against the total amount of bank note.

Table A.5. The statistics of debt operation between 1960 to 1964[a]

Year		City Bank	Local Bank
		Unit: 100 million yen	
60	excess buying	3.4	0.6
61	excess buying	1,061.1	250.4
62	excess buying	448.3	108.1
63	excess buying	3,707.4	871.7
64	excess selling	-1,687.9	-380.7

[a]Source: (14).



Source: (24).

Line (A) is capital balance for foreign exchange.

Line (B) is financial capital balance excluding (A).

Figure A.1. Derivation for financial capital against civilian (Unit: one billion yen)

X. APPENDIX B: THE DATA CONCERNING LOCAL BANKS AND CITY BANKS

Table B.1. The comparison of the rate of return on lendings between city banks and local banks (1957 and 1964)[a]

Year		City Bank	Local Bank
		Unit: %	
57	The rate return on lendings	3.358	8.774
	The rate return on both lendings and debt	8.216	8.581
	The rate return on call money	8.203	11.059
	The proportion of call loan's return against total return	0.600	2.600
64	The rate return on lendings	7.758	8.200
	The rate return on both lendings and debt	7.628	8.052
	The rate return on call money	5.591	11.309
	The proportion of call loan's return against total return	0.100	5.400

[a]Source: (4) and (5).

Table B.2. The comparison between city banks' and local banks' lendings toward large (A) and middle-small (B) enterprises (1953-1964)[a]

Year	City Banks: Lending Toward (A)[b]	City Banks: Lending Toward (B)	Local Banks: Lending Toward (A)	Local Banks: Lending Toward (B)
		Unit: %		
53	68.6	31.4	38.0	62.0
54	71.4	28.6	42.9	57.1
55	68.8	31.2	41.8	58.2
56	67.4	32.6	38.3	61.7
57	73.5	26.5	42.5	57.5
58	73.2	26.8	44.5	55.5
59	72.1	27.9	44.3	55.7
60	73.4	26.6	45.6	54.4
61	74.4	25.6	46.4	53.6
62	76.9	23.1	49.3	50.6
63	79.5	20.5	50.4	49.7
64	81.0	19.0	52.4	47.6

[a]Source: (24).

[b]Large enterprises are defined as the companies which capitalized above fifty million yen.

Table B.3. The debt holdings between city banks and local banks (1962-1964)[a]

	Year	Government Debt	Local Debt	Financial Debt	Others
			Unit: 100 million yen		
City Bank	62	31	277	299	188
	63	32	502	394	303
	64	34	716	665	393
Local Bank	62	68	242	1,284	937
	63	68	312	1,456	1,116
	64	64	393	1,418	1,402

[a]Source: (5).

Table B.4. The balance sheet of city banks' and local banks' lendings by regional groups (1964)[a]

		City Bank		Local Bank	
		Unit: 100 million yen			
Five Major Cities	Deposit (A)	89,374	(100%)[b]	14,966	(100%)[b]
	Lendings (B)	84,325	(94.3%)	13,416	(89.6%)
	Balance of (A) & (B)	5,049		1,550	
Other Areas	Deposit (A)	13,808	(100%)	42,499	(100%)
	Lendings (B)	7,782	(56.4%)	32,061	(75.4%)
	Balance of (A) & (B)	6,026		10,438	
	Call Loan	10		1,630	
	Call Money	7,277		313	
	Difference	-7,267		1,317	
	Loan to Financial Institutions	--		37	
	Debt to Financial Institutions	3,196		72	
	Difference	-3,196		-35	
	Deposit in Financial Institutions	2,234		1,368	
	Deposit from Financial Institutions	7,928		2,355	
	Difference	-5,694		-987	
	Securities	17,230		7,924	
	Lendings from the Bank of Japan	13,365		137	

[a]Source: (5).

[b]Numbers in parentheses are the percentage of lendings against deposit.

Table B.5. The comparison between large and middle-small enterprises concerning the proportion of capital for accommodation in total lendings (1963)

	Large Enterprises		Middle-Small Enterprises	
	Capital for Accommodation	Balance of Total Lendings	Capital for Accommodation	Balance of Total Lendings
City Banks	13.6%	47.1%	7.5%	22.8%
Local Banks	3.7%	13.5%	11.9%	26.0%

Table B.6. City banks external debt from 1954 to 1964[a]

Year	Total Capital Used[b]	Credit Loan	BJ's Loan	Call Money	Debt and Call Money
		Unit: 100 million yen			
54	27,518 (100)[c]	2,346 (8.2)	2,122 (7.7)	568 (2.1)	(9.8)
55	31,977 (100)	834 (2.6)	291 (0.9)	747 (2.3)	(4.9)
56	42,798 (100)	1,951 (4.6)	1,170 (2.7)	910 (2.1)	(6.7)
57	50,937 (100)	5,497 (10.8)	5,201 (10.2)	1,258 (2.5)	(13.3)
58	56,747 (100)	3,960 (7.0)	3,361 (5.9)	1,806 (3.2)	(10.2)
59	65,128 (100)	4,285 (6.6)	2,899 (4.4)	2,297 (3.5)	(10.1)
60	79,387 (100)	5,733 (7.2)	4,349 (5.5)	2,376 (3.0)	(10.2)
61	98,801 (100)	13,320 (13.5)	11,177 (12.3)	1,903 (1.9)	(15.4)
62	113,496 (100)	13,890 (12.2)	11,894 (10.5)	3,747 (3.3)	(15.5)
63	144,162 (100)	13,283 (9.2)	10,847 (7.5)	5,542 (3.8)	(14.0)
64	168,555 (100)	13,622 (8.1)	9,370 (5.6)	10,810 (6.4)	(14.5)

[a]Source: (5) and (24).

[b]Total capital used = Capital + Debt.

[c]Numbers in parentheses are the percentage against total capital used.

Table B.7. Capital distribution for major financial institutions in 1961 and 1971[a]

	1961 (percent)	1971 (percent)
City Bank	39.2	35.4
Local Bank	22.3	19.4
Trust Bank	8.1	10.6
Long-term Credit Bank	7.2	7.6
Mutual Bank	8.8	8.4
Credit Bureau	7.9	10.5
Others	6.4	8.1

[a]Source: (24).

Table B.8. The averaged balance of call market money flow concerning city banks and local banks only (1953-1964)[a]

	Call Money Supplier		Call Money Demander	
Year	City Bank	Local Bank	City Bank	Local Bank
	Unit: Percent			
53[b,c]	15.7	15.5	56.3	14.9
54[b,c]	30.1	30.1	77.2	7.3
55[b,c]	20.1	20.1	72.7	6.8
56[b]	17.1	26.5	63.2	5.5
57[b]	12.0	21.4	61.2	6.1
58[b]	14.4	26.5	64.3	4.1
59[b]	9.4	25.8	63.4	3.4
60[b]	2.7	23.3	55.2	2.2
61[d]	6.5	17.7	43.7	5.3
62[d]	0.5	22.1	55.8	2.2
63[d]	0.3	14.9	68.7	3.5
64[d]	0.1	11.5	80.5	2.4

[a]Source: (13).

[b]1953-1960 was the total of Tokyo and Osaka markets.

[c]1953-1955, city banks included long-term credit bank.

[d]1961-1964 included newly established Nagoya Market.

Table B.9. The statistics of city and local banks' owned capital in 1972[a]

Capital (a)	Reserve Fund (b)	Owned Capital (a) + (b) Unit: 100 million yen	Deposit & Debt (d)	a/d	c/d	a/c
8,216	32,568	(40,784	713,016	1.2%	5.7%	20.1%

[a]Source: (13).

Table B.10. Financial institutions' lending balance toward the enterprises in selected years[a]

	Toward Large Enterprises		Toward Middle-Small Enterprises[b]	
Year	(A)[c]	(B)[d]	(A)[c]	(B)[d]
55	58.8		41.2	
59	59.5		40.5	
64	61.4	57.6	38.6	42.4
69		56.0		44.0
72		55.1		44.9

[a]Source: (13).

[b]Middle-small enterprises includes individuals.

[c](A) Large enterprises which are capitalized above 10 million yen.

[d](B) Large enterprises which are capitalized above 50 million yen.

Table B.11. The proportion of large enterprises' loaning from city and local banks in selected years in percentages[a]

Year	City Bank		Local Bank	
	(A)	(B)	(A)	(B)
55	68.9		41.8	
59	72.1		44.3	
64	81.0	76.0	52.4	44.6
69		73.8		43.5
72		69.6		45.0

[a]Source: (13).

Table B.12. The movement of city and local banks' deposit in selected years[a]

		1961	1968	1971	1973
		-percent-			
Fixed Deposit against Total Deposit	City Bank	51.5	52.8	56.7	53.1
	Local Bank	62.6	60.1	60.3	57.2
Personal Deposit against Total Deposit	City Bank	33.5	33.9	35.7	32.5
	Local Bank	53.2	49.4	49.3	49.0
Fixed Deposit against Judirical Person's Deposit	City Bank	39.7	44.5	46.7	43.8
	Local Bank	46.2	44.7	45.5	42.7
Fixed Deposit against Personal Deposit	City Bank	71.2	75.5	74.8	71.3
	Local Bank	75.7	75.9	75.5	71.5

[a]Source: (13).

Table B.13. City and local banks' capital cost during 1958 to 1964[a]

Year	Averaged Deposit Interest Rate	Personal Expenses	Non-Personal Expenses	Tax Rate	Total
			City Bank		
58	4.139	1.350	0.853	0.269	6.613
59	4.260	1.260	0.811	0.237	6.568
60	4.313	1.105	0.781	0.272	6.443
61	4.066	1.118	0.794	0.244	6.219
62	4.061	1.077	0.830	0.241	6.240
63	3.882	1.052	0.817	0.377	6.038
64[b]	3.917	1.050	0.817	0.377	6.161
			Local Bank		
58	4.408	1.522	0.685	0.299	6.914
59	4.502	1.370	0.654	0.293	6.819
60	4.490	1.301	0.627	0.311	6.729
61	4.176	1.256	0.658	0.402	6.492
62	4.115	1.223	0.678	0.390	6.476
63	4.068	1.223	0.678	0.390	6.359
64[b]	4.033	1.224	0.688	1.074	7.019

[a]Source: (5).

[b]Tax rate in 1964 included juridical person tax.

Table B.14. City and local banks' capital cost and the rate of return from lendings in 1973[a]

	City Bank	Local Bank
	-percent-	
Interest rate for deposit	4.133	3.941
Rate for personal and non-personal expenses	1.625	1.847
Tax rate	0.093	0.058
Cost for deposit	5.977	6.004
The interest rate for loan	4.769	4.320
Cost for deposit, loan and call money	5.776	5.839
Rate of return on lendings	6.660	7.263
Profit margin[b] from lendings	0.690	1.242

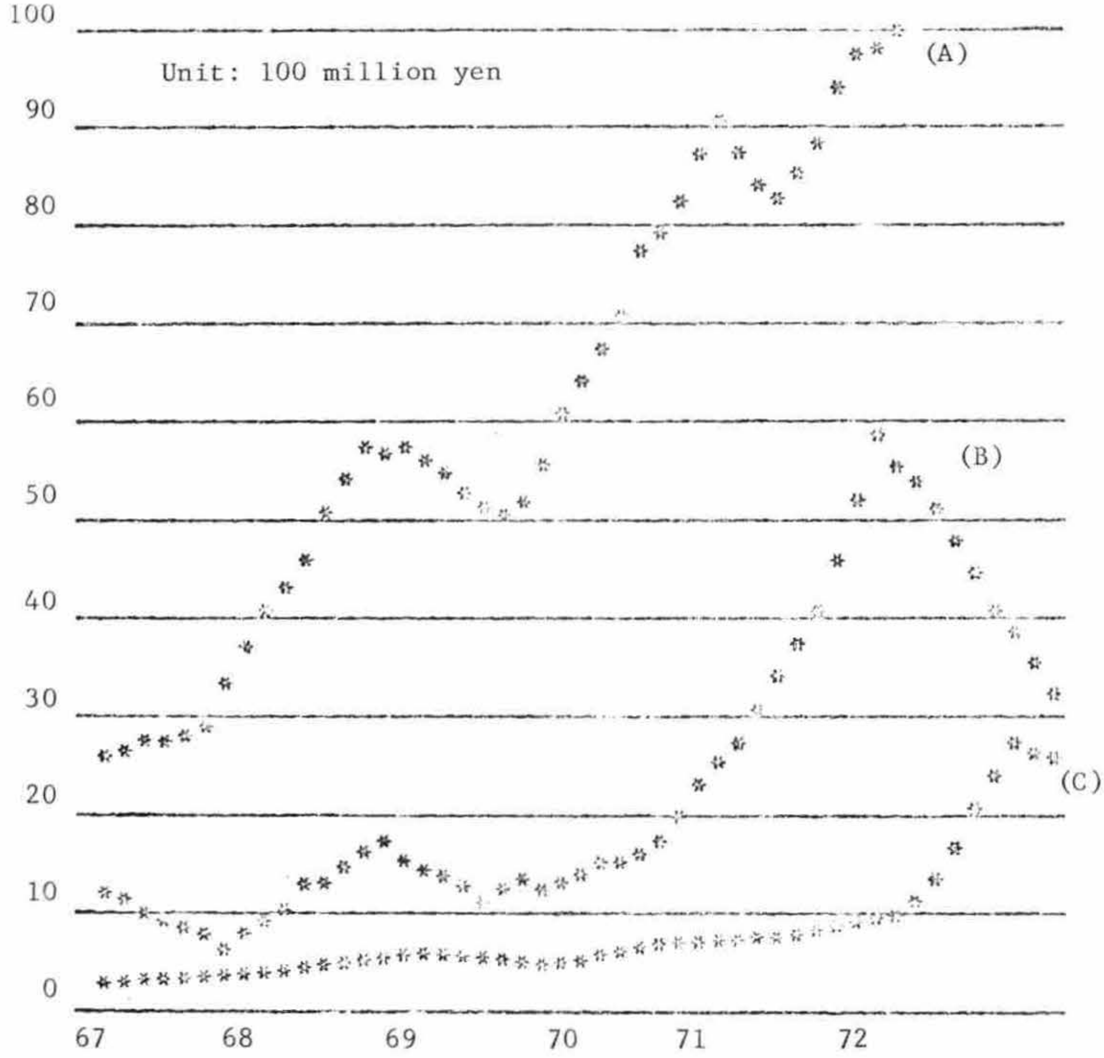
[a]Source: (6).

[b]The profit margin against the cost for deposit.

Table B.15. Current situation of the major city banks in September, 1972[a]

	Capital	Deposit & Debt
	Unit: 100 million yen	
Daiichi Kangyo	540	50,632
Mitsui	400	29,430
Fuji	504	43,797
Mitsubishi	504	42,046
Kyowa	240	20,885
Sanwa	504	38,488
Sumitomo	504	42,759
Daiwa	240	18,220
Tokai	380	30,269
Tokyo	300	19,334
Nihon Kogyo	480	36,207
Nihon Choki	340	28,299

[a]Source: (6).



Source: (13).

(A) indicates large enterprises and (B) indicates middle-small enterprises. (C) indicates individuals.

Figure B.1. A graphic approach to the additional city banks' lendings (1967-1972)

XI. APPENDIX C: SUBJECT TO BANK-RELATED ENTERPRISES

Table C.1. The proportion of financial institutions' lendings toward enterprises during 1953 to 1964[a]

Year	Toward Large Enterprises	Toward Middle-Small Enterprises[b]
	- percent -	
53	57.7	42.3
54	60.0	40.0
55	58.8	41.2
56	57.1	42.9
57	56.4	43.6
58	54.8	45.2
59	53.5	46.5
60	53.6	46.4
61	53.9	46.1
62	51.4	48.6
63	60.0	40.0
64	60.9	39.1

[a]Source: (24).

[b]Middle-small enterprises are defined as the enterprises or individuals which are capitalized under 10 million yen.

Table C.2. The difference of actual interest rate concerning the enterprises during 1958 to 1962[a]

	Gross Rate of Interest		Actual Rate of Interest	
Year	Large Enterprises	Middle-Small Enterprises	Large Enterprises	Middle-Small Enterprises
58	8.43	9.67	8.62	10.54
59	8.24	9.62	8.44	10.59
60	8.44	9.59	8.63	10.66
61	8.48	9.26	8.73	10.22
62	8.55	9.51	8.65	10.51

[a]Source: (23).

Table C.3. The comparison of averaged loan interest rate between different scale of enterprises during 1956 to 1970[a]

Enterprises' Capital	Averaged 1956-60	1961-65	1966-70
Under 5 millions	17.02	14.05	13.29
5-10 millions	14.99	15.02	13.96
10-50 millions	14.27	15.43	14.18
50-100 millions	13.38	14.44	13.60
Above 100 millions	9.56	10.02	9.85
Above 1000 millions	8.52	9.32	9.26

[a]Source: (24).

Table C.4. The capital distribution for juridical-person' enterprises in selected year[a]

Against Total Capital Used	1964					
	A[b]	B[c]	C[c]	D[e]	E[f]	F[g]
			-percent-			
Owned Capital	19.3	17.7	15.6	17.3	18.5	24.5
Floating Debt	71.9	73.6	70.8	64.3	61.7	49.5
Fixed Debt	8.8	8.7	13.6	18.3	19.7	26.0
Debenture	--	--	--	0.1	0.1	5.0
Loans from Financial Institutions	24.1	23.7	23.7	27.7	27.8	34.4
Long-term Loan from Financial Institutions	23.2	21.1	33.1	40.4	44.4	49.5
Discount Draft against Credit Sell	26.7	27.6	49.1	44.1	44.2	30.0
Fixed Debt against Fixed Assets	32.2	31.4	46.7	52.5	53.0	56.3

[a]Source: (16).

[b]A: under 2 million yen.

[c]B: 2-10 million yen.

[d]C: 10-50 million yen.

[e]D: 50-100 million yen.

[f]E: 100-1000 million yen.

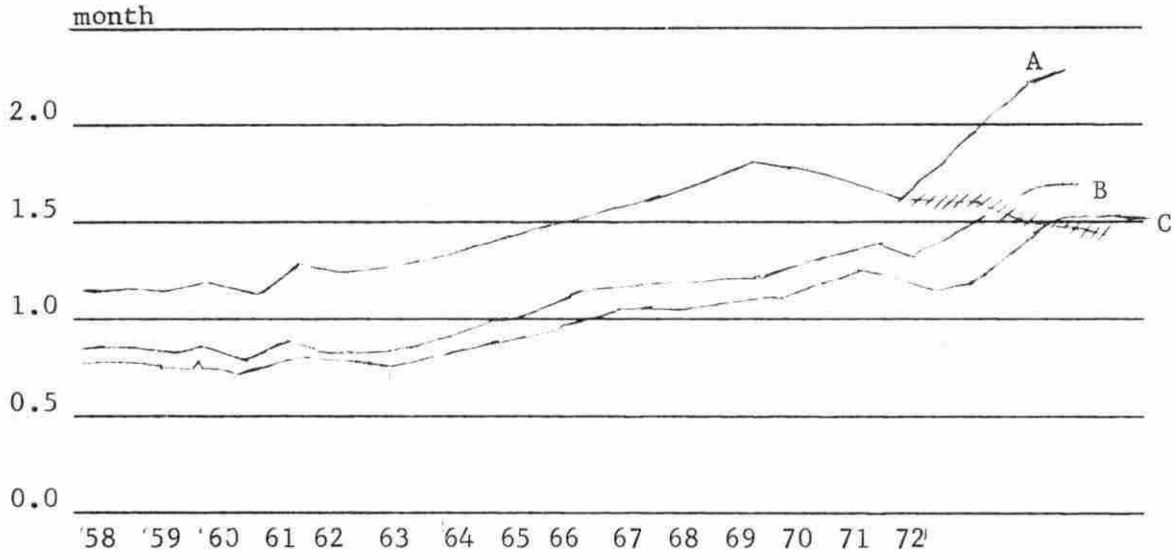
[g]F: above 1000 million yen.

Table C.5. The proportion of financial institutions' loan of different scale enterprises in selected years[a]

Year	Scale of Enterprises (100 million yen)	Proportion of Enterprises %	Balance of Total Capital %	Financial Institutions' Loan (A)[b] %	Long-Term Loan in (A)[b] %
1972	2-10	77.7	11.9	10.9	7.7
	10-50	18.4	17.0	15.3	13.1
	50-100	1.8	5.0	4.5	3.9
	100-1000	1.8	16.5	17.0	18.0
	above 1000	0.3	48.5	52.0	57.3
1959	2-10	85.1	19.5	17.0	7.3
	10-50	11.3	11.4	9.3	6.4
	50-100	1.4	4.6	4.2	3.2
	100-1000	1.8	17.8	18.4	18.4
	above 1000	0.4	46.6	51.1	64.7

[a]Source: (15) and (17).

[b](A) is total of debt and capital.



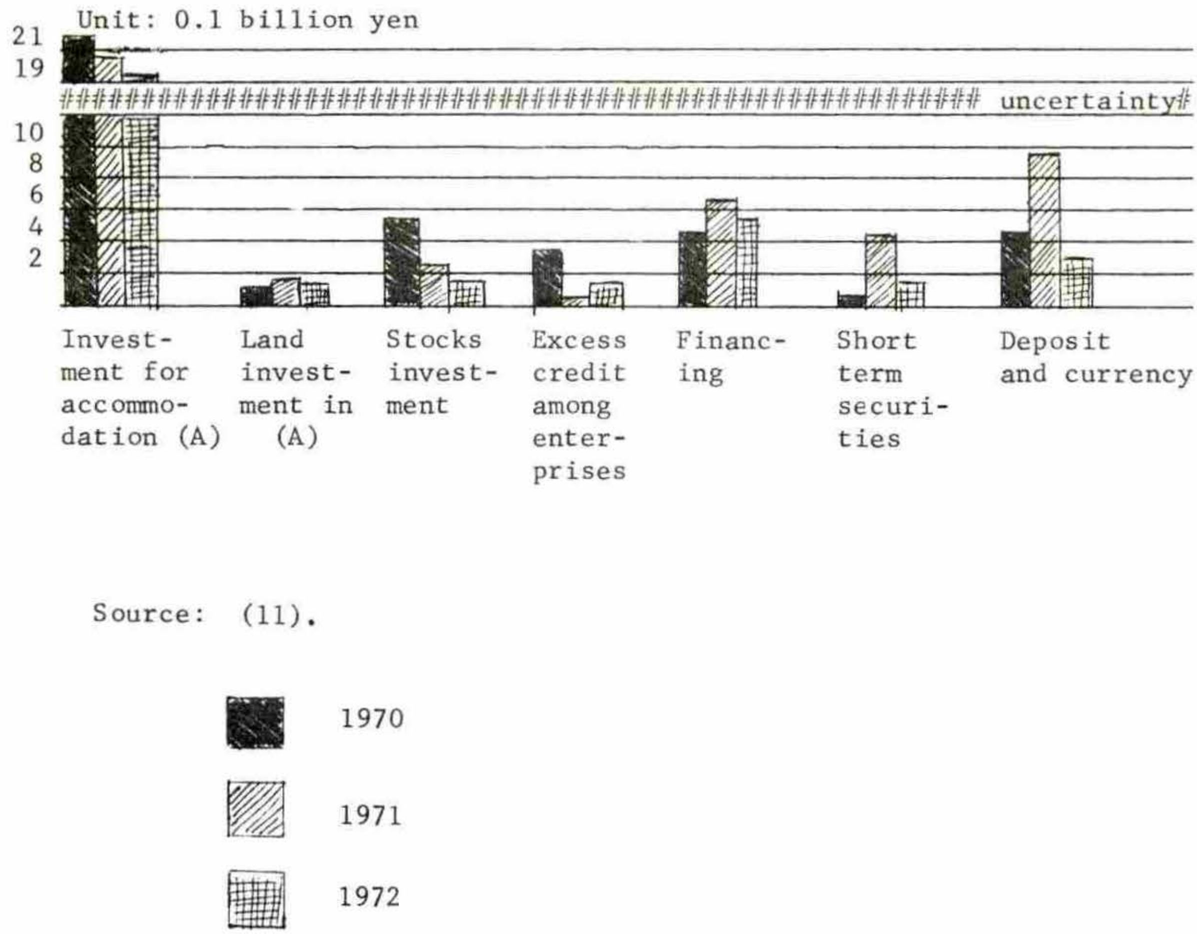
Source: (11).

$$A = \frac{\text{currency, deposit + securities}}{\text{averaged amount of monthly sell}}$$

$$B = \frac{\text{currency, deposit + short-term securities}}{\text{averaged amount of monthly sell}}$$

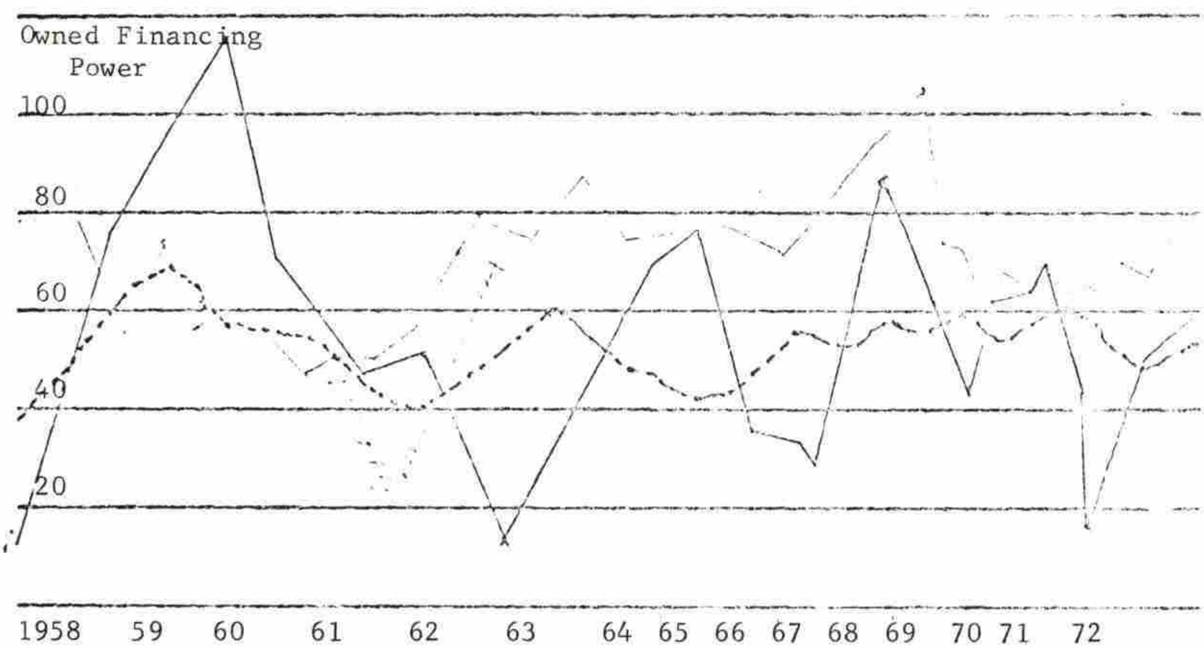
$$C = \frac{\text{currency, deposit balance}}{\text{averaged amount of monthly sell}}$$

Figure C.1. The money floating movement of major enterprises during 1958 to 1972



Source: (11).

Figure C.2. The alternation of capital demand for major enterprises



Source: (11).

A = the rate of actual profit balance

B = owned financing power = $\frac{\text{owned capital}}{\text{object investment}}$

C = the rate of selling amount balance

Object investment = investment of accommodation + stocks' investment.

Figure C.3. Owned financing power of major enterprises during 1958 to 1972

XII. APPENDIX D: MISCELLANEOUS

Table D.1. Mutual stock sharing ratio of systematized city banks' lendings in 1963[a]

Group	The ratio of mutual stock sharing	The ratio of stock sharing by major banks	The ratio of stock sharing by systematized financial institutions
		-percent-	
Mitsui	9.633	2.258	5.523
Mitsubishi	17.752	2.709	12.540
Sumitomo	19.189	4.277	12.497
Fuji	10.335	4.181	7.072
Daiichi	10.176	2.801	4.617
Sanwa	9.962	3.347	6.428

[a]Source: (26).