THE BANKING SYSTEM IN JAPAN AND ITS PROBLEMS

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I

The modernization of the monetary system in Japan dates back to the time when the Mexican dollar was first imported, as a result of which, the treble metallic standard, or parallel standard based on gold, silver and copper, which had been in force during the Tokugawa Shogunate, was replaced by the modern gold standard, and with its development the banking system began to be well organized. Until the Kawase Kaisha, an exchange firm, was established as a banking institution in the Meiji era, exchange brokers, pawn-shops and money lenders had constituted the banking institutions in Japan. Many of the old style banking concerns found it hard to maintain their business towards the end of the Tokugawa era, because of the decline in the price of silver, which had remained very high after 1830, as shown by the parity of gold and silver contained in the old Ichi-Bu-Gin (i.e. silver coin of 2.3 momme weight). The parity of the old Ichi-Bu-Gin was 1 : 4.669 in the 8th year of the Tempo era (1837), while the parity of the new Ichi-Bu-Gin became unfavourable to silver with 1 : 5.132 in the 6th year of the Ansei era (1859). The parity of gold and silver in foreign countries was around 1 : 15.5 at that time, and the Japanese parity began to approach that of foreign countries with the commencement of foreign trade.

The decline in the price of silver in Japan hit hardest the traders in Osaka who traded much by silver. Furthermore, owing to the prohibition of transactions in "Gimme"—a silver monetary unit weighing sixty "momme" to one gold "Ryo"—in 1867, exchange brokers in Osaka, where transactions in bills expressed in "Gimme" were prevalent, failed in succession. Accordingly, the Meiji Government sponsored the establishment of exchange firms in eight cities, making them financial organs as a new type of bank, with the right of issue. But such firms which had no experience in the management of the new type of bank proved to be loose in the issue of bank notes, and found it very hard to maintain themselves owing to the increase of distressed loans around 1872, and were all finally dissolved except the Yokohama Exchange Company which was converted into the Second National Bank. The national bank system was introduced by Hirobumi Ito from America in the same way as the New Currency Act, 1872, which was based on the recommendation of Ito. This bank system was established under the National Bank Act, November 15, 1873, the principal purposes of which were first to supply funds to industries and second to readjust paper money. Gold Certificates (Kinsatsu) and other Government Notes which had been issued from the beginning of the Meiji era (1868) became difficult either to withdraw or to convert.

Both the withdrawal and conversion of the Gold Certificates and other Government Notes, which had been issued since the beginning of the Meiji era (1868), became impossible; moreover, even the paper money issued in large amounts by the eight exchange companies became inconvertible. Thereupon, the Government endeavoured to make it possible automatically to change Government Notes into national bank notes, convertible into gold specie, by establishing national banks and thereby to supply funds to industries by resorting to the issue of convertible bank notes. This was an attempt to supply money through commercial banks which was merely an imitation of the system in America. The national banks paid 60 percent of their capital to the Government in Government Notes, while the Government in exchange delivered 6% Exchequer Bonds for Exchange Gold Certificates to the national banks, which deposited these Exchequer Bonds with the Government and received in exchange national bank notes which they supplied through discounts or loans to industrial circles. Forty percent of the capital of a national bank was kept in gold specie, which was made a convertible reserve. If this plan had successfully been realized, both the supply of funds to industry and readjustment of inconvertible notes would have been carried out simultaneously. According to the above mentioned National Bank Act, the First National Bank was established in Tokyo, the Second National Bank in Yokohama, the Fourth National Bank in Niigata and the Fifth National Bank in Osaka; the Third National Bank was approved to be established in Osaka but failed to open. Since, however, these national banks enjoyed little credit with the public and, moreover, there were margins between silver and paper money, a run occurred on the bank notes issued and, consequently, these banks fell into difficulties in maintaining their business with the bank notes issued showing little increase.

Meantime, inflation which had started early in Meiji era became aggravated, with a consequent greater margin between silver and paper money. Hence, only four national banks could get established, and thus the plan of supplying funds to industry by national banks proved to be quite contrary to expectations. Thereupon, the Government, revising the National Bank Act in August, 1877, raised the limit of issue of bank notes to 80% of the capital and reduced the restrictions on descriptions of public bonds to be deposited with the Government to any kind of public bond bearing over 4% interest; moreover, it adopted the system of conversion of bank notes into

Government Notes in place of conversion into gold. As a result, the establishment of national banks showed a rapid increase as far as the 153rd National Bank in Kyoto in December, 1880, while, on the other hand, national bank notes also became inconvertible and, together with the Government Notes, aggravated inflation. In view of the situation, the Government decided that no more national bank should be established.

As mentioned in the beginning of this article, the Government sponsored the establishment of exchange firms as the model for a new type of bank, while, on the other hand, it encouraged the founding of private banks by its policy under the Memorandum of the Commerce Office (Tsusho-shi-Kokoroe-sho), in August, 1871. Although applications for the establishment of the Mitsui-Gumi Bank, The Tokyo Bank, The Ono-Gumi Bank, etc. were submitted, the granting of permission was delayed because the Government had not decided a definite policy. However, businesses resembling banks were being operated, without Government permission, since the Goverment allowed them to take their own course. In 1877, such businesses were allowed to use the nomenclature "bank" under the revised National Bank Act, and following the example of the Mitsui Bank, which was established by reorganizing the Mitsui-Gumi Bank, many private banks appeared in succession. The establishment of private banks increased particularly after 1880, when the new establishment of national banks was stopped. They numbered 176 in 1883.

In the meantime, the Seinan Incident (1878) spurred the inflationary tendency which had been progressing since early in the Meiji era, with the resultant rise of the Mexican dollar price, and further increasing the margin between silver and paper money. One of the countermeasures taken to meet the adverse situation was the establishment of the Mexican dollar exchange in 1880; another was the establishment of the Yokohama Specie Bank in December, 1880 under the National Bank Act, the main purpose of which was to collect hoarded silver and to increase the supply of silver by receiving deposits in gold specie and making payments in silver, thereby to force down the price of silver. Of the total capital of that bank amounting to 3,000,000 yen, 1,000,000 yen represented Government investment and 400,000 yen private investment paid in silver; the remaining 1,600,000 yen was subscribed in paper money. But the Yokohama Specie Bank suffered a great loss due to the margin between silver and paper, far from eliminating the margin due to transactions in specie. Hence the bank changed its policy by making foreign exchange transactions its main business in 1884. The bank was at first established according to the National Bank Act, and was granted loans without interest or at a low interest by the Government, but in 1890, it was converted into a foreign exchange bank as a special branch of a commercial bank under the Yokohama Specie Bank Act, conducting foreign exchange business by obtaining loans at low interest from the Bank of Japan, and thus contributing much to the development of foreign trade in Japan.

II

As has been mentioned, the banking system early in the Meiji era was such that gold specie and Government Notes were supplied by the Mint Agency and the Note Money Office respectively, which were operated on a Government enterprise basis, while as regards the issue of bank notes a system of multiple bank issue on a commercial bank basis was adopted. In brief, both exchange firms and the national banks issued paper money, and supplied funds to industries mainly through commercial loans, while private banks, without being allowed to issue bank notes, collected funds through deposits and supplied them in the form of short-term loans.

With the system of multiple bank issue proving a failure owing to the unsatisfactory results under the national bank system, the policy was changed in favour of a central bank system under which the issue of bank notes was conducted by a single bank.

On March 1, 1883, the Finance Minister, Masayoshi Matsukata, who had been exerting great efforts to accomplish the difficult task of readjusting the paper money by resorting to a decisive deflation policy, suggested to the Cabinet to establish a central bank, as a consequence of which the Bank of Japan Act was promulgated in June, 1883. On October 10 of the same year, the Bank of Japan was established as the "Bank of banks," with a capital of 10,000,000 yen, half of which was invested by the Government, being duly authorized to issue bank notes. However it failed to issue convertible bank notes, since there was still a margin between silver and paper money.

An amendment of the National Bank Act effected on May 5, 1884, prescribed that (1) the business period to be allowed a national bank shall be full twenty years from the date of license to commence business, and after that period the bank be allowed to convert into a private bank; (2) a national bank must wipe off the bank notes issued during its business period.

Since the principle of disposing of national bank and national bank notes was thus decided, the Convertible Bank Notes Act was enacted by the Ordinance of May 26, 1885. Since the readjustment of paper money planned by Masayoshi Matsukata thereby progressed steadily, with the resultant elimination of the margin between paper money and silver towards the end of 1886, the conversion of Bank of Japan Notes was commenced from January 1, 1887. Thus the Bank of Japan became the central organ of the banking system throughout Japan as the "Bank of banks," being authorized to issue convertible notes based on specie reserve.

The national banks, which it had formerly been decided should be dissolved, transferred their main business to deposits with the progress of the liquidation of bank notes issued by them, and came to be reorganized as ordinary banks (Futsuginko) together with the aforementioned private banks under the Bank Act promulgated in July, 1894. Ordinary banks, numbering 545 at the end of 1894, constituted the commercial banking system under the control of the Bank of Japan, among them, however, local banks, which found it hard to maintain themselves by handling only commercial credits, also conducted loans on the security of farm land and other real estate. Agricultural credits had hitherto been handled by private money lenders who loaned money at usurious interest, and under these circumstances ordinary banks soon succeeded in entering this line of activity.

In the meantime, the industrial revolution in Japan made steady progress following the lead of foreign industries, even railway construction showing considerable development. The deflation policy pursued by Masayoshi Matsukata for readjusting the paper money, which had been continued until the end of 1886, was responsible for bringing Japanese economy into an excessive depression on the one hand, while, on the other hand, it forced down commodity prices, the general price index declining from 86 in 1882 to 54 in 1887, causing the margin between silver and paper money to disappear (a one yen silver coin equalled 1.73 paper money in October, 1882, while it was exchanged at par at the end of 1886). Consequently, conversion of the Bank of Japan Notes was commenced from January 1, 1887 and a silver standard was actually established in Japan. Under this stabilized financial situation, Japanese industry showed remarkable development, also rising to a higher international standing. Hence, business fluctuations in Japan became closely connected with the international situation, as proved by the panic in 1891 in connection with the Sherman Silver Act, 1890, in the U. S. A.

While Japanese economy in the middle of the Meiji era thus started development, industrial credits were granted by ordinary banks with the Bank of Japan as the central organ; or by short credit financial institutions. Ordinary banks at that time bore some resemblance to deposit banks in England or to national banks without the right of issue in America, securing funds by deposits and making their main objective the granting of short term credits to industries. Meanwhile, comparatively long term credits and immovable credits were advanced mostly by private money lenders in which local banks participated to some extent. Needless to say, however, the development of Japanese industry could not sufficiently be supported by only such short term credit financial institutions. Under those circumstances, the long term investment financial institutions appeared after the Sino-Japanese War (1895-1896) as described below. The Japan Hypothec Bank was established under the Japan Hypothec Bank Law, April, 1897, starting business from August, 1898. Its aim was the granting of long term credits through loans secured on immovables with the funds raised by issuing long-term bonds. With agricultural credits as the main business, it handled also some other business. Under the Agricultural and Industrial Bank Law, April, 1897, an Agricultural and Industrial Bank was established in each prefecture after 1899, with the object of granting small credits with funds raised by issuing Agricultural and Industrial Bank bonds. At the end of 1901, these Banks totalled 46, with one in each prefecture. Moreover, under the Hokkaido Development Bank Law promulgated in March 1900, the Hokkaido Development Bank was established as an immovables bank on a scale larger than the Agricultural and Industrial Banks, in view of its larger business area.

Although all these banks were undeniably necessary for the development of Japanese economy, it was hard for them to carry on in their too big scale. Admittedly they contributed much to agricultural economy in Japan, but there was not enough business to maintain as many as 46. On the other hand, local ordinary banks were obliged to go into the field of immovable credits and agricultural and industrial credits, competing with the above mentioned immovables credits banks, since they could not maintain themselves solely by commercial credits. Consequently, the prefectural Agricultural and Industrial Banks were gradually merged from 1921 with the Japan Hypothec Bank as branches of the latter.

The Japan Industrial Bank came into being under the Japan Industrial Bank Law in March, 1901. Its functions are a credit mobilier with the object of financing various manufacturing industries, railways, mining, construction etc., with funds raised by the issue of Industrial Bank Bonds. This Bank also had to tread a thorny path in competition in many spheres with the Japan Hypothec Bank.

These credit mobilier and immovables banks were not necessarily restricted in their activities to the original objective, while ordinary private banks also granted industrial credits in the form of short term credits and, as a consequence, supplied funds for capital equipments. The banking system of Japan was thus established by combining the financial institutions for commercial credits, which consisted of the Bank of Japan and ordinary banks, and the financial institutions for movables as well as immovable credits which financed new investments. The sphere of activity in banking thus established was completed as a system based on the industrial circulation of currency, which will later be explained. With this banking system as the nucleus, savings banks were established under the Savings Bank Law promulgated in 1891, enforced in July, 1894, for the deposit of small amounts. Credit associations were established under the Industrial Association Law in 1901, and thus the whole banking system was completely established. Such an orderly division of activities in banking undoubtedly contributed much to the development of Japanese economy, though there were some overlapping in their business sphere.

Ordinary banks numbered 1,867 in 1902, the highest ever recorded, after which they decreased in number due to the tendency to amalgamate, though showing an augmentation of capital.

Japanese economy pursued a steady development after the Russo-Japanese War (1905–1906), to attain a very high level during the First World War, after which, however, inactivity prevailed for a long time, during which gold reserves became depleted due to the depression, which was world wide. After the Manchurian Incident (1931), business activities recovered, but, during the Second World War, Japanese econony was forcibly driven into a totalitarian controlled economy, and banking in Japan was put on a wartime footing, with the Financial Control Association for the whole of Japan as the central organ, all financial institutions being controlled by the State. In addition, many public banking corporations (Kinko) were established.

After the surrender, the reconstruction of post-war Japan was started along democratic lines, and the utmost efforts have been exerted to attain a return to free economy. For this purpose, reforms aiming at peace and freedom have been predominant, and needless to say the financial system has not been an exception in this regard.

III

It must be admitted that the monetary system in Japan, at least in its functions, swerved under the controlled economy in force during the war, but the monetary system based on a division of activities in banking, established during the middle of the Meiji era (1868–1912), remained as ever the nucleus, being supplemented only by various financial institutions and controlled in its functions. After the war, however, when reconstruction of Japanese economy loomed up as the subject at issue, the banking system has been fundamentally destroyed. Put in concrete terms, the so-called special banks (established according to the respective special laws), except the Bank of Japan, and the ordinary banks established under the Bank Act, 1894 and the Bank Law, 1933, or the revised Bank Act, and all savings banks have been reorganized as ordinary banks.; the Yokohama Specie Bank, the Japan Industrial Bank, the Japan Hypothec Bank, the Development Banks and savings banks were changed to ordinary banks functioning as short term financial institutions with the character of commercial banks and deposits banks. However, since it cannot be said that Japanese economy needs no more long-term credits, long-term credit banking has not necessarily become useless for the democratization of banking. And since Japanese economy cannot be sustained only by a short-term credit banking system, it is expected that further rationalization of the division of activities in banking will be revived some time in the future. Although one cannot speculate as yet in what form the banking system of reconstructed Japan will be established, it is to be earnestly hoped that it will be based on historical facts and be backed by the correct theory of exchange economy.

Financing is the supply of funds, on the one hand, and the raising of funds, on the other; briefly, it is nothing but the borrowing and the loan of funds. Borrowing and lending are conducted between any economic concerns, but in modern exchange economy, banks constitute the center of such monetary transactions, and most of the funds held by society center in the banks and are then dispersed to society. Such relationships in exchange economy constitute the substance of the whole banking system; that is, the keynote of banking in a country lies in the fact that banks collect funds, on the one hand, and give credits, on the other. What necessitates such accommodation of funds is the buying and selling of goods, principally constituted by the trading of goods, and the pivot of trade in goods is the trade of annual products. There are various trades, besides buying and selling of annual products, such as the buying and selling of land and other resources which are not products, and buying and selling of capital equipments invested that are products in the past or their titles to capital stock. But the trade in goods annually produced is the biggest in volume and most important in that it constitutes the keynote of exchange economy, and it matters little if we neglet for the present the trades that are not included in this category.

Annual products go from the stage of production into the market, and after circulating therein, finally lose their marketability by being used for the recovery of capital loss, for consumption or for the increase of productive capacity by investment. Such is the life of products as merchandise, and money (it is money when viewed from the standpoint of the market, while it can properly be said to be funds as a source of purchasing power when viewed from the standpoint of the subject of receiving or paying it) is supplied for the purpose of making possible the circulation of these products.

Money is supplied in consequence of the price formation at the time of trade in products and the money thus supplied is given a particular character in the respective trade. Products are composed of the following two parts, discriminated according to their price formation; one is the annual products, with capital melted into them in the case of price formation, which should be called back for recovering the original status of capital in the necessity of maintaining the capital, and the other is a quite new product, or net income which can be divided into consumption and savings. The money supplied according to the price formation of the products is given the character of money capital as well as money income, the latter being classified into money income available for consumption and money income available for savings.

Under conditions where no substantial money exists and only bank notes are made final money, this money is formed and supplied as bank funds by being created or absorbed by banking institutions for meeting the necessity of circulation of products. When the products circulate within the market, after departing from the stage of production, the persons who are concerned with buying and selling of the goods are merchants, who pay and collect funds through buying and selling. Since the term between buying and selling is ordinarily short, it is reasonable to assume that the funds to be supplied by bank credits are short term funds, which are created by bank notes and transfer deposits, and the absorbed funds available as short funds. Such short term funds are supplied through the discount of bills or loans on bills as a means of financing the circulation of products. The funds thus granted as short credits, therefore, are paid as the price for the products to the producers, being given the character of money capital and money income. The money capital received by producers is paid to capital goods merchants for recovering the loss of capital goods or is paid as the price of raw materials to raw material merchants. And thus the money capital of producers becomes money capital of capital goods merchants and raw meterial merchants, who will then buy fixed capital goods and raw materials, which constitute the merchandises proper to their businesses, for making themselves ready to meet the requirements of producers in the following year. The business assets of these merchants, aside from profits, only circulate in the following way; money capital→merchandise capital→money capital, and when they take the form of money capital, they are deposited with banking institutions as business deposits. Meanwhile, the capital flowing into the annual products cannot be reduced unless reduced reproduction be admitted.

The money income corresponding to the net products is distributed as income by the producer to those contributing to the production, and then is divided into money income available for consumption and money income available for savings. Some of the former is deposited with banking institutions until it will be used for purchasing consumption goods which are part of the products, while the latter is transferred (or deposited) to the banking institutions as savings deposits and proceeds of issued bank bonds and lent to agriculture and industry through ordinary loans and for underwriting stocks or debentures. With bank notes and transfer deposits as the main source, to which also available consumption deposits, business deposits and the government deposits are added, short-term bank credits are given for financing circulation of products by means of discounting bills and loans on bills, while, on the other hand, the savings income which returns to the banks, the saving deposits and the funds raised by issuing bank bonds, are used in the form of long-term credits for supplying equipment funds to agriculture and industry, and the entrepreneurs invest the above mentioned funds in their businesses by purchasing investment goods, or a part of the annual products, and the funds become extinct after thus making the final circulation.

The money and funds, which are thus supplied when the annual products are produced, return to the original supplier of the money and funds when the products lose their marketability, and illustrate in a balance sheet of a bank the movement of short-term funds vis-à-vis short-term credits and long-term funds vis-à-vis long-term credits, constituting thereby the banking circulation. This is the reason why bank funds should qualitatively be associated and quantitatively be balanced with bank credits.

Such bank funds and bank credits, which characterize exchange economy, together with treasury deposits and treasury credits, which represent the relationship between public finance and economy and between public finance and banking, constitute a balance sheet of the whole banking circulation, a well balanced status between the funds and credits being required within its complicated movements. This equilibrium is caused by liquidity of bank funds in relation to bank credits, and is maintained during several days at the shortest and fifty years at the longest, the fact being verified by the existence of demand deposits vis-à-vis discount on bills in commercial credits and bank bonds vis-à-vis loans in yearly instalment in agricultural credits.

To maintain this status of correspondence caused by the liquidity of bank funds in relation to bank credits is the fundamental principle in the management of a banking business, and the harmony between profit rates and soundness should be sought in this "reasonable maintenance of liquidity." However, it is naturally difficult for one bank to operate all kinds of banking business based on liquidity, the period of which ranges from several days to several decades, and such difficulties are avoided by the specialization of banks with regard to their functions according to the extent of the development and complexity which industry and society attains. In other words, the specialization of banks arises when bank funds and bank credits are combined by several different types of liquidity which meet the requirements of industry and society.

When the issue of bank notes and transfer deposits, on the one hand, and the discount of bills and loans on bills, on the other, are made the main business of a bank, a commercial bank comes into existence; when functions such as the issue of bank notes and the rediscounting of bills are charged on one bank, a central bank, or central organ of all commercial banks, comes into existence.

When the funds absorbed from income available for savings are combined with industrial credits, credit mobilier as an industrial credits organ comes into being, and when the same funds are combined with agricultural credits, an agricultural bank (or an immovables bank, though a little different in character from an agricultural bank) comes into being. When a commercial bank makes the discounting of foreign exchange bills its main business, a foreign exchange bank comes into being separately. Sometimes a colonial bank is established in the form of a combination of foreign exchange bank, a central bank and an agricultural bank.

Such a specialization of banks comes into existence as a natural consequence of the development of production and circulation of products, which necessitates supply money or funds, like blood to the human body, as it were, for its satisfactory attainment. Therefore, the development of industry and the specialization of banks keep pace with each other in their nature, and neither of them can get ahead nor fall behind the other. If the specialization of banks is in excess of necessity, getting ahead of the development of industry, the bank will find it hard to maintain itself and finally will be reduced to a level corresponding to the degree of development of industry.

The specialization of banks which thus comes into being constitutes a reasonable banking system, and contributes to the development of the exchange economy of a country with a portion of the banking business allotted to each.

In any country, however, there are some kinds of banking outside the scope of the above mentioned banking circulation, and these are conducted by banks or by other financial organs. The money market in each country, therefore, is constituted by the addition of financial institutions other than those in the above mentioned banking system.

And thus the money market in each country covers a reasonable banking system, established in accordance with the exchange economy of the respective country, which, at the same time, by adding other financial institutions, forms the present money market as a result of historical development. Now if we reflect on the Japanese banking system, it is understandable that the specialization of banks in Japan is based on the theory explained in this chapter, with the only exceptions where it got ahead of the industrial conditions, and consequently the established specialization of banks encroached on another's sphere. These evils, however, were remedied as a result of the economic prosperity of Japan during the period of the First World War. Although the banking system in Japan after the termination of the last war has been remarkably simplified, it cannot be considered that movables and immovable financial institutions will not be needed any more in the future. The reform of the banking system, including the revival of these kinds of financial institutions, should be carried out some time in the future, based on the theory of the banking circulation of money explained above.

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