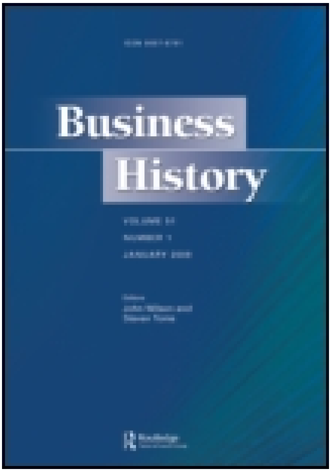

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The Evolution of the Financial System in Post-War Japan

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The Evolution of the Financial System in Post-War Japan

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Many scholars, businessmen and policy makers regard the Japanese experience as a model for developing countries, while others try to derive lessons for the transforming socialist countries of eastern Europe. The Japanese financial system in the post-war period has been of particular interest, and recent research has focused on the roles of the main banks that support industrial enterprises[1] and complementary institutional arrangements.[2] The main banks were supported by the regulatory framework created by the Ministry of Finance (MOF), public financial institutions such as the Japan Development Bank (JDB), as well as the industrial policies of the Ministry of International Trade and Industry (MITI). The relationships and functions of these institutions have never been fully investigated and documented, and this paper will focus on their historical evolution and inter-relating roles, as well as exploring the main bank system.

II

JAPANESE FINANCIAL STRUCTURE

The sectoral saving–investment balance of post-war Japan was generally characterised by a large deficit in the corporate sector, a large surplus in the personal sector, and a small surplus in the public sector (Table 1). A major aim of the financial system was, as is well known, to intermediate the flow of funds from the personal to the corporate sector.[3] The process of financial intermediation had distinct characteristics, and these are outlined in *The Flow of Funds Accounts*, published by the Bank of Japan. The personal sector overwhelmingly preferred cash and deposits as safe and divisible assets, and the ratio of bonds and stocks was very low (Table 2). The assets of households being small on average, the risks and transaction costs of bonds and stocks were too great a disincentive. During the Second World War, the Japanese economy lost about a quarter of its national assets, and the personal sector was badly affected. The rich, who had bought bonds and stocks in the pre-war period,

TABLE 1
SAVING-INVESTMENT BALANCE BY SECTOR 1955–74

	% of GNP Corporate	Household	Government
1955-59	-8.9	7.7	0.5
1960-64	-10.9	8.2	1.4
1965-69	-7.7	6.8	0.7
1970-74	-10.9	10.1	0.6

Source: Economic Planning Agency (ed.), *Choki Sokyu Suikei Kokumin Keizai Keisan Hokoku* (*Long-Term Retroactive Estimation of National Accounts*).

TABLE 2
APPLICATION OF FUNDS BY PERSONAL SECTOR (%), 1955–74

	1955-59	1960-64	1965-69	1970-74
Total	100.0	100.0	100.0	100.0
Currency	4.4	5.7	6.3	6.8
Deposits	61.4	53.7	59.0	65.3
Trusts	4.1	5.2	6.5	6.3
Insurance	11.9	9.6	13.0	13.0
Government Bonds	0.2	-0.1	{	0.7
Public Corp. Bonds	0.3	1.0	{ 7.1	1.3
Bank Debentures	2.1	2.6	{	3.7
Industrial Bonds	0.4	0.4	{	1.0
Stocks & Securities				
Investment Trusts	9.2	11.0	2.1	1.3
Other	6.0	10.9	6.0	0.6

Source: Bank of Japan, *Flow of Funds Accounts*.

suffered the majority of losses as a result of post-war reforms and hyper-inflation.[4] Most of the funds acquired by the financial sector were made available as loans (Table 3). In other words, the ratio of bonds and stocks compared to total assets to be found in the financial sector was low in post-war Japan.

There was a range of institutions within the financial sector. The commercial banks held the largest share of funds. They gathered deposits from both the corporate and the personal sectors and invested

TABLE 3
APPLICATION OF FUNDS BY THE FINANCIAL SECTOR (%), 1955–1974

	1955-59	1960-64	1965-69	1970-74
Total	100.0	100.0	100.0	100.0
Currency & Deposits	2.0	1.7	1.2	2.4
Government Bonds	1.1	0.9	{	3.2
Public Corp. Bonds	2.0	1.7	{ 14.5	2.2
Bank Debentures	3.8	2.9	{	3.1
Industrial Bonds	3.9	3.2	{	1.4
Stocks & Securities Investment Trusts	6.4	6.8	2.5	3.8
Call Money	0.7	0.1	-0.3	0.8
Loans	77.5	77.6	79.0	78.5
Other	2.6	5.1	3.1	4.5

Source: Bank of Japan, *Flow of Funds Accounts.*

them in loans or securities. There were moreover two types of commercial bank. The city banks included Mitsui, Mitsubishi, Sumitomo, Fuji, Daiichi (Kangyo), and Sanwa, and they have been defined as having 'their headquarters in a metropolitan area and nationwide networks of many banking branches'. The regional banks had 'their headquarters in large or medium-sized cities throughout the country and carry on most of their business in the prefecture in which the head office is located'.[5] There were three long-term credit banks: the Industrial Bank of Japan (reorganised in 1952), the Long-Term Credit Bank of Japan (established in 1952), and the Nippon Credit Bank (established in 1957). The purpose of these credit banks was to supply long-term loans to industries which were particularly capital-intensive, and they were consequently permitted to issue bank debentures as a means of raising the necessary funds.[6] Besides city banks and long-term credit banks there were trust banks specialised foreign exchange banks, insurance companies, and institutions for small firms, agriculture, forestry and fishery. In the public sector, some institutions such as the Japan Development Bank and the Export-Import Bank of Japan engaged in policy-based finance.[7] Looking at the corporate sector, we find that most of the funds were raised from these financial institutions, especially the commercial banks (Table 4). This pattern can be discerned in the flow of funds to industry for the purchase of equipment (Table 5). Nevertheless, the links between specific industries and financial institutions did differ. Some, notably electricity, shipping, and coalmining, depended heavily on

TABLE 4
FUNDS TO INDUSTRY (%), 1955–1974

	1955-59	1960-64	1965-69	1970-74
Total	100.0	100.0	100.0	100.0
Stock	13.5	16.2	6.2	5.8
Industrial Bonds	4.4	4.5	·3.3	3.1
Loans	82.1	79.4	90.5	91.1
Private Financial Institutions	73.3	72.8	81.2	83.1
Long-Term Financial Institutions	6.2	5.1	6.1	6.5
Public Financial Institutions	6.7	5.2	8.0	7.1
Other	2.1	1.4	1.3	0.9

Source: Toyo Keizai Shinposha, *Showa Kokusei Soran*, Vol.2 (Tokyo, 1991).

public finance, the JDB being the main contributor. There was also a heavy reliance on bonds issues by electricity, iron and steel, and transportation concerns. Variations were reflective of the historical circumstances that influenced institutional arrangements and the policies of government.

III

CITY BANKS, THE REGULATORY FRAMEWORK, AND INDUSTRIAL POLICY

As previously mentioned, a number of economists have come to regard the main banks as the most remarkable characteristic of the post-war Japanese financial structure. Aoki *et al.*, in one of the most important recent contributions to the literature, define the main bank arrangements as 'an informal set of practices, institutional arrangements, and behaviour patterns that constitute a system of corporate financing and governance',[8] and this definition is adopted here. Links include reciprocal shareholdings, the appointment of directors, loans and credits, bond-issue trusteeships, payment settlements, and the provision of foreign exchange. These functions stem from the main bank's ability to monitor the performance and activities of client firms, although they are additionally contingent upon the financial condition of the firm, its

TABLE 5
SOURCES OF FUNDS FOR INVESTMENT BY INDUSTRY, 1955–64

1955-59			%		
	Bonds	Stock	Loans		
			Private	Long-Term Credit Banks	Public
Total	3.3	14.1	62.1	18.6	20.5
Electricity	5.2	11.1	49.1	15.4	34.6
Iron & steel	6.2	29.8	59.3	28.8	4.8
Shipping	0.1	11.4	62.9	19.4	25.6
Coal	1.1	15.9	49.0	42.1	34.0
Textiles	3.6	8.6	74.2	25.0	13.6
Chemicals	2.9	17.2	71.8	28.9	8.2
Ceramics	0.8	17.3	68.3	6.8	13.6
Machinery	5.3	32.3	52.2	25.0	10.2
Non-ferrous metal	2.4	13.2	64.5	21.7	19.9
Land transport -ation	7.7	14.3	62.3	18.3	15.7
Agriculture & fishery	0.4	4.0	44.8	9.6	50.7
Others	1.8	8.5	75.2	11.2	14.5
1960-64			**%**		
Total	5.6	16.0	64.1	15.4	14.4
Electricity	16.3	12.8	51.3	12.7	19.6
Iron & steel	9.8	30.5	56.2	19.2	3.4
Shipping	0.0	3.8	47.8	12.9	48.5
Coal	1.8	3.2	38.2	23.3	56.8
Textiles	7.4	13.1	66.4	20.6	13.1
Chemicals	4.4	22.4	66.4	21.8	6.8
Ceramics	2.6	17.6	68.9	22.0	11.0
Machinery	7.2	27.6	57.0	19.0	8.1
Non-ferrous metal	3.0	15.9	65.6	21.6	15.8
Land transport-ation	8.8	12.5	60.4	13.4	18.3
Agriculture & fishery	0.6	3.2	48.7	5.7	47.5
Others	1.3	10.3	76.7	11.5	11.7

Source: Japanese Development Bank.

stage of development, and relations between firms and other financiers, between the latter and the main bank, and between the main bank and the regulatory authorities.[9] The nature of bank–firm relationships in the post-war high growth period can be checked alongside the historical statistics. A data set can be gathered from the Securities Report (*Yukashoken Hokokusho*) and a number of directories.[10] In the manufacturing industries, there were 239 firms which specified their debts in 1955, 1965, and 1975. Most of the literature on the main bank system concentrates on the debts carried by firms. One of the city banks was the largest creditor to 50–60 per cent of the 239 companies (Table 6). In other words, it had the largest share in the explicit or implicit loan consortia that supported these manufacturers. The long-term credit banks or trust banks were the second largest contributors. It is worth noting that

TABLE 6
BANK-FIRM RELATIONSHIPS I: LINKS WITH CREDITORS

	Total	City Bank	Long-Term Credit Bank	Trust Bank	Insurance Company	Other
1955						
A	239	141	50	19	8	21
B	121	86	13	8	6	8
C	55	45	6	0	2	2
1965						
A	239	121	41	46	5	26
B	159	97	21	30	3	8
C	77	55	16	4	1	1
1975						
A	239	126	46	40	2	25
B	207	122	38	37	2	8
C	120	83	17	8	2	10
1955-65						
D	116	85	20	8	1	2
1965-75						
D	142	83	29	21	2	7

Notes: A = number of firms classified by the categories of financial institutions to which they owed the largest debt
B = number of firms whose largest creditor was amongst their top ten shareholders, classified according to financial institution
C = number of firms with a director dispatched from their largest creditor, classified according to financial institution
D = number of firms whose largest creditor did not change from 1955–65 or from 1965–75, classified according to financial institution

the number of firms which maintained their links with their largest creditors were smaller than might be expected from the accepted interpretation of these connections, particularly in the years 1955 to 1965.[11] More than half of the sample altered their financing arrangements. Furthermore, in 1955, the largest creditors of almost half the firms were not amongst their top ten shareholders, and almost three-quarters of them did not dispatch directors to their firms' boards. Yet these are supposed to be the conditions by which the main banks monitored their clients and harmonised potentially conflicting interests.[12] The high changeability of the largest creditors and the low ratio of shareholding and interlocking seems to indicate that the main bank system was not solid nor pervasive in the latter half of the 1950s and in the first half of the 1960s.

The prevailing arrangements of this period resulted, to a substantial extent, from the division of work between short-term and long-term financial institutions. To examine this point, another data set is needed. From the above 239 firms, information on the short-term and long-term debts of 89 enterprises were available. Tables 7 and 8 demonstrate the results, and their impact on bank–firm relationships. Even during the rapid growth of 1955 to 1965, some 52 of the 89 firms (or 58 per cent) stayed with their short-term creditors. With regard to long-term creditors, the ratio was only 34 per cent. It is also remarkable that different financial institutions provided short-term and long-term loans. Most of the largest short-term creditors were the city banks, while the majority of the largest long-term creditors were the long-term credit banks and trust banks. The high turnover of long-term creditors and fluctuation in the ratio of long-term loans to short-term loans help explain the weak links between companies and their most important banks (see Table 6 and paragraph above).

Far more than long-term lenders, it was short-term creditors which became the large shareholders of client firms, and it is these institutions which appointed directors. It was not the largest creditor but the largest short-term creditor that was closer to the ideal type of main bank described in the theoretical literature. This implies that the role of the main banks, in many cases city banks, were complemented by the long-term financial institutions. It is worth noting that, even in the case of short-term lenders, the ratio of firms whose top ten shareholders included their largest creditors amounted to only 56 per cent, and that only 29 per cent of them had directors dispatched from their largest creditors (Table 7). Shareholding and interlocking were useful to both the firm and its main bank, but they were by no means indispensable.

The role of main bank imposed heavy burdens on the city banks. They diversified their loans and obligations through consortia and the

TABLE 7
BANK-FIRM RELATIONSHIPS II: LINKS WITH SHORT-TERM CREDITORS

	Total	City Bank	Long-Term Credit Bank	Trust Bank	Insurance Company	Other
1955						
A	89	65	13	2	2	7
B	50	39	5	1	2	3
C	26	24	1	0	0	1
1965						
A	89	69	3	1	1	15
B	60	55	2	1	1	1
C	36	34	1	0	1	0
1975						
A	89	82	4	0	1	2
B	79	75	3	0	0	1
C	58	54	3	0	0	1
1955-65						
D	52	49	3	0	0	0
1965-75						
D	64	63	1	0	0	0

Notes: A = number of firms classified by the categories of financial institutions to which they owed the largest short-term debt
B = number of firms whose largest short-term creditor was amongst their top ten shareholders, classified according to financial institution
C = number of firms with a director dispatched from their largest short-term creditor, classified according to financial institution
D = number of firms whose largest short-term creditor did not change from 1955–65 or from 1965–75, classified according to financial institution

co-operation of long-term financial institutions, but an aggregated balance sheet of their position indicates genuine difficulties (Table 9). The composition of both assets and liabilities changed dramatically from the pre-war to the post-war period. The ratio of securities, especially government bonds, decreased, while that of credits increased. As a result, the liquidity of their assets declined substantially. The head of the credit analysis section at the Daiichi Bank (one of the big six city banks) wrote in 1956 that 'the present bank assets differ greatly from those of the pre-war period' and that the 'decline in the ratio of government bonds, the very best assets, indicates above all the decline in the quality of banks' financial position.'[13] Worse still, the ratio of capital liabilities to total liabilities had also fallen since before the war, and this change was a cause of similar concern.[14] The overall deterioration in liquidity

TABLE 8
BANK–FIRM RELATIONSHIPS III: LINKS WITH LONG-TERM CREDITORS

	Total	City Bank	Long-Term Credit Bank	Trust Bank	Insurance Company	Other
1955						
A	89	10	44	24	8	3
B	16	0	2	8	6	0
C	4	2	2	0	0	0
1965						
A	89	6	33	41	6	3
B	48	6	10	27	4	1
C	12	3	5	4	0	0
1975						
A	89	9	37	37	5	1
B	69	9	28	26	5	1
C	20	8	7	3	2	0
1955-65						
D	30	2	19	8	1	0
1965-75						
D	60	3	27	28	2	0

Notes: A = number of firms classified by the categories of financial institutions to which they owed the largest long-term debt
B = number of firms whose largest long-term creditor was amongst their top ten shareholders, classified according to financial institution
C = number of firms with a director dispatched from their largest long-term creditor, classified according to financial institution
D = number of firms whose largest long-term creditor did not change from 1955–65 or from 1965–75, classified according to financial institution

damaged their ability to bear risks, and, while causing instability in the financial system, it could have choked off funds to industries. It is not surprising that, since the 1950s, the 'over loan problem' – excessive bank loans depending on the backing of the BOJ – became a matter of widespread discussion in financial circles, governments, and the press. Several measures of reform had to be imposed on the city banks, and institutional arrangements complementary to the main bank system had to be evolved, these being reliant on the regulation of funds allocation by MOF and MITI, the long-term credit banks, the JDB, and the control of bonds issues.

The regulation of the city banks had to comply with the investment needs of the industrial policy devised by MITI and the MOF. Guidelines for the bank management and the allocation of bank loans were key

TABLE 9
BALANCE SHEET OF CITY BANKS

	1935	1944	1950	% 1955	1960	1965	1970
Assets:							
Currency & deposits	6.9	4.7	11.6	12.3	11.2	10.3	9.0
Call money	4.7	0.3	0.0	0.3	0.0	0.0	0.0
Securities	35.5	27.7	5.9	9.2	11.4	12.4	10.7
Government bonds	19.5	23.9	2.3	1.3	0.4	0.1	0.9
Local govn. bonds	3.8	0.2	0.0	0.5	0.9	1.2	1.4
Industrial bonds	10.7	3.3	3.3	6.2	8.1	9.0	5.9
Stocks	1.5	0.8	0.3	1.1	1.9	2.1	2.4
Loans & credits	42.7	63.3	50.1	56.7	59.3	57.5	58.9
Loans	35.5	61.6	33.1	33.4	36.8	37.7	38.9
Discounted bills	7.2	1.7	17.1	23.3	22.5	19.9	20.1
Liabilities:							
Demand deposits	23.2	27.6	30.6	31.0	23.2	21.7	18.5
Time deposits	58.0	37.7	18.7	36.8	41.5	39.8	43.6
Loans	0.0	16.1	9.2	2.6	7.2	8.3	7.3
Foreign exchange	0.7	0.0	12.9	1.2	3.3	3.5	2.8
Call money	0.0	0.0	0.3	2.3	3.0	4.9	5.5
Capital	14.6	3.9	2.8	2.8	3.8	3.3	3.9

Source: Bank of Japan, *Keizai Tokei Nenpo* (*Annual Report of Economic Statistics*).

policy issues for the MOF until the first half of the 1960s, involving the stabilisation of bank management (*kenzenka*) and qualitative credit adjustment (*shitsuteki shin'yo chosei*).[15] Measures designed to influence commercial practice were regulations on interest rates, the opening of bank branches, and performance indices. MOF sought to avoid the bankruptcy of any bank, the so-called 'convoy policy' (*Goso Sendan Gyosei*). The Temporary Interest Rates Adjustment Law (*Rinji Shikin Chosei Ho*) was introduced in 1947, and maximum returns on deposits and loans were to be decided by the MOF in accordance with BOJ's Policy Board.[16] The controls afforded the banks a positive profit margin of between one and two per cent in the 1950s, while it had been about 0.5 per cent in the pre-war years (see Bank of Japan's *Annual Report on Economic Statistics*). As well as the 'price' of interest rates, non-price competition was also curtailed by controls on the opening of branches and entry into the banking sector. Under the Banking Law (*Ginko Ho*), the MOF did not sanction any entrant and the number of institutions has remained stable since 1952.[17] Businesses attracted by the increased profits to be made in banking were prevented from destabilising the industry, just as existing institutions could not open branches that disrupted the activities of rivals.[18] The MOF was equally determined that the additional profits and rents assisted the stabilisation of the financial sector and the welfare of depositors.[19] It had therefore to set a number of performance indices. First, the Ministry in 1949 set a guideline ratio of ordinary expenses to ordinary income. In August 1953, a letter from the chief of MOF's banking section issued clear instructions that any surplus should be used to boost reserves, reduce the interest rates on loans, or increase the returns on deposits.[20] The distribution of profits to shareholders was restricted through the regulation of dividend payments.

There were, in addition, questions of industrial policy. Since the Temporary Law on Funds Allocation Control of 1937 (*Rinji Shikin Chosei Ho*), and the Rules on Funds Allocation by Financial Institutions of 1937 (*Kin'yu Kikan Shikin Yuzu Junsoku*), the MOF and the BOJ had overseen the granting of finance by private banks.[21] Although direct controls had been abolished after the war, the MOF still gave administrative guidance to a system of voluntary regulation. In 1951, the government announced a series of policies intended to restrain inflation, supply funds to strategic industries, and limit the financing of 'unnecessary' sectors. The MOF issued a notice setting out instructions for the granting of loans, and the National Federation of Banking Associations (NFBA, or *Zenkoku Ginko Kyokai Rengokai*) formed a Committee for the Self-Regulation of Loans (*Yushi Jishukisei Iinkai*), charged with 'examining loans to be restrained, announcing criteria, and providing guidelines for the discretion of each bank'.[22] At first, in July 1951, the committee chose to limit funds for building, real estate, and public amusements, and in 1953 loans for speculation and excessive or duplicate investment were rigidly restrained.[23] Then the institutions overseeing this system of indirect control were substantially extended, at a time when macro-economic policy was tightened between 1954 and 1957 in a response to trade imbalances. In 1954, the MOF informed all the banks that, in addition to limiting so-called unnecessary loans, they should give priority to key parts of the economy and an improvement in exports.[24] In other words, the Ministry wanted private banks through self-regulation to concentrate their financing on the strategic industries of coal, iron and steel, electricity, and shipping, just as public funds were being targeted. The ruling Democratic and Liberal Parties were also seeking to reduce the pressure on public funds, which were in short supply. They therefore planned to regulate directly the allocation of bank funds by law, and drew up a draft Funds Committee Law (*Shikin Iinkai Ho*) in 1955. When financial and business circles became strongly opposed, the MOF withdrew its support, and the legislation was never enacted. As a substitute, the Council on the Funds of Financial Institutions (*Kin'yu Kikan Shikin Shingikai*) was established in 1956 to discuss and co-ordinate the allocation of funds by private financial institutions, and it contained representatives from finance, business, academics, and civil servants.[25]

In the meantime, the NFBA had extended the reach of self-regulation with the aim of invalidating the Funds Committee Law, during a period when the proposal was still current. In 1955, it established the Committee for Investment and Loans (*Toyushi Iinkai*),[26] and this new body assisted the funding of industries identified by the government as strategic. The Committee, composed of the presidents and directors of major banks, and representatives from the MOF and BOJ, discussed loan policies in relation to key economic sectors and the provision of public finance.[27] The MOF and the NFBA agreed to work in fulfilment of the Five Year Plan for the Independence of the Japanese Economy (*Keizai Jiritsu Gokanen Keikaku*), drawn up in 1955.[28] As macroeconomic policy continued to be tightened, further developments in the public and private sectors followed. In June 1957, a cabinet meeting decided on the Emergency Measures against the Imbalance of Trade Payments, and the restraint of unnecessary investments was emphasised. The MOF instructed the banks to give priority to strategic industries, and they were told to minimise the levels of funds even to these sectors.[29] To implement the policy, the NFBA merged its Committee for Investment and Loans and the Committee for the Self-Regulation of Loans. The Committee for the Regulation of Funds Allocation (*Shikin Chosei Iinkai*) was formed, and under it a Managerial Meeting for the Regulation of Funds Allocation (*Shikin Chosei Kanjikai*) was appointed.[30] During these events, institutional arrangements to secure the co-operation of industries were planned, and, in 1957, a working committee representing finance, business, and the civil service was created under the Council on the Funds of Financial Institutions. Delegates from the Tokyo Chamber of Commerce, the Federation of Business Associations, the Electricity Association, the Japan Iron and Steel Association, the Coal Association, and the Chemical Association represented business, and this small committee had a role in co-ordinating funds allocation and the investment plans of manufacturers.[31] Co-ordination between the financial and industrial sectors was finally systemised in December 1957 through the establishment of the Funds Branch of the Council on Industrial Rationalisation

(*Sangyo Gorika Shingikai Sangyo Shikin Bukai*) at MITI.[32] It consisted of representatives from the Federation of Business Associations, NFBA, JDB, IBJ, and several business organisations and large companies. Reviewing the work of the Council on the Funds of Financial Institutions and the NFBA's Committee for the Regulation of Funds Allocation, the new Funds Branch adjusted and co-ordinated the investment plans of industries. These loan policies were first prepared by the respective bureau at MITI (*genkyoku*), framed through discussion with each industry's business association. After the adjustments of the Funds Branch, negotiations between industries and *genkyoku* were repeated in an iterative manner. The banks secured high quality information on the direction of industrial policy at MITI and sanctioned investment projects, and their loans were gradually adjusted according to official priorities. When the Council on Industrial Rationalisation was transformed in 1964 into the Council on Industrial Structure (*Sangyo Kozo Shingikai*), the Funds Branch was continued.[33]

IV

LONG-TERM FINANCIAL INSTITUTIONS AND THE BONDS MARKET

Other measures were taken to secure the stability of the financial system and the supply of funds to the strategic industries. First, public funds were provided to relieve the shortage of long-term finance to business. The Reconstruction Finance Corporation (RFC, or *Fukko Kinyu Kinko*) had had an important role since 1947, but was ordered by the US's General Headquarters in 1949 to cease lending new funds. The RFC's substitute, the USAID Counterpart Fund, proved insufficient, and its special clients in the coal, iron and steel, shipping, and electricity industries were especially hindered, despite their strategic role. As a result, the Japan Development Bank was founded in 1950.[34] The JDB had to assist the government's industrial policy, whilst exercising its own independent judgement in each case. The framework was determined by the Basic Policy for Loans (*Un'yo Kihon Hoshin*), as decided by a cabinet meeting for every fiscal year. In 1952, the electricity, shipping, coal, iron and steel, chemical, machinery, agriculture, fishing, and synthetic fibre industries were deemed to be strategic.[35] Following the basic policy, and relying on information from the funds branch at the Council on Industrial Rationalisation, the JDB examined the creditworthiness of each project. During the 1950s, coal, iron and steel, electricity, and shipping received continuous support, and, after that, more attention was paid to regional development. From the beginning, the JDB explored joint loans with the private banks.[36] JDB loans were 'cow bells', signalling whether a project met the twin objectives of industrial policy and individual creditworthiness.[37]

Two years after the JDB, in 1952, the Long-Term Credit Bank Law was passed. The Industrial Bank of Japan (IBJ) was reorganised, and the Long-Term Credit Bank of Japan was founded. These institutions were expected to supply long-term funds to officially determined strategic industries, and the bank debentures which they issued enjoyed an advantage as collateral for all those seeking BOJ credit. As we have noted, the credit banks played a complementary role to the main bank system, offering long-term finance to the short-term provision of the city banks. Moreover, the large part of bank debentures issued by the credit banks were held by the city banks, although the interest rates on these debentures were lower than those to be gained through loans. In addition to providing collateral for the BOJ, the city banks expected the long-term credit banks to lend money to their customers in industry.[38] The LCBJ wrote that 'We supplied long-term funds to the client firms of the commercial banks which were the main holders of our bank debentures in order to relieve those bank burdens, and we also take care to make the funds return to those banks as deposits'.[39]

The corporate bonds market was another means of long-term funds. Their promotion began with the regulation of the financial institutions by the Bank of Japan after 1949, and the BOJ took two measures in order to effect this policy. First, it screened and rated the bonds that qualified as collateral for its credit *ex ante*, and in practice only these could be issued. Second, when a bank bought bonds, the BOJ purchased an equal sum in government bonds from that bank.[40] As the interest rate of BOJ credit was substantially lower than the market rate, both measures acted as *de facto* subsidies to the banks.[41] The bank regulated the interest rate and the level of bond issues through the Conference on Bonds Issue (*Kisai Kondankai*) and the Consultation Meeting on Bonds Issue (*Kisai Uchiawasekai*). The former consisted of the MOF, BOJ, the entrusting banks, and the big four securities companies, and these decided on bonds issue policy. The latter, composed of BOJ, the entrusting banks, and the big four securities companies, set the conditions for respective issues.[42] Through the regulation of the bonds market, strategic industries could be given priority, and, although *ex ante* screening and rating was abolished in 1956, the Consultation Meeting on Bonds Issue continued to be influential.[43] The entrusting banks, members of the Consultation Meeting, maintained good contacts with the Committee for the Self-Regulation of Loans and the

Committee for Investment and Loans at the NFBA, in order to ensure that the banks held the bonds of strategic industries.[44] Furthermore, they not only advised the issuing firms, but also monitored them on behalf of bond holders, and it was natural for the main banks to assume this role. We can examine all the bonds issued by our sample of 89 firms between 1960 and 1965 (see above). In 439 of 489 cases (that is about 90 per cent), the main banks, which were the largest short-term creditors in 1965, took part in entrusting. As to those companies whose main banks were also city banks, the ratio was nearer 100 per cent, the issuing of bonds complementing the system of main banks (see Table 10).

TABLE 10
BONDS ENTRUSTED WITH MAIN BANK

	No. of Firms	No. of Bonds Issues	No. of Cases Main Bank Entrusted with Bonds Issues
Total	54	489	431
IBJ	2	4	4
Mitsui Bank	9	102	102
Mitsubishi Bank	4	42	42
Sumitomo Bank	5	73	73
Fuji Bank	7	68	68
Sanwa Bank	4	29	29
Daiichi Bank	5	68	68
Kangyo Bank	5	28	28
Tokai Bank	1	3	3
Kyowa Bank	2	16	14
Norinchukin Bank	9	48	0
Foreign Bank	1	8	0

Source: Industrial Bank of Japan, *Shasai Ichiran (Lists of Industrial Bonds)* (Tokyo, 1970).

V

THE JAPANESE FINANCIAL SYSTEM AND COMPETITIVE ADVANTAGE

The Japanese financial system in the high growth era was one of complementary institutions, which involved the main banks, long-term finance institutions, and financial regulation and industrial policy. The main banks co-ordinated explicit and implicit loan consortia which supplied funds to client firms, and in this objective they were assisted by funds from the long-term finance institutions, bond market regulation by the BOJ, bank regulation by the MOF, and the funds allocations of the MOF and MITI. There was a characteristic division of labour within Japan's financial system in the post-war period. Aoki *et al.* argued that many financial functions – the monitoring of companies and their investment projects *ex ante*, *interim*, and *ex post* – were carried out by the main banks in an integrative manner, and that the main banks' *ex ante* monitoring was supported by that of public financial institutions, long-term credit banks, and government councils such as the Council for Co-ordinating Electric Energy Source Development.[45] We have shown that this structure was true of not just the electricity industry, a public utility under rigid government control, but of all industries. Aoki *et al.* also underrated the role of the MOF and MITI, carried out through the Council on the Funds of Financial Institutions and the Funds Branch of the Council on Industrial Rationalisation, in co-ordinating and screening investment in industry.

How well did this system perform? It is well known that Japanese industries grew rapidly in the post-war period, and that they depended on funds borrowed from financial institutions. The system was highly influenced and shaped by the recognition, expectation and behaviour of the agents which composed it. The head of the credit analysis section of Daiichi Bank wrote in 1956 that 'it is said that depositors' thinking has been changing since the end of the war. They may confide only in the banks because they are banks'.[46] The MOF's 'convoy policy' had removed any element of risk. In 1959, the head of MOF's banking division wrote that 'it cannot be denied that the banks have to some extent lost consciousness of how they are entrusted with depositors' funds because they are confident in banks not being bankrupted.[47] Regulation also altered perspectives of industrial enterprises. In 1962, the president of the Fuji Iron and Steel Company said that 'I suppose that the rationing of funds itself encourages a demand for large-scale financing, because the industries feel that the projects to which the funds are allocated are authorised by the government'.[48] Government regulation and co-ordination of the financial system stimulated investment in industrial firms, as did its willingness to limit in effect entry into a number of sectors. In 1965, the president of the Petrochemical Association said that the projects planned by many firms were encouraged by these controls, because, if a firm obtained government permission for the investment, it could expect future limitations on the right of entry into that sector.[49] It was this alteration in outlook and attitude that stimulated large-scale investment and high-speed growth. Nonetheless, there were historical circumstances that enabled the system to function well in post-war Japan. Close bank–industry and government–firm relations already existed, and, in the push to overcome economic backwardness, it was relatively easy to agree on strategically important industries. The experiences of the Japanese 'bubble' economy in the 1980s, and its subsequent bursting, revealed faults in a financial system that had not adjusted to the realities of a developed nation.

NOTES

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2. Masahiko Aoki, 'Historical Conditions for Monitoring Roles of the Japanese Main Bank System', forthcoming in Aoki and Patrick, *Japanese Main Bank System*; Kazuo Ueda, 'Institutional and Regulatory Frameworks for Main Bank System', forthcoming in ibid.
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12. Horiuchi and Sui, *Main Bank System*, pp.6–7.
13. Kaoru Inoue, 'Ginko Shisan no Seijoka ni tusite' ('On the Normalization of Bank Assets'), *Kin'yu* (Oct. 1956), pp.5–6.
14. Ibid., p.5.
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16. Ibid., pp.118–22.
17. Ibid., pp.95–8.
18. Ibid., p.80.
19. Ibid., p.80; Ueda, 'Institutional and Regulatory Frameworks', pp.9–10.
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21. Tetsuji Okazaki and Masahiro Okuno-Fujiwara, 'Gendai Nihon no Keizai Shisutemu to sono Rekishiteki Genryu' ('The Contemporary Japanese Economic System and its

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44. Ibid., p.126.
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