

《研究ノート》

Why is Bank Rate below Call Rates in Japan ?

——a few questions concerning the basis of
monetary control in post-war Japan——

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Preface

Monetary control in post-war Japan has not been carried out by means of textbook-like or traditional methods at all.

It has been the core of the system of monetary control in post-war Japan for the Bank of Japan (Nippon Ginko or Nichi-gin) to set Bank Rate below call rates and ration funds among city banks (Toshi-ginkoh or To-gin⁽¹⁾) on the ground of excess demand from To-gin, the excess demand being the outcome of the 'low Bank Rate'. Changing Bank Rate, buying & selling bonds, and the reserve deposit system have all been made use of as the supporting or subsidiary instruments to credit rationing.

(1) To-gin are the bigger ones among common banks. They have their head offices in a few of the largest cities (Tokyo, Osaka, Nagoya), and spread their branch network all over the country. At present 12 are enumerated as To-gin, including The Bank of Tokyo, the special bank for foreign exchange. Among common banks those which keep their head offices in prefectural capitals are called Chihoh Ginkoh or Chi-gin. Their business is, more or less, limited to regional areas. They are much smaller in size compared with To-gin.

But, when we read *Hundred Years of the Bank of Japan* (Nihon Ginkoh Hyakunen-shi, 6 vols. with 1 vol. of supplementary materials, 1982-1986), no clear explanation is found of why and how this 'low Bank Rate' came to take root. In particular, while the question whether this policy (i. e. the low Bank Rate) was promoted by the Bank or by the government seems to be important, no historical explanation thereof can be found.

It is the aim of this research note only to raise this question and examine its importance. To get the final answer further investigation will be required.

(1) Outline of the Method of the Monetary Control in post-war Japan

Monetary control in post-war Japan has, basically, been carried out by means of credit rationing based on an artificial cheap-money policy.

In capital markets, the cheap-money policy took the form of controlling the yields of newly-issued government bonds, together with long-term credit banks' bonds (Kin-yuh-sai⁽²⁾), and long-term prime rate⁽³⁾, while credit rationing, supported by the cheap-money policy, appeared typically

(2) Kin-yuh-sai is a bond which only long-term credit banks can issue. They issue two kinds of Kin-yuh-sai. One is Waribiki-sai (discountable bond), which matures after one year from issue. The other is Ritsuki-sai (coupon bearing bond) which matures after five years from issue. Ritsuki-sai is much more important than Waribiki-sai. Credit banks raise money through these bonds and lend it to big firms for long periods, which constitutes their main business.

(3) Long-term prime rate is that which is applied by long-term credit banks, trust banks, and life insurance companies when they lend money to big firms.

as the control of newly-issued private bonds.

In short-term funds markets, the cheap-money policy took the form of controlling the rates of deposit (both of banks and of the postal savings system⁽⁴⁾) and bank lending, which has its legal ground in the Temporary Interest Rates Arrangement Act (Rinji Kinri Chohsei Hoh or Rin-kin-hoh) in Dec. 1947. The cheap-money policy, in the sphere of short-term funds markets, also fixed Bank Rate below call rates (let us call it the 'low Bank Rate' as we already did above).

Meanwhile, credit rationing, between the Bank and To-gin, took the form of adjusting the degree of restraint on lending⁽⁵⁾ and of the credit ceiling system (Kashidashi Gendogaku Seido)⁽⁶⁾, which was supported by the 'low Bank Rate'. The Bank also intervened between To-gin and industrial & commercial firms, having To-gin ration credit by means of checking the increase of their lending to the latter. (Kashidashi Zohkagaku Kisei or Madoguchi Kisei)⁽⁷⁾

Hitherto, when the Bank intended to tighten the call money market, it supplied, by means of purchasing bonds from banks⁽⁸⁾ (mainly from

(4) In Japan, the weight of postal savings in total national savings is very large. Out of a total of 405 billion (English billion) yen of outstanding national savings at the end of 1989, postal savings accounted for 133 billion yen.

(5) This is the subject of this research note. It means that the Bank adjusts the degree of restraint on lending. Y. Suzuki expresses it as the 'strength of credit rationing'.

(6) A system under which the Bank fixes a credit ceiling to each To-gin and controls them by adjusting the margin between the ceiling and its lending outstanding to them.

(7) Madoguchi Kisei means that the Bank advises each city bank to limit the latter's lending to firms to a certain level, say within 105% of the sum lent in the same period in the previous year. Superficially this is a kind of moral suasion, but really a very powerful measure.

To-gin), only a small part of the amount of the Bank notes increase which was estimated to be necessary or adequate in the near future. By doing so, the Bank forced To-gin to rely upon its lending. Having thus arranged the stage, the Bank faced the strong demand for money from To-gin in a restraining manner. Thus the Bank was able to tighten the money market efficiently.

As Bank Rate was always fixed below call rates, it was wise for To-gin to rely on Bank lending first, instead of last, when they were confronted with any pressure for money. Faced with demand for borrowing from To-gin, if the Bank, on one hand, suppresses new borrowing requirements, and collects former lendings on the other, the liquidity of To-gin will be reduced, the money market being efficiently tightened.

Thus making use of the circumstances that there remained excess demand for funds on the part of To-gin, the Bank was able to ration funds to them. This is the 'credit rationing'. As the Bank rationed funds where excess demand existed, monetary control was quite efficient in Japan.

The reason why there was excess demand is due, directly, to the technique of monetary control explained above (the low Bank Rate). But the basic reason for excess demand was that in the real economy high growth lasted for a long time and there was always vigorous demand for funds on the part of manufacturing and commercial firms.

The description above is now widely known. But once we proceed to

(8) Operations in Japan are not conducted in the open market. They are carried out between the Bank and each city bank rather in a face-to-face manner. Not everybody can take part in the dealing. Further the vehicle is not TB but long-term government bonds and government-guaranteed bonds.

inquire into the reason for and the promoter of the 'low Bank Rate' policy, we notice that some important questions remain unsolved. In this research note, we would like to raise the following two questions about the low 'Bank Rate' which is the core of the cheap-money policy and credit rationing. These questions are:

- ① Why was Bank Rate fixed low ? Was it necessary at any cost in order to enforce the cheap-money policy consistently ?
- ② Did the 'low Bank Rate' take root by the intention of the Bank or by that of the government ? Did it aim at improving the efficacy of monetary control and at strengthening the authority of the Bank ? Or was it only an outcome of the government's wish to encourage economic growth and to discharge the budgetary burden ?

Let us start with ① first.

(2) Regulation of Interest Rates on Deposit & Lending and the 'low Bank Rate'

Putting the 'low Bank Rate' aside, the regulation of interest rates appears in two places. One is deposit & lending markets, and the other is capital (long-term fund) markets. Let us examine the relation between deposit rates regulation and the 'low Bank Rate' first.

As described above, the 'low Bank Rate', linked with credit rationing, is a powerful instrument for monetary control. But logically it is not necessarily associated with the regulation of rates of deposit. Even if the latter are regulated, it is possible for the Bank to put Bank Rate above call rates, thus making it penalty rate for To-gin.

In this case, if the Bank tightens the money market, call rates which

are not regulated will rise relatively higher than deposit & lending rates. To-gin will only rely on the Bank when it is indispensable for them to take Bank money which bears a penalty rate higher than call rates. Credit squeezing here will have an effect on the market not through liquidity but through cost.

Thus regulating deposit rates does not necessarily require the 'low Bank Rate'. This is clear from the fact that, in the U. S. up to Dec. 1983 where the upper limit of deposit rates were regulated by the Glass-Steagall Act in 1933, the relation between Bank Rate and Federal Funds rate was not fixed: i. e. in the U. S. Bank Rate was not always placed below money market rates as it was in Japan⁽⁹⁾.

Then how about the relation between the interest rates on bank lending and the 'low Bank Rate' ? There has been a controversy concerning the effectiveness of fixing the upper limit of the lending rates.

In Japan the upper limit has been regulated by Rin-kin-hoh. But in addition To-gin introduced a short-term prime rate as their self-imposed control since 1959, which they fixed a little above Bank Rate and made it work together with the latter⁽¹⁰⁾. Short-term prime rate became the

(9) Also, in the U. S., even if Bank Rate is lower than the Federal Funds Rate, the rules and formalities on borrowing from the Bank are so troublesome that member banks are not always eager to take money from the Bank. (B. M. Friedman, *Monetary Policy in the United States: Design and Implementation*, 1981, Chap. 3, B)

(10) The self-imposed rule on short-term prime rate was altered in Jan. 1989. The new rule prescribed that the new prime rate would be placed at a level based on a market-basket rate which was composed of some regulated rates and some free rates as well.

lower limit of lending rates. Also the upper limit of lending rates came to be controlled by their self-regulation. Superficially the ceiling of the self-controlled lending rates seemed to be regulated by the Rin-kin-hoh limit. But the regulation by the law could not be said to be powerful, because sometimes the Rin-kin-hoh limit was changed following the self-imposed limit.

Moreover To-gin forced borrowing firms to deposit Buzumi & Ryoh-date. Buzumi is a kind of compulsory deposit which is required when a commercial bill is discounted. A part of the money discounted must be deposited. Ryoh-date is a similar kind of deposit when a loan is given to a firm. By using such technique banks can raise the effective interest rates on lending when they lend money to private firms.

Because there are such circumstances as above, there was a controversy whether the cheap money policy was carried through in lending markets as well as in the deposit market. But regardless of the result of this controversy, we can infer that the lending rates will not require the 'low Bank Rate'. The regulation of lending rates is tied up with that of the deposit rates. So even if banks suffer loss because lending rates are fixed artificially low, they will be able to make it up by fixing the deposit rates low.

Thus it is almost certain that fixing lending rates low would not bring about the 'low Bank Rate'.

Though the regulation of interest rates on deposit & lending does not necessarily require the 'low Bank Rate', doesn't that of the interest rates in capital market require it? In Japan, the interest rates on Kin-yuh-sai, private bonds, and long-term prime rate were also regulated on the basis of the regulation of government bond rates. Doesn't this situation

necessitate the 'low Bank Rate' ? Let us examine this question next.

(3) Long-term Interest Rates and the 'low Bank Rate': the analysis by J. Teranishi

It is J. Teranishi who argued most strongly that the regulation of long-term interest-rates requires the 'low Bank Rate'⁽¹¹⁾.

He divided the regulated financial markets in Japan into three⁽¹²⁾, i. e. the long-term funds market, the Bank lending market, and the deposit market. Paying full attention to their mutual relations which are not one way, he concludes finally that basically it is the need to regulate the long-term funds market that gave rise to the regulation in the Bank lending and deposit markets.

Hitherto the yields of government bonds, local government bonds, Kin-yuh-sai, private firms' bonds, have been fixed artificially low by the government's cheap money policy. The government half-forced To-gin to hold these bonds, which, Teranishi argues, was equal to levying a tax on To-gin. In order to persuade To-gin to hold them, he says, it was indispensable to lower Bank Rate and thus offset the implicit tax.

If so, in so far as the above discussion is concerned, neither To-gin nor the government did not gain anything from the cheap money policy. It was neutral with regard to their interests⁽¹³⁾. Thus "the main purpose of

(11) J. Teranishi, *Japan's Economic Development and Money & Banking* (Nihon no Keizai-hatten to Kin-yuh, Iwanami, Tokyo, Japan, 1982)

(12) Teranishi says that the short-term lending market is not regulated in reality, because the short-term lending rate is basically decided by a self-imposed rule, on one hand, and there is a forced convention of Buzumi and Ryoh-date, on the other hand. (pp. 453, 508)

the artificial cheap money policy was, above all, to promote the process of high growth which was driven forward mainly by plant and equipment investment by the private sector"⁽¹⁴⁾.

That is to say, according to Teranishi, the very aim of the cheap money policy was neither to lighten the debt charge of the government nor to help banking firms but to supply industrial & commercial firms with low-cost capital which was necessary for high economic growth⁽¹⁵⁾. To regulate long-term interest-rates was, indeed, indispensable to such a cheap money policy.

In short, according to Teranishi's analysis, in so far as the long-term funds market is regulated by the cheap money policy, the 'low Bank Rate' will be almost inevitable. Returning to the question ① raised before, his answer would be that "in order to enforce cheap money policy consistently, it was indispensable to fix Bank Rate low."

Now in regard to Bank lending, Teranishi takes another point of view. That is the 'passiveness' of Bank lending, which means that when the Bank faces borrowing demand from To-gin, it will almost automatically, i. e. without exercising its discretion, accept their demand. Teranishi says that hitherto the way of giving credit by the Bank has been based on

(13) But he adds that To-gin gain by deposit rates regulation which is the corollary of long-term rates regulation (p. 494).

(14) pp. 495-496

(15) This is a conclusion which comes out of his analysis that the government will gain nothing from the cheap money policy because the reduction of debt charges must be cancelled out by the decrease of National Treasury receipts which should have come from the Bank. But he adds that there can be a gap between subjective motive and objective effect, so that the original intention of the government to reduce debt charges through the cheap money policy does not have to be disallowed completely. (pp. 486-487, 496)

this passiveness. He adds that "it would be the only policy rule that could be chosen" on the premise of pursuing high economic growth which includes an artificial cheap money policy (p. 592).

Concerning the relation between the regulation of long-term fund rates and the 'low Bank Rate', it would be safe, having learned from Teranishi's study, to say as follows:

The artificial cheap money policy cannot help containing the 'low Bank Rate' in its framework. The promoting factor is, so far as we observe 'directly', not the regulation of short-term fund rates but that of long-term fund rates. Here it does not matter so much whether the motive of the regulation of long-term fund rates includes not only supplying industries of low-cost funds but also reducing the budgetary charge on the government. (Here the word 'directly' implies that we have not examined such a detour-logic as 'necessity of regulating deposit & lending rates → necessity of regulating long-term fund rates → low Bank Rate')

(4) Promoter of the 'low Bank Rate'

Now on the question ② raised above (i. e. the origin and promoter of the 'low Bank Rate'), Teranishi does not say anything.

He stresses the 'passiveness' of Bank lending. But, needless to say, the Bank has not always accepted the demand for funds from To-gin. In other words, it has not accepted the demand in the manner expected by the extreme Banking School. The Bank often drove To-gin into reliance on itself using the 'low Bank Rate' as its weapon. In such a situation, the Bank has suppressed the borrowing demand from To-gin (credit rationing). Such 'activeness' of Bank lending Teranishi does recognize, of

course.

But for Teranishi the logic of 'low issuing yields of bonds → necessity of subsidies to To-gin as compensation → low Bank Rate' appears on the front of the stage. And, we consider, the occasions where the Bank displays its 'activeness' seem to be put in the rear. If we concentrate our attention on the fact that, roughly speaking, monetary control displayed distinctive features in post-war Japan compared with other advanced countries, to stress only the passiveness of Bank lending might be misleading.

When we regard the effectiveness of monetary control and the activeness of Bank lending as important, there will be a question: wasn't it that the 'low Bank Rate' was not merely a link in the cheap money policy of the government but also a deliberately chosen policy of the Bank itself in order to control the financial world ?

The question that the 'low Bank Rate' might be a policy which the Bank, along with the government, itself chose is nearly equivalent to the question whether the 'low Bank Rate' was promoted by the government or by the Bank.

When we read the 5th and 6th volumes of *Hundred Years of the Bank of Japan*, bearing the above question in mind, we notice a curious fact. That is to say, this question is neither raised nor answered. In particular it is a little perplexing that in several sections where such subjects as the over-loan phenomenon⁽¹⁶⁾, the penalty-rate bearing lending ceiling system

(16) 'Over-loan' is an English word coined in Japan which means the following: as city banks lend heavily to private firms meeting the vigorous demand from the latter (the latter being in over-borrowing), their lending tends to exceed the availability of funds, so that they always resort to the Bank in order to make up the deficit.

(Koh-ritsu Tekiyoh Seido⁽¹⁷⁾), and the call market are described, nothing special is said about the origin and the promoter of the 'low Bank Rate' policy.

Is it that the question is not important ? But the 'low Bank Rate', which is the key to the credit rationing at the Bank vs. To-gin stage, cannot be a trifle.

Is the 'low Bank Rate' not an outcome of any policy but an economically natural phenomenon to begin with ? Namely, is there an economic climate where call rates naturally rise above Bank Rate at whatever level the Bank might set its rate ? Accordingly is it not proper, from the beginning, to raise this question ? As we have seen before, however, it is possible to adopt a policy which makes Bank Rate thoroughly follow the money market and sets it a little above call rates. As it was inadequate, for some reason or other, to adopt this policy, the government and (or) the Bank must have chosen the 'low Bank Rate'. Then why do they not explain the reason they took this way ?

Indeed, if this policy is nothing but a mere continuation from the pre-war period, it might be useless to mention its origin and promoter again, but it was usual in the pre-war period that Bank Rate was higher than call rates⁽¹⁸⁾. Moreover, it is said that about after the adoption of

(17) A kind of irregular Bank Rate policy, which was used up to 1955. Under the system, the Bank fixed one or two ceiling line(s) on its lending to each bank. If a bank's borrowing, excluding some preferred sorts such as discounting short-term commercial bills or borrowing on foreign trade bills, reached the ceiling, the Bank charged a higher penalty rate. But really the supposed penalty rate became ordinary Bank Rate, superficial Bank Rate having become a preferential rate ... especially to foreign trading companies. (The system remained even after 1955 until 1963, but its character was changed then and it returned to one involving a penalty.)

the gold standard system in 1897, city banks came to feel ashamed when they borrowed from the Bank⁽¹⁹⁾. Even in war-time call rates stood higher than Bank Rate⁽²⁰⁾. So the 'low Bank Rate' policy was not an uncritical continuation from the pre-war period but must be one that was started, at some time in the post-war period, bearing the intention of some part of society, and then took root. When, by whose intention, and for what purpose was it started ?

Returning to *Hundred Years of the Bank of Japan* again, there is no part that clearly answers such a question. On page 91 vol. 6, it refers to the remark by T. Yoshino⁽²¹⁾, "if we intend to use the Bank's lending policy as a powerful instrument for control from now on in order to attain a stable economic growth, the dissolution of over-loan cannot be taken lightly." (His remark was given at a round-table talk reported in *Shuh-kan Toyo Keizai*, 4 and 11 Mar. 1961)

On this remark, *Hundred Years* comments, "this remark pointed out a problem which the Bank was rather definitely conscious of, when it considered the over-loan problem from the view of strengthening the ability of monetary control." But this is too brief to explain its intention concerning the 'low Bank Rate' policy.

Further on pages 97-100, the difference of opinion in the Bank on

(18) *Hundred Years of the Bank of Japan*, supplementary volume, 1986, pp. 424-433.

Concerning the history of the call market, see also S. Goto, *Development of Short-term Money Markets in Japan: A History* (Nihon Tanki Kin-yuh Shijoh Hattatsu-shi, Nihon Keizai Hyoh-ron Sha, Tokyo, Japan, 1986)

(19) S. Goto, *op. cit.*, p. 101

(20) *Hundred Years*, *ibid.*

(21) T. Yoshino is also an economist from the Bank. As he has written so many books, I have to give up, for the present, judging whether he has explained somewhere fully the origin and the promoter of the 'low Bank Rate'.

Monetary Normalization is revealed. [see foot note (25) of this research note] But it is not clear how this difference relates to the Bank's policy before and after that time.

Putting the Bank itself aside, how do economists from the Bank answer this question ? B. Kure⁽²²⁾, in his book *Financial World in Japan* (Nihon no Kin-yuh-kai, Toyo Keizai Shimpo Sha, 1981), says, "the system for To-gin to rely on the Bank makes call rates always higher than Bank Rate. If this condition is left uncorrected, it is impossible to lower call rates below Bank Rate. Though we know it well, as the matter is concerned with the attitude of people (To-gin ... Ichinose), namely a matter of mental posture, we cannot find out the way of correction. What the Bank has done so far was nothing but preaching repeatedly." (p. 252) or "connected with the Bank lending policy, call rates have stood at a level usually higher than Bank Rate" (p. 245), and "the Bank has been critical to the fact that call rates are higher than Bank Rate and that call loan is regarded as a way of investment rather than the reserve for payment. The Bank regarded the correction of these conditions as the object of Monetary Normalization (Kin-yuh-Seijoh-ka). But it did not take any effective step for normalization." (p. 246)

The first and the third remarks can be regarded as calling firstly the attitude of To-gin into question and secondly the responsibility of the Bank which will not correct the situation (leaving an important problem unsolved). The second remark seems to be inconsistent with this. That is to say, it suggests that the 'low Bank Rate' is the policy of the Bank

(22) Another important book of his is *Monetary Policy*. (Kin-yuh Seisaku, Toyo Keizai Shimpo Sha, Tokyo, Japan, 1973)

(not an abandonment but a positive intention). His saying around here is not easy to understand. But as a whole his assertion can be taken as follows: the 'low Bank Rate' originated as the result of the behavior of To-gin: and after a certain consideration, the Bank left the 'low Bank Rate' uncorrected: this is the way the 'low Bank Rate' was born.

But still it is not explained clearly why the Bank did not normalize the situation, or, in other words, why the 'low Bank Rate' has been maintained.

Y. Suzuki says, in his book⁽²³⁾, as follows concerning Monetary Normalization in the middle of the 1950's: raising Bank Rate in 1957 could not help being insufficient given the policy atmosphere at the time. "Thus, the level of Bank Rate was low compared with the penalty rate of the second ceiling of the former Kohritsu Teki-yoh Seido. It became much lower than the equilibrium level which was to balance demand for and supply of the Bank lending. Under these circumstances, the lending policy since 1955 was started, which adjusts the strength of 'credit rationing' to To-gin through 'day to day guidance to their financing' and the 'assessment of their lending to firms' as well." (pp. 175-176)

In Suzuki's explanation, we find that the 'low Bank Rate' seems to have been adopted, at least deliberately, since about 1957. On the question why it was adopted, he merely answers with the word 'the policy atmosphere at the time', but it is not clear whether the atmosphere refers to the Bank's or the Treasury's. Nor is it clear whether it was

(23) Y. Suzuki, *Money and Banking in Contemporary Japan* (Gendai Nihon Kin-yuh-ron, Toyo Keizai Shimpo Sha, Tokyo, Japan, 1974) Another important book of his is *Effects of Monetary Policy* (Kin-yuh Seisaku no Kohka, Toyo Keizai Shimpo Sha, Tokyo, Japan, 1966)

adopted on the ground of the Treasury's cheap money policy or because of the intention of the Bank to keep strong powers for monetary control.

A. Kuroda, in his *Financial Market in Contemporary Japan* (Toyo Keizai Shimpo Sha, Tokyo, Japan, 1988)⁽²⁴⁾ inquires into the transmission mechanism of monetary policy, using the 'activeness and passiveness of the Bank lending' as his key words when he analyzes short-term financial markets.

But he does not mention the origin and promoter of the 'low Bank Rate', either. On this point he only says briefly, "As Bank Rate in our country usually remains lower than call and bills rates, lending is given at the option of the Bank in the form of credit rationing, so that it has been the most mobile instrument for credit control." (p. 27)

Conclusion

So far as we have seen, neither *Hundred Years* by the Bank nor the economists from the Bank can be said to have given a clear explanation about the 'low Bank Rate'. Let us repeat the question again. Why and by whose intention was it started and did it take root ? Was it only a link in the government's cheap money policy or the embodiment of the Bank's own intention to devise an efficient weapon for monetary control ?

It seems to me a little perplexing that on this fundamental question no clear explanation is found at least in *Hundred Years*. The 'low Bank Rate', I infer, seems to be not only a result of the government's cheap

(24) Another important book of his is *The Term Structure of Interest Rates in Japan*. (Nihon no Kinri Kohzoh, Toyo Keizai Shimpo Sha, Tokyo, Japan, 1982)

money policy but also the consequence of the Bank's wish to maintain the power over monetary control⁽²⁵⁾.

If this is proved, the common view will have to be modified or supplemented that the cheap money policy in post-war Japan has been motivated by the government's wish to pursue high economic growth and low debt charge at the same time. This verification is the next task.

(25) Here we might have to bear in mind that there were two streams of thoughts in the Bank concerning the attitude to monetary control, one being 'controllism', the other being 'marketism', as it were. (*Hundred Years*, vol. 6, pp. 97-100)