

Bank-Business Conglomerates — the Japanese Experience

I. Introduction

From an American point of view, the existence of combines of banking and industrial firms, each consisting of one major bank and perhaps 20 to 30 major companies [27, 41], is perhaps the most striking structural feature of the Japanese economic system. The zaibatsu, the well-known combines of the prewar period, were dissolved during the American Occupation, but they were succeeded in the postwar period by new groups which again combined major banks and major business firms. The existence of these conglomerate-type combinations in Japan contrasts sharply with the United States where the permissible activities of bank holding companies are strictly regulated (under the Bank Holding Company Act of 1970) because of public concern about the possibility of adverse effects when bank holding companies engage in conglomerate activities.

The conspicuous economic growth of Japan in the 1950's and 1960's especially after the end of the period of conversion, recovery and rehabilitation in 1952-54 [31, 20], has raised a question about the prohibition on conglomerate activities for bank holding companies in the United States. Accordingly it is the purpose of this paper to examine the experience of the Japanese combines during the 1950's and 1960's in light of the adverse effects which have motivated the restrictive United States legislation on conglomerate bank holding companies.¹ The possibility of adverse effects on economic (including banking) concentration will be examined in Section III, on unaffiliated business firms in Section IV, and on

¹ The argument that the United States must adopt the Japanese model of bank-dominated conglomerates in order to be successful in world markets [27, 44] is not examined in this paper which is concerned exclusively with domestic effects.

economic growth in Section V. But we must begin with a brief look at some important differences between the postwar combines and the zaibatsu of the prewar years (Section II).

II. Bank-Business Conglomerates: Prewar and Postwar

In prewar Japan, the holding companies which combined banking and industrial firms in huge conglomerate organizations were called "zaibatsu" (money groups), and the names of the largest zaibatsu (Mitsubishi, Mitsui, Sumitomo, Yasuda) were familiar in all parts of the world. These prewar conglomerates tended to be tightly controlled organizations in which the component elements were "not operated for their individual advantage but collectively for the advantage of the top holding company" [19, 23]. The top holding company exercised centralized control by virtue of the vast ownership holdings of the zaibatsu families. The management of the top holding company was thus able to appoint the top management of the major companies and of some of the other companies as well. The management links were reinforced by interlocking directorates among the combine firms. The great trading companies which received sole-agency rights to buy and sell for the key subsidiaries and which granted them preferential terms were another instrument for tying together the operations of the conglomerate. The combine bank exercised a key role in this control apparatus, and together with the other financial institutions of the combine, gave the top holding company a hold on a vital aspect of the operations of the combine firms [19, 27-29].

During the American Occupation, the zaibatsu were dissolved and holding companies were made illegal. The dissolution was ordered partly as a retributive action towards a vanquished country [46, 88], but the dismemberment of large banking and industrial combinations was also consonant with American thinking on anti-monopoly policy and on the steps that were considered necessary to introduce economic democracy in Japan. This antimonopoly policy began to be moderated at an early date in the Occupation period, however; and, even before Japan regained its independence in 1952, substantial steps had been taken to restore economic organization along prewar lines and often under prewar names (Mitsui, Mitsubishi, Sumitomo, etc.) [46, 89]. In spite of this

tendency to undo the dissolution of the zaibatsu, the postwar combines² differed from the zaibatsu in important ways. This was partly because the component firms of the old zaibatsu had developed a spirit of independence during the years of enforced dissolution. Moreover, as noted, the holding company form of organization became illegal; and the common ownership provided by the holdings of the zaibatsu families no longer existed. Group loyalty was a powerful force in reuniting the firms of the prewar zaibatsu, but the ties based on group sentiment have been weakening with the passing of the old guard. Similarly, although the intragroup relations among firms have been cemented by the traditional means of mutual shareholdings (including bank shareholdings in business firms and vice versa), the interlocking shareholdings are far below prewar levels — “inside” (intragroup) holdings have been estimated to be about 29 per cent in the Mitsubishi group, 27 per cent in the Sumitomo group, and about 14 per cent in the Mitsui group [32 (June 1970), 11]. Finally, although loans made to the affiliated companies by the bank in each group are an important bonding element, the combine banks are not the only important suppliers of credit to the business firms in each group. At present, therefore, the postwar groups are not monolithic business organizations under tight central control but loose combinations of independent companies which have joined together for reasons of mutual benefit and interest. Each of the (eight or ten) postwar groups is clustered around one of the leading city banks which are the principal bankers for large enterprises [9, 34; 28, 495-6], but the main control in each combine appears to be exercised through a board of company presidents (shachokai) which meets regularly and makes decisions about policy or personnel of the member companies and in other ways exercises guidance of the group on a noncompulsory basis. In spite of the loose controls, the “zaibatsu groups function as smoothly coordinated entities” [32 (June 1970), 11].³

² The postwar combines are called keiretsu rather than zaibatsu, although the latter term is still used in some of the literature. The major firms of a keiretsu are linked together by multiple ties — ownership, credit, management, marketing. For a further discussion of business groupings, see [19, 257; 11, 10-11].

³ The *Oriental Economist* correctly observes that the operation of the zaibatsu groups remains a mystery to foreigners. A non-Japanese who was also a former director of Nippon Electric Company has stated that “No foreigner will ever be given access to the inner workings of a Japanese zaibatsu” [27, 41].

To summarize, contrary to a popular impression outside of Japan, the postwar combines of giant banks and giant nonbanking business firms are not tightly-knit, monolithic conglomerates as in the prewar period. They are loose organizations based on mutual convenience and advantage. The community of interest is expressed by preferential buying, selling, financing, and personnel exchange among the member firms of each group, but the old exclusiveness is gone [28, 497; 3, 189-194; 19, 256; 39, 267]. The balance of this paper examines some of the important consequences of the fact that banks are at the center of this system of mutual arrangements.⁴

III. Impact on Concentration

Bank holding company conglomerates can have an important impact on the level of economic (and political) concentration. In prewar Japan, for example, “Four family groups at war’s end controlled one-quarter of the corporate and partnership capital of the nation” [19, 331-2]. Unfortunately it is not possible to be equally categorical about the impact of the bank-business combines on the postwar concentration of economic resources. As shown in the previous section, the membership of the postwar groups is not clearly identifiable by means of common ownership, and the public lacks full information about the ties which presently define membership in a particular group. Therefore, it is only possible to present a broad general picture of the situation. The following figures are suggestive on the extent of economic concentration among the (say) top six industrial groups in 1972 — DKB, Fuyo, Mitsubishi, Sumitomo, Sanwa, Mitsui [32 (August 1972), 14]. Companies in the top six industrial groups comprised 58 per cent of the 100 largest companies and transacted 67.4 per cent of the sales in that group; they were 44 per cent of the 200 largest companies and had 59.9 per cent of the sales in that group [Table 1].

The existence of bank-business groups can also affect the level of concentration in the banking sector, a particularly important part of the economy. There was a high level of concentration of

⁴ The reader will note that this study is not concerned with the effects of conglomerates as such but rather of conglomerates which contain an important bank at their center.

TABLE I

SALES BY LARGE AFFILIATES OF TOP SIX INDUSTRIAL GROUPS (1972)*

Industrial Group	Affiliates in Top 100 Firms***			Affiliates in Top 200 Firms***		
	Number	Sales (\$ million)	Per cent of Top 100 Sales	Number	Sales (\$ million)	Per cent of Top 200 Sales
DKB	17	8,087	19.4	27	9,178	17.6
Fuyo	8	5,774	13.8	15	6,531	12.5
Mitsubishi	8	5,078	12.2	12	5,448	10.4
Sumitomo**	9	4,362	10.4	10	4,449	8.5
Sanwa	12	3,920	9.4	16	4,227	8.2
Mitsui	4	923	2.2	8	1,400	2.7
TOTAL	58	28,144	67.4	88	31,233	59.9

* Sources: For the identification of the top six industrial groups and the names of their affiliated firms in 1972, see [32 (August 1972), 20; (September 1972), 21; (November 1972), 25 and 17; (October 1972), 17 and 25].

For the sales figures in 1968, see [42, 48-51].

** Includes Sumitomo's indirect affiliates.

*** Includes only firms in manufacturing and mining.

banking resources in Japan before the end of the second world war — in 1944, four zaibatsu banks (Mitsui, Mitsubishi, Sumitomo, Yasuda) held 74.9 per cent of all bank loans [47, 112]. The concentration of banking resources has also been very high in postwar Japan. At the end of 1972, the thirteen city banks held 58 per cent of total bank deposits (as compared with 30 per cent of all insured commercial bank deposits for the 13 largest banks in the United States) [38]. Moreover this figure understates the extent of concentration among commercial banks for at least two reasons. First, in Japanese banking statistics, the category "all banks" includes city banks, local banks, and foreign banks, but also trust banks and long-term credit banks [5]. Second, the city banks are not the thirteen largest banks in Japan, because some local banks are equal in size to the city banks [11, 136].

It is reasonable to suppose that the existence of the zaibatsu was responsible for much of the prewar banking concentration. As noted earlier, there was a high degree of common ownership

of the bank and business firms in each zaibatsu organization, and the zaibatsu firms were overwhelmingly if not totally dependent on their family bank for credit [1, 256]. Under those circumstances, the deposits of the affiliates would have been closely held in each group's own bank [32 (April 1971, 9)]. There is a looser connection between bank concentration and the existence of combines in the postwar years because ownership ties are much weaker and the large business firms usually have more than one banker. On the other hand, the large business firms "traditionally enter into a close business relationship with a specified city bank" [8, 30] — presumably the combine bank for each large firm with a group affiliation. Hence, it is reasonable to infer that affiliated firms in the postwar groups have also tended to place their deposits in their respective group banks. To this extent, the increase in size of the postwar combines (by acquiring existing nonbanking business firms, or by *de novo* entry and by internal growth) has as a byproduct tended to raise the level of concentration in banking.

The relative size of the city banks tends to support the hypothesis that concentration of bank deposits was heavily influenced by the existence of bank-business groups.⁵ The city banks are the principal bankers of the large business firms in the major groups — indeed, the emphasis on big business is what distinguishes the city banks from the local banks [11, 135-6] — but all city banks are not associated with important groups. Significantly this characteristic is highly related to bank size. Table 2 shows that six of the seven largest city banks in 1972 were the group banks of the top six industrial groups in the country. It is pertinent in the light of the above to note that the Bank of Kobe, one of the smaller city banks without group connections, began to form its own industrial group in 1972 [32 (September 1972) 27]. The absence of strong group connections was also a major consideration in the merger of the Dai-Ichi and Nippon Kangyo banks, because their relative positions among the city banks⁶ were unstable « due

⁵ The concentration of the city banks rests heavily on their holdings of large business deposits. On June, 1972, 55.4 per cent of the city bank deposits were "Private corporation deposits" (which are overwhelmingly large corporate deposits). By contrast, corporate deposits were only 38.5 per cent of total deposits in local banks. Cf. Special statistics reported in [6 (July 1972), 175].

⁶ Before the merger on October 1, 1971, Dai-Ichi Bank was the sixth largest city bank and Nippon Kangyo Bank was the eighth largest city bank.

DEPOSITS OF CITY BANKS, DECEMBER 1972*

TABLE 2

Bank	Deposits (Y 100 million)
Dai-Ichi Kangyo	50,958
Fuji	43,192
Sumitomo	42,394
Mitsubishi	41,784
Sanwa	40,528
Tokai	31,015
Mitsui	30,204
Kyowa	22,537
Daiwa	19,246
Kobe	16,696
Saitama	15,331
Taiyo	14,633
Hokkaido Takushoku	13,540

* Source: [32 (April 1973), 20 and 23].

to the lack of specific affiliations with the former zaibatsu groups and top enterprises among their customers" [32 (May 1972), 86].⁷

Although the group ties between large banks and large business firms have played an important part in concentrating banking resources in Japan, the government has also been a major contributor to the present level of bank concentration. Between the first and second world wars, the government encouraged bank mergers and at times required them. As a result, the number of banks was reduced (by liquidations as well as by mergers) from 1987 banks in 1920 to 61 banks by the end of the war [35, 42]. Eight of the 61 banks were large banks, mostly with nationwide branch systems (city banks); the balance were provincial banks, usually smaller and often concentrated in one prefecture (local banks) [2, 106].⁸ During the fifties and sixties, banking facilities

⁷ It was widely expected that the new bank would strengthen its financial relations with its key client enterprises, especially in the Kawasaki and Furukawa groups [32 (April 1971), 12]. Further evidence on the new bank's group will be presented later.

⁸ This banking structure was not disturbed by the American Occupation authorities who pressed vigorously for a policy of economic deconcentration in the industrial sector but left banking concentration essentially untouched.

were expanded primarily by means of new branch offices and the number of banks did not change much; but toward the end of the sixties, the authorities decided that the banking structure required major structural reorganization. The government's view (as expressed by the Bank Bureau Chief of the Ministry of Finance) was "to promote bank mergers wherever possible" because "If the scale of banking institutions grows bigger, they can enjoy the economies of scale by introducing powerful machinery and management technologies which smaller banks cannot afford" [32 (April 1973), 23]. Accordingly the government approved a number of bank mergers to eliminate many banks which were too small to enjoy scale economies. The government's merger policy affected some of the large banks as well on the grounds that even some major banks were plagued by unnecessary and wasteful duplication in terms of branches, investment in computerization projects, overlapping personnel, etc. The government also wanted Japanese banks to become larger in order to keep pace with growth of the banks' borrowers and to be a bulwark against the advance of major foreign banks into Japan [32 (April 1971), 12]. In Japanese banking circles, it was widely speculated that the Ministry of Finance wanted to cut the number of city banks to one-half or one-third [32 (March 1971), 15; 32 (April 1971), 37]. As noted above, the government approved the merger of Dai-Ichi and Nippon Kangyo banks as of October 1971. In February 1973, Taiyo Bank and the Bank of Kobe were merged as the Taiyo-Kobe Bank, again with government encouragement [32 (April 1973), 20-24].

The government has also contributed to the concentration of banking resources by the overloan policy of the Bank of Japan. Japanese business firms have had to rely heavily on external financing for their investment during much of the postwar years,⁹ and the banking system has been the major supplier of those external funds. The banks in turn have relied heavily on their borrowing privileges at the Bank of Japan. In practice, Bank of Japan overloan policy has been biased in favor of the large banks. At the end of 1972, for example, Bank of Japan loans to banks amounted to

⁹ One measure of the importance of bank loans to Japanese business firms is that "In the case of corporations listed on the first section of the Tokyo Stock Exchange, a 0.5 per cent decline of the contracted interest rate on loans by all banks... serves to raise the corporate profit by about 8-9 per cent" [32 (June 1972), 5].

TABLE 3

CITY BANK BORROWINGS AT BANK OF JAPAN, 1952-72*

End of Year	Borrowings from Bank of Japan (¥100 million)	City Bank Deposits (¥100 million)	Borrowings as Percent of Deposits
1952	1,676	12,599	13.3
1953	2,525	17,119	14.7
1954	2,122	19,014	11.2
1955	290	24,073	1.2
1956	1,169	31,490	3.7
1957	5,201	35,711	14.6
1958	3,361	41,805	8.0
1959	2,899	47,800	6.1
1960	4,349	55,803	7.8
1961	12,176	62,927	19.3
1962	11,893	72,367	16.4
1963	10,847	95,432	11.4
1964	9,369	108,098	8.7
1965	11,363	124,992	9.1
1966	13,482	141,983	9.5
1967	11,538	154,614	7.5
1968	13,552	180,470	7.5
1969	17,225	214,189	8.0
1970	21,237	242,983	8.7
1971	5,386	314,308	1.7
1972	19,053	397,723	4.8

* Source: [5].

¥2,067 billion — ¥1,905 billion went to the city banks and only ¥92 billion to the local banks.¹⁰ Table 3 shows that city bank borrowing at the Bank of Japan has provided a significant (and permanent) portion of their loanable funds during the postwar years.

¹⁰ The balance was borrowed by trust banks (¥39 billion) and long-term credit banks (¥31 billion).

IV. Discrimination in Allocation of Credit

Credit Rationing

In the prewar years, access to zaibatsu bank credit depended on whether the borrower was an insider or an outsider. The major zaibatsu firms received preferred access to the credit of the group bank because common ownership under the zaibatsu holding companies made intragroup ties extremely strong. In at least one case (Mitsubishi), the zaibatsu bank was actually a department of the top holding company; and, while outsiders were not necessarily denied credit, they got it only after the needs of the insiders had been served [19, 157 and 163]. In the postwar period, the allocation of group bank credit has taken place in the context of an elaborate system of rate controls. Due to the inflation and general disruption in the aftermath of the war, the Japanese government did not favor a free-market determination of interest rates. However, the prewar practice of fixing loan rates by agreement among the commercial banks was prohibited by the (Occupation-inspired) Antimonopoly Law of 1947. Accordingly the government imposed its own ceiling-rate controls on both loans and deposits under the authority of the Temporary Money Rates Adjustment Law of 1947. In 1955, the banks agreed upon a system of "voluntary" ceiling rates within the limits fixed by the Temporary Interest Rates Adjustment Law. These voluntary (or conventional maximum) rates supplemented and eventually superseded the government's ceiling rates. The Bank of Japan hailed the system of voluntary rates as "strengthening the autonomy of bank management" [4 (1955), 5; 4 (1958), 75], but it has continued to keep a firm hand on the situation. Thus, although the voluntary ceiling rates are announced by the commercial banks, they are actually based on negotiations among the Federation of Bankers' Association, the Bank of Japan, and the Ministry of Finance. Since the bankers are keenly conscious of the government's power to impose legal ceiling rates, any changes which they negotiate on the conventional maximum rates tend to be as effective as if the Bank of Japan had made a change in the legal maximum rates [35, 135].

For our purposes, the important point to note is that the voluntary ceiling rates have tended to become the actual rates as

well,¹¹ and that they are probably below the level of free market rates. The latter is in keeping with the government's desire (particularly stressed by the Ikeda government) to reduce the cost of capital for Japanese business firms in order to improve their competitive position in world markets [2, 304]. Moreover, especially during periods of tight money — a recurring condition in post-war Japan —¹² the ceiling loan rates are also typically below their equilibrium levels.¹³ In order to subsidize low loan rates, deposit rates have also been held below their equilibrium levels. In sum, the government supports a system of rate controls in which loan rates are not free to fluctuate in order to balance the demand and supply for bank credit and in which loan rates are often below their equilibrium levels. Under these circumstances, credit (administrative) rationing is inevitable, and the balance of this section examines how the bank-business conglomerates have operated in this environment.

Allocation of Credit to Affiliated Firms

In the postwar period, the allocation of group bank credit has taken place under conditions of administrative rationing made necessary by the government's insistence on ceiling rates that are below equilibrium levels. In this context, the affiliates of a bank group became natural candidates for preferred access to the credit of their respective group banks. There is a basis for this preference insofar as the group bank is a shareholder of the affiliated companies.

11 This statement must be qualified. First, some loan rates are not regulated — e.g., rates on loans for more than one year or rates on loans for less than ¥1 million. Second, the widespread practice of requiring compensating balances permits the banks to escape somewhat from the system of loan ceiling rates. The compensating balances have often been quite high — as much as 30 to 40 per cent [2, 135] — even though the Bank of Japan has repeatedly instructed the banks not to require excessive compensating deposits [4 (1958), 76; 4 (1963), 66]. It should also be mentioned, however, that compensating balances usually earn interest (but under the constraint of ceiling rates on deposits). Finally, as shown later, the rate controls are not always observed.

12 For example, during the decade of the 1960's, credit restraints were in effect from July 1960 to May 1961; from January 1962 to January 1963; from October 1964 to May 1967; from February 1968 to May 1969, and from September 1969 to October 1970.

13 This view is widely held by scholars and other informed observers of the Japanese banking scene. Cf. [34, 605; 12, 96]. In this connection commercial banks sometimes take short-term losses by lending to their preferred customers at rates below the penalty rates which the banks must pay for overloans at the Bank of Japan [35, 139].

When a bank lends below the equilibrium interest rates, the cost of capital is below the borrower's expected profit from investing the loan [20, 85]. Thus the group bank would benefit as a shareholder by lending to an affiliate rather than to an outsider.¹⁴ The scope for this kind of direct benefit is limited in Japan, because the Antimonopoly Law prohibits banks from holding more than ten per cent of the shares of any business firm. However, there is also a strong basis for preferential lending to affiliates rather than to outsiders on grounds of group solidarity and loyalty.¹⁵ Indeed, in keeping with the widely observed Japanese ethic that "once firmly established, a relationship should be maintained even despite economic loss" [30, 98-99],¹⁶ group banks will often lend to their affiliated firms during periods of tight money even if they must do so at a loss. Similarly, when the city banks extend credit to their affiliates by buying their securities instead of making loans, "the yield is often disregarded and banks hold the securities of firms with which they are more or less intimately connected" [1, 256].

There are three kinds of evidence for the hypothesis that group banks have allocated credit on a preferential basis to their affiliated firms during the postwar years. One kind consists of the statements of scholars and other informed observers of the Japanese banking scene. For example, Shinohara has stated that "lending tends to be preferential in nature concentrating on affiliated big companies than on a wide range of enterprises" [43, 22]. In a similar view, Bronfenbrenner has noted that "loans go primarily to each bank's zaibatsu affiliates and interlocks..." [12, 96]. Rotwein has also

14 In this connection, the lifting of the tax on intercorporate dividends has "expedited financial affiliation of banks to the industrial and business firms of their choice and further concentration of their loans in the firms so affiliated" [25, 76].

15 Group solidarity, especially among the successors of the old zaibatsu, has been attributed to "historical sentiment among cronies", and to "clannish interdependence of the 'blood is thicker than water' variety which was fostered in the old zaibatsu era" [32 (June 1970), 11]. As noted earlier, however, the postwar groups are based on a community of mutual interest, and the solidarity of the postwar groups is critically dependent on "the importance of the relative strength of leadership within the groups" [49, 340]. For an interesting sociological interpretation of business relations in which the solidarity of group firms is compared to the strong group loyalty which typifies traditional family relations, see [30].

16 Sanwa Bank appears to be a maverik. According to its business-firm critics, "Sanwa Bank has become timid, cold or callous in regard to group businesses in distress. This is just the opposite of Sumitomo behavior" [32 (November 1972), 27]. The criticism arose because Sanwa Bank wanted to increase its personal loans and to operate more as a people's bank.

expressed the belief that "zaibatsu firms have better access to credit than other firms..." [39, 272]. In Ehrlich's view, the Japanese "banking system [is] committed to 'related' companies, rather than... to serving all who ask on the merits of their loan request..." [19, 287]. Hadley concurs that "ties between banks and industrials inevitably make for favoritism in the extension of credit..." and she has declared flatly that "Japan's entire modern period (1868 to the present) has been built on discriminatory bank credit" [19, 287]. Adams and Hoshii also cited group relations as the "chief reason why banks prefer to lend to large enterprises..." [2, 131], and they noted that the bonds between banks and enterprises are "particularly close between the city banks and the companies belonging to their particular groups..." [2, 340]. The Bank of Japan has provided the most authoritative expression of this view: "When the relation between banks and enterprises becomes too close, the former become involved in the competition against other groups of enterprises, and find themselves obliged to adopt an easy lending attitude. This is one of the factors contributing to the tendency to excessive economic expansion in Japan" [19, 269-70].

A second kind of evidence that group banks prefer to lend to their own affiliates consists of specific cases of discrimination which are cited in the literature. One of the most interesting examples of preferential lending to affiliates came to light as a result of the merger of the Dai-Ichi and Nippon Kangyo banks. Before the merger, the trading firm of C. Itoh and Company had relied on Sumitomo Bank as its primary bank; but it was considered a peripheral member of the Sumitomo group. Although Itoh's true leanings were towards the Dai-Ichi bank, Dai-Ichi was too small before the merger to finance Itoh's needs; and, as the president of Itoh remarked, "it is not easy to show one's true colors" under those circumstances [32 (May 1971), 14]. After the merger, when Dai-Ichi Kangyo Bank was in a better position to finance Itoh's needs, Itoh began to "show its true colors" by a number of acts which indicated its intent to become a strong member of the Dai-Ichi Kangyo Bank group as the main trading firm for the group.¹⁷ By the same token, although Dai-Ichi Kangyo had indicated at the

¹⁷ Specifically, Itoh Company "greatly increased its holdings of Dai-Ichi Kangyo Bank's stock, limited the growth of the shares of Sumitomo Bank to a minimum and ... reduced the share of its stockholdings of Fuji Bank" [32 (November 1973), 20].

time of the merger that it would be a "neutral" bank,¹⁸ informed observers anticipated that the group would gradually move to "wash its hands of the corporations definitely belonging to the Mitsubishi group" [32 (August 1972), 17]. As the *Oriental Economist* explained: "If C. Itoh and Company is to be cultivated as the main trading portal for the Dai-Ichi Kangyo group, it will no longer be practical to continue nondiscriminatory lending. There is high probability of gradual reduction of the amounts piped into Mitsubishi Shoji and Mitsui & Co. as the pipeline to C. Itoh becomes enlarged" [32 (May 1971), 14].

A third way to support the hypothesis about preferential lending to affiliates by group banks would be to cite statistical evidence from the literature. Unfortunately the usual tests of discrimination are flawed. For example, in one test of credit discrimination, the size of loan which an affiliated firm receives from its group bank is compared with the size of loan it receives from other banks. The problem with this test is that the size of its loan from a bank is the usual criterion for identifying a company's primary bank, and the latter information is regarded as major evidence of a firm's group affiliation [19, 212]. One way to break out of this circularity is to examine the bank loans received by selected major companies which belong to the successor groups of the prewar zaibatsu. Since the successors of the prewar zaibatsu are bound by multiple ties (i.e., they are not exclusively credit-related groups), the group affiliation of the major companies is not in doubt. Table 4 shows the loan situation (in 1966) for twelve such companies, viz., four major companies for each of three combines (Mitsubishi, Mitsui, and Sumitomo) which were also important zaibatsu in the prewar years. In conformity with the hypothesis of preferential lending to affiliates, the table shows that each firm received a larger loan from its group bank than from any other city bank.¹⁹ With only

¹⁸ This was very important to many borrowers because, as one business man observed, "major city banks affiliated with former zaibatsu groups are likely to place top stress on loans to the companies within their groups" [32 (April 1971), 12].

¹⁹ This pattern would not necessarily be the same if the table had included government banks (viz., Japan Development Bank or Export-Import Bank) or the three long-term credit banks (Industrial Bank, Long-Term Credit Bank, or Hypothec Bank). The government banks and long-term credit banks as well as trust banks and insurance companies have been excluded in this comparison because they are long-term lenders whereas the city banks (which are commercial banks) are primarily short-term lenders. On September 1971, 94 per cent of the loans and discounts of the long-term credit banks had a maturity of

TABLE 4

LOANS RECEIVED BY AFFILIATED COMPANIES FROM THEIR GROUP BANKS AND FROM OTHER CITY BANKS, 1966*

Affiliated Company**	Loan from Affiliate's Group Bank (Y million)	Largest Loan by Another City Bank (Y million)	Largest Non-group Bank Loan as Percent of Group Bank Loan (percent)
Mitsui Trading	31,747	30,711	96.7
Mitsui Petrochemical	7,152	4,732	66.2
Mitsubishi Electric	12,880	8,510	66.1
Mitsubishi Chemical	5,958	3,704	62.2
Mitsui Mining	4,498	2,717	60.4
Mitsubishi Trading	32,652	17,036	52.2
Toyo Rayon	4,283	2,165	50.5
Sumitomo Trading	17,961	8,284	46.1
Mitsubishi Heavy Ind.	33,475	10,379	31.0
Nippon Electric	10,775	2,120	19.7
Sumitomo Metal Ind.	15,802	1,130	7.2
Sumitomo Chemical	9,609	470	4.9

* Source: Based on loan information in [19, 227-31].

** Based on 12 affiliated companies: 4 Mitsui firms, 4 Mitsubishi firms, and 4 Sumitomo firms.

one exception, the loans from the nongroup banks were at most two-thirds as large as the group bank loans; most were far smaller, and the smallest was less than five per cent as large as the group bank loan. In short, although Table 4 does not provide conclusive evidence about the existence or extent of preference shown to affiliates, the results are consistent with the hypothesis that group banks give significantly preferential treatment to their affiliates.

Although much evidence supports the hypothesis that affiliated

more than one year; on the same date, only 15.7 per cent of the city bank loans and discounts had a maturity of more than one year — 21.0 per cent were for less than two months; 29.6 per cent were for 2-3 months, and 32.6 per cent were for three months to one year [5]. To this extent, the excluded lenders do not provide substitutes for commercial bank short-term loans.

companies are preferred borrowers at their respective group banks, there is an important difference between the prewar and postwar periods. Among the prewar zaibatsu, preferential treatment meant that the financial institutions of each zaibatsu organization met most if not all of the credit needs of their affiliates. The Mitsui-affiliated firms, for example, were financed almost exclusively by the Mitsui Bank or by other financial institutions of the group [1, 256]. During the postwar years, the group banks have continued to be important loan suppliers to their respective affiliates, but they have fallen far short of supplying their full needs. Table 5

TABLE 5

LOANS RECEIVED BY 48 AFFILIATED COMPANIES FROM THEIR GROUP BANKS AND FROM OTHER FINANCIAL INSTITUTIONS, 1971-72*

Affiliate's Group Bank Loan as Percent of Its Total Borrowings (percent)	Number of Firms**
Less than 5	2
5 to 9.9	11
10 to 14.9	11
15 to 19.9	12
20 to 24.9	8
25 to 30	2
More than 30	2

* Source: Based on [32 (October 1972), 17 and 25; 32 (November 1972), 17]. Figures are for end of 1971 or beginning of 1972.

** Number of firms affiliated with each group: Sumitomo, 12; Mitsui, 15; Mitsubishi, 21.

(based on data for the end of 1971 or beginning of 1972) shows the loans received by 48 affiliates from their respective group banks (Sumitomo, Mitsui, and Mitsubishi) as a per cent of their total borrowings (including loans from long-term banks). One-half of the companies in the sample received less than 15 per cent of their total borrowings from their group banks; and only 8.5 per cent of the companies received more than 25 per cent. By groups, the average proportion was 19.9 per cent for the Sumitomo affiliates; 14.4 per cent for the Mitsubishi affiliates; and 13.4 per cent for

the Mitsui affiliates — or an average proportion of 15.5 per cent for the three groups. These figures are markedly below the estimated level of a decade earlier (based on 1961 data for eight old and new groups) that “operating affiliates typically get about 30 per cent of their loans from the group bank...” [28, 496]. In order to put this decline in perspective, it should be recognized that the prewar system of heavy (and sometimes exclusive) reliance on the group banks had already begun to break down during the immediate postwar years when the inflation made it impossible for one or two banks to meet the rapidly-increasing demand for funds by big enterprises [7, 9]. Thus the postwar inflation gave an early and important impetus towards making the relationship between banks and big companies multilateral. This trend has continued during the postwar years due to the growing inability of the group banks to fill the needs of their affiliates.²⁰

It has been argued above that group banks prefer to lend to their affiliates but that they are not large enough to supply the full credit needs of their affiliates. On the other hand, the group banks probably do not lend more than 10-30 per cent of their resources to their respective affiliated firms.²¹ Under the circumstances, it is important to stress that this comparatively low percentage — especially in view of the large needs of the affiliates — is probably due to risk considerations, not to any weakening of group ties. If the ten per cent rule²² is used as a rough guide to conservative diversification of the loan portfolio, the three group banks (Sumitomo, Mitsubishi, Mitsui) have extended credit beyond “safe” loan limits for 29 per cent of their major affiliated firms [Table 6].²³ Moreover these figures probably understate how much credit the affiliated firms received from their group banks — to say nothing of loans

²⁰ Many Japanese firms have also begun to tap foreign sources of credit [32 (October 1971), 15].

²¹ In his 1962 volume, Patrick stated (on the basis of 1954 data) that at least 20 per cent of Mitsui Bank loans went to its group affiliates, about 25 per cent of Mitsubishi Bank loans, and about 30 per cent of Sumitomo Bank loans; and he believed that the percentages had not declined since then [35, 46]. These figures are consistent with Lockwood's statement in 1965 (based on 1961 data) that group banks committed no more than 10-25 per cent of their loans to affiliated firms [28, 496].

²² United States banks generally cannot lend more than 10 per cent of their capital to a single borrower. This rule does not exist in Japan.

²³ It should be mentioned that the capital figures of Japanese banks do not correspond exactly to American usage. For these and other reasons mentioned in the text, the figures in Table 6 are suggestive rather than precise indicators.

TABLE 6
LOANS TO AFFILIATES BY THEIR GROUP BANKS
AS PERCENT OF EACH BANK'S CAPITAL, 1971-72*

Loans as Percent of Bank Capital (percent)	Affiliated Firms	
	Number	Percent
25 and over	4	8.33
15-25	4	8.33
10-14.9	6	12.50
7- 9.9	6	12.50
5- 6.9	5	10.42
3- 4.9	10	20.83
2- 2.9	2	4.17
1- 1.9	11	22.92
Less than 1	0	0.00

* Source: Same as Table 5.

from other financial organizations (life insurance companies and trust banks) in their groups — because the city banks sometimes make “hidden loans” to their preferred customers, i.e., “loans which lender banks do not record on their books so that such loans may not come under the purview of the fund position guidance by Bank of Japan” [32 (June 1970), 5]. In September, 1972, for example, the estimated volume of off-record loans of the city banks was ¥800 billion [32 (October 1972), 35]. In short, although the figures in Table 6 are only suggestive, they are generally consistent with the hypothesis that group banks allocate a comparatively small percent of their funds to their affiliates due to risk considerations and not to a declining sense of group identity.²⁴

Allocation of Credit to Nonaffiliated Business Firms

Large business borrowers. As already noted, large business firms have preferential access to bank credit in Japan, because most major business firms are affiliated with one of the large

²⁴ In this connection, see Lockwood's view that “Financial institutions ... prefer to diversify their loans and to adhere to the role of bankers rather than combine operator” [28, 497].

combines. In addition, the large business firms are preferred customers at city banks other than their group banks. This may be partly related to the competition for deposits. In an economy where credit conditions have often been tight even during the contraction phase of the business cycle, the city banks have not ignored the fact that the major business firms are an important source of their deposits (55.3 per cent in June 1972).²⁵ In any case, the city banks believe that they can maximize their long-term profits by establishing close relations with large borrowers [35, 45-6], and they express their preference for large borrowers in a number of ways. For example, in competing for the loan and deposit business of large business firms when money is tight, the city banks do not hesitate to restrict credit to less favored borrowers [29, 19]. In addition, the city banks have been willing to lend to large corporate borrowers at the ceiling rates even when this forced them to borrow from the Bank of Japan at higher penalty rates [34, 604].²⁶ In a country where the government exercises immense moral (and actual) authority over the banks and the economy, a particularly impressive manifestation of the city banks' regard for their large customers is their willingness on occasion to violate the ceiling rates on deposits [4 (1948), 76; 4 (1962), 6; 4 (1963), 66] and to make illegal "hidden loans" to their preferred customers.²⁷

The large business firms have also done well in the allocation of bank credit in Japan because they can get funds not only from the city banks but also from trust banks, long-term credit banks, insurance companies, and government financial institutions. During recent periods of tight money, large firms have also secured funds from local banks, mutual banks, and foreign financial institutions [32 (October 1971), 13 and 16-17]. Some large borrowers (e.g., the mammoth Nippon Steel Corporation) have gone directly to minor provincial banks to secure bank credit [33, 41]. In addition, the large firms have had indirect access to the resources of the local

²⁵ A considerable part of corporate deposits represents required compensating balances.

²⁶ This could be consistent with long-run profit maximization for the banks, but they may also lend under such conditions in order to maximize their size or to maintain their position in the banking community [19, 234-5].

²⁷ Hidden loans first appeared in significant amounts in June 1957 and continued on a much reduced scale into 1958 [35, 154-5]. In 1963, the Bank of Japan stressed the necessity for the banks to absorb (i.e., eliminate) their off-record loans [4, 1963, 66]. However, as noted earlier, hidden loans were again quite large in 1972.

and mutual banks via the call money market. The city banks borrow heavily in the call market during tight money periods, and the local and provincial banks are the major suppliers in that market.

Finally the large business firms have enjoyed preferential access to bank credit in Japan because the government has wanted it to be that way. The government's partiality for large business shows up in many ways. One is the overloan policy of the Bank of Japan which has made the central bank an important and virtually permanent supplier of funds to the city banks. The funds secured in this way are overwhelmingly employed in loans to large business firms. The government's partiality for large business also assures them of preferential consideration for long-term loans at the government banks [47, 165]. At the end of 1971, the loans of the Japan Development Bank (¥1,959 billion) and the Export-Import Bank of Japan (¥1,757 billion) were equal to almost 14 per cent of the total loans and discounts of the city banks [5] — and the loans of these banks are extended primarily to large businesses [9, 62].

Small and medium-size business borrowers. The discriminatory allocation of credit in Japan has had a severely adverse impact on the small and medium-size business firms. The familiar tendency for a high correlation between bank size and borrower size is heightened in Japan by the group ties between large banks and large business firms. One survey of the loan structure of different-size borrowers showed that the city banks allocated less than 17 per cent of their loan volume to small (less than 300 workers) business firms²⁸ (as compared with almost 50 per cent for the local banks) [14, 43].²⁹ On a number of occasions, the government has urged the city banks to extend more credit to small and medium business firms. As early as 1953, the Ministry of Finance had noted that

²⁸ The 1957 survey recorded size of business firm in terms of number of workers. Japanese firms with less than 5 employees are considered "very small", from 5 to 30 are "small", and from 30 to 100 are "medium". Firms which employ less than 100 persons are also designated as "small" (in Japanese, "medium-small") [48, 11]. In the Small Business Organization Law, a small business is defined as "those businesses with regular employment of less than 300 workers in manufacturing and less than 30 workers in commerce and service businesses" [4, 326].

²⁹ The local banks have a long history as important suppliers to small business. During the recessions of 1920-31, the total number of banks was drastically reduced by bankruptcies and mergers. The loss of the small and medium-size banks was a "terrible blow to the small-medium enterprises" [43, 25 and 323].

the banks were charged with lack of interest in extending loans to medium and small enterprises, and it "recommended that all financial institutions make special efforts to help medium and small firms, e.g., by setting up special departments to administer such loans" [40, 149]. Notwithstanding such requests, the city banks have not significantly changed the percent of their total loans and discounts allocated to small business firms. In 1957, 26.5 per cent of the city banks' total loans and discounts were small business loans (as compared with 57.4 per cent for the local banks); at the end of 1971, the city bank figure was 26.2 per cent (and 53.0 per cent for the local banks) [5].³⁰ During the credit restraint period from September 1969 to October 1970, the city banks earmarked part of their loanable funds for prime medium and small business [10, 20; 8, 43-44]; but it is not apparent from the figures that this represented any basic change in the attitudes of the city banks with respect to their small business loans. The ratio of city bank loans to small business was not higher at the end of 1969 (26.2 per cent) or at the end of 1970 (25.8 per cent) than it was at the end of 1971 (26.2 per cent), a year of monetary ease [5]. In 1972, the ratio did increase — to 27.9 per cent by the end of June 1972, and to 30.8 per cent by September 1973 [6]; and the Federation of Credit Associations of Tokyo reported that, in the first half of 1972, "lending campaigns directed at minor enterprises with less than nine workers on their payrolls by city banks have become notably fierce in recent months" [32 (April 1972), 37]. However, the main reason for this behavior by the city banks was apparently the excess liquidity in Japan during that period [23, 216].

In addition to the fact that the small business firms receive a comparatively small percent of the city banks' loanable funds, they are also the first to be shut out by the city banks during tight money periods. This adverse discrimination is particularly serious for the small business firms because the loans they get from the city banks are an important part of their total credit from non-governmental

³⁰ The 1957 figures based on [5] are different from those cited earlier based on [14]. The difference appears to be due to a different definition of small business in the two sources. The definition of a small business was based on number of workers in [14] and on size of capital in the firm in [5]. In the latter source, the 1957 figures for "small business" (which includes private persons) included enterprises capitalized at ¥10 million or less; the 1971 figures included enterprises capitalized at ¥50 million or less (or ¥10 million or less for wholesale and retail trade and service industries).

financial institutions — in the 1957 survey, city banks supplied 36.0 per cent of the loans received by small business from non-governmental financial institutions (as compared with only 39.2 per cent from their "natural" suppliers, the local banks) [14, 43]. The adverse discrimination of the city banks is also serious because the loan window at the local banks is often closed to small business firms during tight periods. This is not a matter of administrative discrimination by the local banks; it is a response to market signals. Unlike the city banks which will even incur a loss to accommodate their preferred customers in tight periods, the local banks typically do not feel any obligation to accommodate their small borrower customers in such periods. Instead they may lend to large business firms.³¹ During tight periods, the local banks are particularly active lenders to the call market. The call money rate, one of the few unregulated interest rates in Japan, rises sharply during tight money periods; and it is usually more profitable for the local banks to lend to the call market than to their own small and medium-size customers. As shown above, this means that the funds of small and medium financial institutions are thus also funnelled to the large borrowers.

Unlike the large firms, the small firms cannot rely to an important degree on borrowing from government banks. In recognition of the problems of the small firms, the government did establish special financial institutions for small business financing — the Central Bank for Commercial and Industrial Cooperatives (which is conventionally included among the government organizations even though it is a semigovernmental institution), the Small Business Finance Corporation, and the People's Finance Corporation. However, these are generally of little significance due to the amount of the loans and the conditions attached to them [47, 165]. In the 1957 survey, governmental financial institutions provided 7.4 per cent of total small business borrowings. Similarly, in September 1971, the small business firms (in this case firms capitalized at less than ¥50 million, or less than ¥10 million for wholesale and retail trade and services) received only 5.3 per cent of their total

³¹ There is a similar pattern among other small-business lenders. In 1962, for example, the government asked the mutual loan and savings banks, credit associations, etc. to "refrain from increasing loans to big enterprises from the standpoint of facilitating the small enterprise financing" [4 (1962), 6].

borrowings from the Small Business Finance Corporation and the People's Finance Corporation; and the amounts received from Japan Development Bank and Export-Import Bank were negligible [45].

Finally, the adverse position of the small firms is further aggravated in tight periods because the large firms may delay paying their small-firm subcontractors for as much as seven to nine months or even a year. This forces the small firms to become involuntary lenders to the large firms. Although this practice is illegal, the small firms are reluctant to press for legal relief, because they are dependent on good relations with the large firm [47, 163; 40, 169].

For the reasons described above, many small firms are forced to borrow from relatives and acquaintances [14, 42 and 47] or at very high rates (20-30 per cent) from money lenders [18, 136]. Many others cannot get the credit they need from any sources — during the period of “black-ink bankruptcy” in 1964-65, a period of official tight-money policy, “small firms were often unable to borrow enough funds to finance even the production of output for which orders were already in hand” [23, 216] — and bankruptcies of small firms are common during tight money periods. In short, although all borrowers, including the largest, may experience reduced credit availability during tight-money periods, the brunt of any credit restriction is overwhelmingly borne by small and medium-size firms.³² As shown above, the credit discrimination due to group ties is an important reason for this outcome.

V. Combines and Economic Growth

The discriminatory allocation of credit described in the preceding section has held down entry and limited the growth of competing nonaffiliated business firms while at the same time fostering the growth of the affiliated firms. To this extent, it has also contributed to the growth of industrial concentration and to the emergence of many new oligopolies (e.g., beer, steel, automobiles, sheet glass) which have become firmly entrenched in the industrial structure of Japan during the postwar years [32 (November 1973),

³² One study concluded that “The small and medium business firms continually suffer from a shortage of capital” [14, 46].

44-50].³³ The discriminatory allocation of credit which is associated with the bank-business combines has also strengthened the “dual economy”, a special form of industrial concentration in which modern large enterprises equipped with high-level techniques coexist with smaller enterprises, including handicrafts.³⁴ Although factors other than credit discrimination have contributed to the development of a dual economy [43, 24-5], the preference which group banks have shown for lending to their own large affiliates is an important reason for the success of the modern large-scale sectors in obtaining the “cream of capital and skilled labour supply” [11, 191].

One of the major concerns about business concentration is that it will lead to economic stagnation. In theoretical terms, this outcome presumes that “monopolies and oligopolies have little incentive to innovate since they can exist comfortably on monopoly profits” [31, 225; 28, 510]. In Japan, however, the large combines have carried out a dynamic and progressive investment program which has been a major contributor to the extraordinary record of economic growth in postwar Japan. That growth record — an annual rate of about 11 per cent per annum from 1960 to 1973 [36, 1] — would be noteworthy in any country, but (at least to Americans) it seems especially noteworthy for Japan, the home of the zaibatsu [26, 104].

The performance has been all the more remarkable because it occurred during a period when the government was actively fostering industrial concentration and monopoly.³⁵ In the traditional Japanese views about concentration and monopoly, the zaibatsu were not villains [11, 193]. On the contrary, a broad section of public opinion “never doubted the positive contribution of zaibatsu to economic growth and efficiency within the context of Japanese capitalism” [46, 90]. In keeping with this view, the government's policy in the postwar economy has been less concerned about

³³ For a different view on concentration and oligopoly in the Japanese economy, see [39, 263-4]. However, cf. also [19, 320 and 356].

³⁴ According to SHINOHARA, “The Japanese economy, which is at present polarized to the two extremes, each proportion being very high, belongs to the very few of such economies worthy of the title ‘dual economy’” [43, 324].

³⁵ It should be noted that the Japanese firms were not monopolists or oligopolists in their international markets. Since they wanted to export their products, they had to compete with the best foreign firms. Thus they had to remain innovative and up to date in their investment behavior. Cf. [31, 225].

excessive concentration than about insufficient concentration. In 1953 — the Occupation ended in 1952 — the government amended the Occupation-imposed Antimonopoly Law of 1947 ("Law Relating to Prohibition of Private Monopoly and Methods of Preserving Fair Trade"), and this permitted M.I.T.I. (Ministry of International Trade and Industries) to follow a policy, especially after 1958, of "pushing mergers as hard as it can" [11, 225; 47, 106].

The government's pro-concentration policy has been motivated by a number of objectives. The government's fundamental premise is that concentration (and cartellization) encourage economic growth [19, 400]. In a narrower sense, the government has been concerned to minimize "wasteful" duplication of facilities and to make it possible for business firms to achieve scale economies. According to a spokesman for M.I.T.I., the "...existence of numerous small scale enterprises never contribute to the development of new technology. When an excessive number of firms, for a given market size, are reduced by means of mergers and unification, it will lead to economies of scale and ability to expand into a new technological frontier" [47, 79]. This intense emphasis on scale economies is related to the government's objective to increase the international competitiveness of Japanese industries. Another objective of the concentration program has been related to the government's program for liberalizing foreign investment in Japan. By promoting mergers and other concentration-inducing actions, the government hopes to make the Japanese firms big and strong enough to meet the challenge posed by giant western firms located on Japanese soil [11, 225]. This is partly a concern about comparative production costs but also that the superior financial resources and connections of the large international companies would enable them to take over Japanese markets and exclude Japanese firms [28, 504].³⁶ The government fears domination by foreign firms partly for nationalistic reasons but also because foreign firms might alter established attitudes and methods of operation in Japan [37, 26] — especially that they might be less responsive to government guidance and thereby frustrate national economic planning [11, 225; 31, 223].

In fostering industrial concentration to achieve its multiple

³⁶ It is pertinent to note in this connection that only a third of the Japanese factories are as big as their American rivals [18, 298].

objectives, the government has not been particularly concerned about the implications of more industrial concentration for market concentration and monopoly. As a result, it has not modified its pro-concentration policy even though the power of big business in general to administer prices arbitrarily has been increasing [25, 100],³⁷ and in spite of evidence that the "keen competition" among rival firms in large-scale industry is "qualified by much consultation, back-stage collusion, price leadership and other such restraints..." [28, 498]. These evidences of monopoly power have been largely ignored by the government, because "the whole idea of policing competition in the public interest is basically foreign to Japanese tradition" [28, 498].³⁸

Given the dominating position of the large combines and the government's pro-concentration policy, how was economic stagnation avoided during the 1950's and 1960's? As shown below, the answer to this question can be found in the roles played by government, consumers, and business firms in what has been a national commitment to economic growth.³⁹

Government's role. The Japanese government has promoted investment by the large business firms in a number of ways. First, as explained above, government policy has assured a supply of investment funds to the large business firms even though credit has generally been tight in postwar Japan. Second, the government's tax policy was specifically designed to encourage investment and promote economic growth, and it included many special exemptions which gave large firms a preferential tax treatment as compared to the small firms [47, 149].

³⁷ KURIHARA referred particularly to the power of big business "to prevent downward price flexibility even in the face of higher productivity which clearly warrants lowering of prices..." In this connection, Kurihara explained the remarkable stability of general prices in postwar Japan "to the offsetting impact of rising productivity on the movement toward higher wages of organized labor and on the price-administering policy of monopolistic business, especially in those industries which produce most of the items entering the wholesale price index" [25, 5].

³⁸ The spiralling price inflation in 1973 appears to be modifying such traditional views. Thus the chairman of the Japanese Fair Trade Commission has observed that oligopolization of Japanese industry has created "hotbeds for managed prices" and the Fair Trade Commission is considering actions to break up firms that are too large [32 (November 1973), 44].

³⁹ It is important to put this discussion in perspective. Japan's progress in the postwar period is an integral extension of a century of development with roots in the emergence of a mercantile class in the Tokugawa period [41, 39-40].

Third, the government has encouraged the investment performance of the large firms by its cartel policy. Cartels have been approved for a number of reasons — trade cartels, recession cartels, and cartels to improve technology or the quality of goods; and the government has pushed cartelization at a fast pace in periods of expansion as well as contraction. One of the government's objectives in fostering cartels was to prevent a fall in prices that might otherwise occur as a result of "excessive competition" [17, 94-5]. This was a stimulus to investment because, as Lockwood has observed, "...many investments in new capacity during this boom era seem imprudent except on the expectation that markets can be collusively sustained and shared in one way or another, so as to permit survival for most competitors whatever their cost differentials" [28, 508]. The government's cartel policy also promoted investment, because it had the effect of rewarding over-investment and penalizing underinvestment — M.I.T.I. and the cartels invariably chose to restrict output by an equal percentage of respective rated capacity [47, 85].

Finally, the investment behavior of large business firms has been highly responsive to the indicative planning which is carried out by the government in consultation with top business leaders. The top business leaders, top government leaders, and high-level bureaucrats have been linked together by a powerful "old boy" network which has significantly facilitated the development of a consensus about national goals and the ways to achieve them. During the 1950's and 1960's, the agreed upon national goal was unambiguously defined in terms of economic growth, and this consensus was a major bond between government and big business [21, 3].

Role of consumers (general public). The Japanese consumers have made an important contribution to Japan's economic growth by supporting a national program that has stressed production rather than consumption. Beginning with the modernization of Japan in the Meiji period — the Meiji Restoration occurred in 1868 — the goals of the state have put heavy emphasis on national objectives, viz., "to catch up with advanced nations" [16, 91]. The purpose, however, was not greater consumption but greater national power and protection against nineteenth century European imperialism [11, 270; 19, 392-3]. Accordingly, there was great emphasis on military preparedness and on industrialization; and

even when private ventures to industrialize were based on public financing, they did not have to demonstrate any other public interest connection [2, 12].

The prewar goal of catching up with advanced nations has been in full force during the postwar years as well. In 1960, Prime Minister Ikeda made it government policy to double Japan's real national income in ten years. As noted earlier, this goal (which implies a 7.2 per cent annual growth rate) was significantly surpassed, but the emphasis continued to be on production rather than consumer well-being. Some of the economic growth has benefitted consumers and Japan is the nearest equivalent in Asia to an affluent society [41, 53]; but this does not change the fact that government policy was not motivated by a concern about consumer welfare [19, 395]. One important bit of evidence is the fact that, notwithstanding its rapid economic growth, Japan's social spending (as measured by the ratio of social overhead capital stock to the gross national product) fell in real terms from 1.02 in fiscal 1955 to 0.80 in fiscal 1961. The ratio recovered slightly to 0.87 in fiscal 1965, but did not rise appreciably thereafter. As a result, social spending has lagged far behind major European countries [16, 51 and 142].

The Japanese have also lagged behind major European countries in critical areas of private consumption. Indeed, one of the most impressive facts about the Japanese consumer has been the high degree of stability in consumption and the extent to which it has been dominated by traditional patterns. In the 1960's, personal savings were at the exceedingly high level of about 20 per cent of disposable income (as compared with 7 per cent in the United States) [31, 236].⁴⁰ In addition, the Japanese consumer has subsidized investment by accepting severe ecological damage as a byproduct of unfettered growth.⁴¹ In recent years, however, national policy has changed markedly from its previous emphasis on industrial growth to a concern about national welfare [32 (September 1972), 26]. This shift is a response to a profound change in the public's attitude to growth — the Japanese are "no longer satisfied by

⁴⁰ For a discussion of the causes of the high savings ratio, see [43, 57-70].

⁴¹ The Japanese voter-consumer's propensity to "feed the hand that bites him" has been attributed to "the influence of lavish campaign funds, and the wild-eyed irresponsibility and violence of the Japanese Left alternative..." [13, 511].

reports of increased gross national product. They are demanding increased wages and improved living standards as well. Industrial pollution isn't tolerated to the degree it once was. And the public no longer accepts a chronic shortage of housing, sewers and paved roads" [36, 1]. To this extent, the public support for rapid economic growth has begun to be eroded.

Role of large business firms. Autonomous investment based on imported technology has been the prime mover of economic growth in postwar Japan. During the 1950's and 1960's, fixed capital formation averaged more than 30 per cent of GNP (as compared with 17 per cent in the United States) [31, 235]. This massive level of investment activity was partly a response to the opportunity for large profits and partly a response to nonmonetary inducements to invest.

A number of circumstances (in addition to the very powerful support provided by the government and consumers) combined to make investment profitable during those two decades. First, the large technology gap which separated Japan from the highly industrialized countries at the end of the second world war provided an opportunity for comparatively low risk investment based on importing world technology [31, 225]. Second, there was an elastic labor supply; and although productivity of labor increased sharply with the introduction of western technology, wages lagged behind the increase in productivity. Third, Japanese big business was able to exploit the underdeveloped part of the dual economy,⁴² while at the same time incorporating the small firms into the modern production process by using them as subcontractors. Fourth, the Japanese proved to be very good at "improvement engineering" (an activity of "carefully taking apart and putting together a little better") which made it possible for them to squeeze more output out of scarce capital [31, 226-7].

The investment behavior of the large business firms was also

⁴² The large firms "tend to exploit their small subsidiary firms, which in turn can survive only by exploiting their nonunion workers to the utmost" [46, 96]. Surprisingly, this exploitation coexists with a "live and let live" paternalistic attitude towards small firms by the large firms [25, 19]. The dual economy has been intensely discussed in Japan for many years, and the "problem of mitigating its undesirable effects, if not its dissolution, has been prominent on the agenda of the postwar Japan's democratization" [46, 96]. The government's efforts in this direction have not been notably successful, and one reason may be that the two sectors of the dual economy are economically complementary.

made in response to powerful nonmonetary reinforcers. This has often been mentioned in the literature. The *Oriental Economist*, for example, has stated that United States business firms place primary emphasis on increasing their profit ratios but that Japanese corporations tend to emphasize expansion of market share [32 (June 1972), 53-4]. Bieda holds an identical view: "The large firms and the keiretsu members do not try to maximize profits but fight to increase their share of the market" [11, 186]. Nakane ascribes this emphasis on market shares rather than profit to an "ever present consciousness of ranking" and he claims that "this social impetus is even more keenly felt and appreciated than the desire to show better profits... In this sense, Japanese values are oriented rather to sociological than economic goals" [30, 92]. In a similar view, Guillain said: "In Japan a firm will often manufacture some not particularly profitable line if that will improve the standing of the group the firm belongs to or even quite simply if it is for the good of the country as a whole. In comparison with the Western executive, the Japanese seems remarkably unaffected and unworried by the distribution of the firm's profits" [18, 71].

The view that the investments of the combines are motivated by group rivalry and prestige rather than anticipated returns — in many cases, there would be no conflict between these objectives — is the basis of the investment theory known as "one settism" [19, 286]. Under one settism, each group strives to have a full set of the same kinds of firms that exist in competing groups and to produce as many different products as possible. One settism thus reproduces in the industrial world a structural pattern which exists among individuals in a family group, viz., large business firms ("parent companies") attaching to themselves a number of affiliated companies ("child companies"). The result is considerable cohesion within the group but hostile or competitive relations towards other groups [30, 93 and 102].⁴³ Under one settism, a movement into a particular new field by any one group becomes a signal for the other groups to do the same. According to Miyazaki, one settism is the key to understanding the pace of postwar investment [19, 269].⁴⁴

⁴³ For a further discussion of Japanese groups (in Nakane's sense) see [44, 28-35].

⁴⁴ HADLEY agrees that large business firms might make a marginal commitment of investment funds on the basis of prestige but she doubts that they would do so with the

Unanswered questions. The analysis of this section has emphasized two major determinants of the impressive rates of economic growth in Japan during the 1950's and 1960's. First, contrary to a widespread theoretical expectation, the huge financial-industrial combines which dominate Japan's economy were key agents of economic growth, not economic stagnation. Moreover, part of their success was due to their large size (which made scale economies possible) and group structure (which assured the affiliates of preferential access to credit from the group bank during a period of chronic credit stringency). Second, in launching the wave of investment which was the prime mover of postwar economic growth, the combines were responding to a set of exceptionally favorable reinforcers, both monetary (in terms of profit-making opportunities) and nonmonetary (related to one settism and the national goal of economic growth).

On the basis of the Japanese experience during those two decades, all we can say for certain is that the two major determinants mentioned above coexisted. The historical record *per se* cannot answer the extremely important question of what would have happened to economic growth in the absence of either determinant. Specifically, given the exceptionally favorable growth circumstances in Japan during those two decades, would the economy have experienced equally rapid economic growth if the combines had not existed? In addition to the more obvious reasons why this question cannot be answered conclusively, some of the (perhaps most important) ingredients of growth are not quantifiable. One of these favorable factors (not mentioned above) was the dissolution of the prewar zaibatsu organization which liberated enormous creative energies in other parts of the population. As Hewins has noted, "A meritocracy, which would have been largely absorbed by the zaibatsu before the war, or stultified, was given a chance in 1945 and was enabled to come to the fore *faute de mieux*. Hence a lot of new blood and the majority of the great new industrialists... who have

bulk of their new funds. Instead she explains the one settism pattern of investment in terms of the problems associated with late entry [19, 287]. It is also true that the "one set of industries" principle is a means to achieve horizontal integration without running afoul of the holding company law or the laws which preclude banks from inducing and financing horizontal integration leading to monopoly [11, 216].

performed the Japanese postwar 'economic miracle' " [22, 157].⁴⁵ Significantly some of the major new Japanese firms in this period (e.g., Sony and Honda) were developed outside of the zaibatsu empires.

A second unanswered question is whether the combines would have been key agents of economic change in the absence of the special circumstances which favored economic growth during those two decades. Although it is not possible to replay history, the future may provide a clue on this second question, because many of the special factors that stimulated the unusually high level of investment during the 1950's and 1960's have begun to fade. Specifically, many of the special factors which made investment unusually profitable are now passing from the scene — viz., closing of the technological gap, reduced elasticity of labor supply, more labor-management conflict, and more attention to ecological damage resulting from investment [31, 237-50].⁴⁶ Some of the nonmonetary inducements to investment have also begun to decline in importance due to a basic shift in national goals. This in turn has undermined the identity of purpose which had been shared by government and big business and which had helped to propel the Japanese economy to striking records of economic growth in the two decades. Instead of the former almost exclusive emphasis on economic growth, the government is now disposed to be more responsive to the growing demands for "welfare". Moreover, while the former consensus on goals has begun to falter, a new consensus has not emerged. As one Japanese banker put it, "For the first time in memory, there is not only a lack of consensus among businessmen and government officials about where the economy is going but also a lack of agreement about where it ought to be going" [36, 1]. Under the new circumstances, it remains to be seen whether the financial-industrial

⁴⁵ Soichiro Honda, one of the "miracle men", has stated that "We've done well out of losing the war. We'd never have had the freedom we have now; I'd never have been allowed to get where I have got. With everything flattened, we could start from scratch, plan from the word go and think big" [22, 280]. Sohei Nakayama, another "miracle man", stated that "When the zaibatsu were broken down, old loyalties went with them. Individual ability was released, which helped the rapid growth of the economy..." [22, 391].

⁴⁶ Ohkawa and Rosovsky have predicted that future levels of growth in Japan will be below the levels of the 1950's and 1960's.

combines will continue to be leaders of economic change or whether they will behave in the manner suggested by economic theory under conditions of heavy economic and industrial concentration.⁴⁷

VI. Concluding Observations

Bank holding companies in the United States are permitted to engage in congeneric activities but not in conglomerate activities because of concern about the possibility of adverse economic (and political) consequences. During the 1950's and 1960's, the Japanese economy, which is dominated by conglomerate groups of banks and business firms, achieved unprecedented growth records; and this performance has raised serious questions about the validity of the American restrictions on bank holding company activities. This paper has reviewed the Japanese experience during those two decades in light of some important American concerns about conglomerates of major business firms which have a major bank at their center.

Contrary to a popular impression in the United States, the postwar bank-business groups in Japan have not been based on the prewar zaibatsu model. The prewar zaibatsu were tightly-knit, monolithic conglomerates with concentrated financial and industrial resources; the postwar successor groups are much looser organizations based on mutual convenience and advantage. Notwithstanding their loose organization, the postwar groups support their common interest by preferential (but not exclusive) buying, selling, financing, and personnel exchanges among the member firms. These preferential dealings, especially between the banks and affiliated business firms in each group, have given a powerful push (reinforced by government policy) to general economic concentration and to banking concentration. The inclusion of an important bank in each conglomerate group has also intensified (again with government help) industrial concentration (including the polarization of the dual economy) and monopoly power — due to the impact on the concentration of banking resources and on the discriminatory allocation of those resources in favor of large firms,

⁴⁷ It is interesting to note in this connection that two leading scholars on Japanese economic growth believe that the recent wave of mergers and consolidations "may also once again bring about prewar-style rigidities, together with all the adverse features that this term implies" [31, 239].

first to their own affiliates and then to other large firms. In short, even though they are loose rather than monolithic organizations, the combination of banks and business firms in the same conglomerates has intensified overall economic concentration, banking concentration, industrial concentration and monopoly power, credit discrimination (with its associated denial to outsiders of an opportunity to enter a field or to grow and prosper in it), and a malallocation of resources. To this extent, the Japanese experience with conglomerates that combine banking and other business firms has confirmed the validity of the concerns in the United States about conglomerate bank holding companies.

This paper has emphasized that the impressive Japanese growth record achieved under the leadership of the bank-business groups during those two decades cannot answer the concern in the United States about the possibility of economic stagnation in an economy dominated by a few conglomerate groups each with an important bank at its center. As we have seen, the performance of the postwar groups was enormously aided by the government and consumers. In addition, the reinforcers of investment activity — both of a monetary nature (i.e., profit-making opportunities) and of a non-monetary nature (i.e., associated with one settism and the dedication to the national goal of economic growth) — were unusually strong during those two decades. A critical question in evaluating bank holding company conglomerates is whether the conglomerate groups would have been agents of economic growth in the absence of such exceptional reinforcers. This important question cannot be answered by the growth record of Japan during the 1950's and 1960's; but the decade of the 1970's may provide a clue, because the special set of circumstances which encouraged investment and economic growth during the preceding two decades have begun to weaken.

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