

Lecture: Contemporary Economic History of Japan

No. 8

1-6 Financial Crisis

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6 Financial Crisis

6-1 Economic Policy without Point in Dispute

- Politically, outstanding issues were settled . . . The popular election was conducted, and the Maintenance of the Public Order Act was strengthened.
- Financially, years of financial expansions accumulated indebtedness, which set the tone for an inevitable financial adjustment.
 - Politically and economically, there was scarce point of policy controversy.
- For an opposition party to take office, points of dispute need to be created for attacking the government, whereby the party drags the ruling party to the election and reverses the standing.
 - Political system turned to attaching too much importance on confrontational phases.

Range between Staged Confrontation and Selected Policy

- Such a political technique, on the other hand, has another aspect to constrain actual policymaking with electoral pledges overly emphasizing differences between antagonistic parties.
- Policies feasible in reality couldn't help being similar whichever party came to power, Seiyu or Kensei.
- Consequently, as if to fill discrepancy in election manifesto, various forms of investigation committees and deliberation councils were formulated, where important policies of every kind was deliberated/studied, and their conclusions were approved as a buildup of "wisdom of public and private sectors." While a validity of policies was secured in this manner, the parliament became a place to choreograph confrontations. The legislature, which raised common people's hopes for participation in politics by the realized popular election, came to be an entity laden with such risks.

Synopsis of major
investigation committees
and deliberation councils

Apr. 1924	Imperial economic council
Jun. 1927	Administrative institution council
Ju.	Population-food problem committee
Jul.	Resources council
Sep. 1928	Economic council
May 1929	Legislation council
May	Rice committee
Jul.	Social policy council
Jul.	Tariff council
Jul.	International balance of payments council
Jan. 1930	Council on the House of Representatives election reform
Jan.	Temporary industrial council
Jun. 1931	Temporary administrative and financial council

6-2 Kataoka's Slip of The Tongue

- “Financial adjustment” was one of the major policies contended by Kenseikai Cabinet.
- In the early 1927, the draft law concerning the re-settlement of the earthquake bills and the banking draft law were provided.
- ← Previously settled behind the curtain between Seiyuukai President Giichi Tanaka and Finance Minister Naoharu Kataoka
- Because this agendum in itself could hardly have been a point in dispute, because the abnormal tone of financial arena, expressed in the high-interest rate causing a micro recession, particularly the repeated commotion/bankruptcy of medium and small banks, was a problem that must be resolved irrespective of party affiliation.

- For this reason, the draft laws concerning the re-settlement of the earthquake bills, submitted to the parliament in the end of January and referred to the committee, were deliberated relatively smoothly.
- But in the beginning of March, the formation of policy agreement between Kenseikai and Seiyu Honto broke out into the open, which drastically changed the attitude of Seiyukai that lambasted outright the administration.
- “Draft law on the earthquake bill re-settlement” was one of its focal points. The criticism took a form of questions trained on collusion between the political world and the business world, such as: whether the government was intended with taxpayers' money to give a relief to certain “political merchants” in danger of bankruptcy.

What Was Earthquake Bill ?

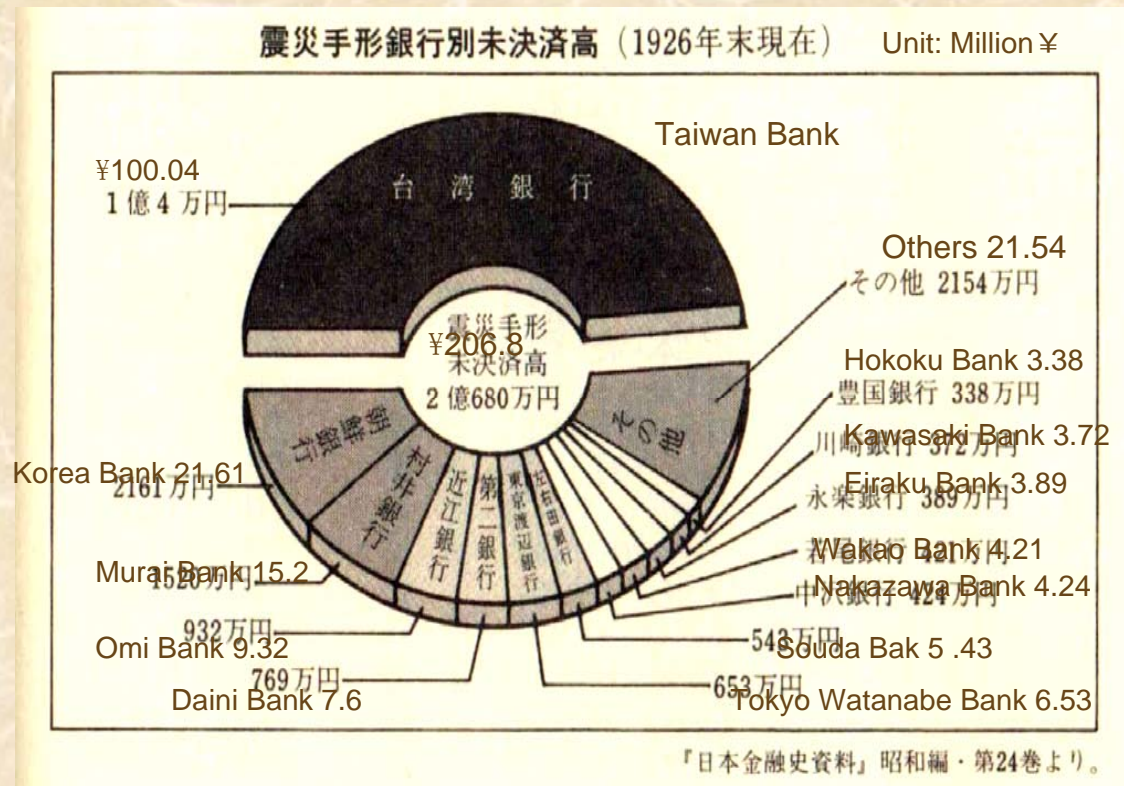
- Bill drawn by a person, who is the payer thereof, who owns sales office in the quake-stricken district, and the renewed one thereof
- Bill drawn by a bank on security of its deposit certificate or call certificate
- These bills were rediscounted by Bank of Japan (BOJ), whose loss incurred thereby was to be compensated up to 100 million yen by the government.

Closer Examination of Earthquake Bill

- Large obligators were a group of companies that had grown rapidly in the wartime such as Suzuki Shoten and Kuhara Shoji.
- Lenders were, except for Taiwan Bank and Korean Bank, second class urban banks.
- Disposition of troubled debt: More than half disposed by the 1926 end

Only Taiwan Bank at a stop = the bill affiliated to Suzuki Shoten

Earthquake Bill Amount Outstanding by Bank (As of 1926 end)



Source: *Data on Financial History of Japan, Showa Canto, Vol. 24*

- Extending a helping hand to corporations which become insolvent from Great Kanto Earthquake was not mistaken in itself. But there was a strong suspicion that rediscounting under such a pretext by BOJ in fact constituted a relief loan to a small number of specific companies.
- For the government to respond concretely to such problem in itself would have only broaden banking panic, which had to be avoided. But no response at all might enhance public anxiety. The government got trapped into the dilemma.

- Famous slip of the tongue of Finance Minister Kataoka flied out in such a surrounding.
- It was in the meeting of the Lower House Budget Committee on March 14. As the two draft laws concerning the re-settlement of the earthquake bills were passed in full assembly on March 4 and were referred to House of Lords, these drafts did not become something of issues in this committee. Bank relief policies of the government, together with the earthquake bill issue on the sidelines, were being interpellated in a rather general way.

Kataoka's counterreply to the interpellation:

- “It is proper for anyone of all people in the position of Finance Minister to make every effort for clearing and relieving in case a bankruptcy should induce in the financial community. But on that occasion unless an underwriting party should be found, no relief could be provided. In fact, around noon today, Watanabe Bank bankrupted at last, which I regret deeply. As to this case, there is a deposit of about 37 million yen, which I believe must be relieved. But giving a relief needs to be based on finding someone who would accept to shoulder whatever assets left after the clearance.”

- The reason why this was an improper speech was that he made mention of “Watanabe Bank bankrupted at last.”
- In reality, Tokyo Watanabe Bank in question completed financing and made settlement for the 14th. The background was that the information was transmitted mistakenly, and the change of situation did not come through promptly to the finance minister.
- Under any circumstance, it should be avoided for a person responsible for financial/monetary policies to risk danger of making relation to a management status of an individual bank and rousing credit impairment.

To make the matter worse, such an evaluation on the management situation was in the wrong, culminating in the gravest issue, and an inappropriate nature of the comment was also recognized in the finance ministry by the 14th evening. Upon discussion among concerned parties, the decision was made to suspend the operations of Tokyo Watanabe Bank and its collateral Akaji Savings Bank from the 15th in fear of “running on banks” if opened the following day.

Drowsy Withdrawal of Deposit

- Watanabe Bank on shutdown → Depositors' anxiety → Drowsy run
Pullout of call money by large banks

The influence gradually penetrated into medium and small banks facing severer managerial problems than Watanabe Bank.

- Nakai Bank on shutdown on March 19
- On the 22nd, three banks suspended operations: Souda, The 84th, and Nakazawa.

These banks encountered the withdrawals amounting to about a third of their deposits in three months starting the end of 1926.

This was **the first wave of the Financial Depression.**

- However, a series of unrest among medium and small banks calmed down once because the law drafts concerning the earthquake bill were adopted/established in House of Lords on 23rd.
- Fund position of bankrupted banks was relatively bad.
- But, not only that, there was a structural problem that the overloan by banks up to medium scale heightened an uneasiness about banking system.

6-3 Taiwan Bank and Suzuki Shoten

- On March 23, BOJ sent a telegram to London and New York, saying, “ a credit impairment has been swept off completely” . . . Settled for the time being.
- With the confrontation between the ruling and opposition parties getting more serious, movements to point fingers about credit impairment and aim at the downfall of the Cabinet exerted a serious influence thereafter.
- At those times, Taiwan Bank made a decision to discontinue new loans (“breakup”) to Suzuki Shoten.

Suzuki Shoten relied solely on Taiwan Bank for money and credit, whereas other influential Zaibatsu managed their own banks, absorbed deposit and refinanced.

Suzuki Shoten's Abbreviated Chronological Table

Approx. 1877	Iwajiro Suzuki opens Suzuki Shoten (sugar trade)
1886	Naokichi Kaneko joins the firm
1894	Iwajiro dies, and widowed Yone leaves the management to two general managers, Fujimatsu Yanagida and Naokichi Kaneko
1900	Obtains distributorship of camphor in Taiwan
1902	Reorganizes to Suzuki Shoten Partnership Corporation (capitalized at 500,000 yen)
1903	Establishes Osato Sugar House (sold out to Dai-Nippon Sugar Production in 1909), and subsequently grows into a big konzern by establishing various affiliated companies and spinning off the trading sector into a general trade company,
1920	Suzuki Shoten Partnership Corp. increases capital (50 million yen)
1923	Establishes Suzuki Shoten Co., Ltd. by separating the trading sector (capitalized at 80 million yen, of which paid-in capital at 50 million yen), and changes Suzuki Shoten's name to Suzuki Partnership Corp. (capitalized at 50 million yen)
1927	Suzuki Shoten and Suzuki Partnership Corp. go insolvent

(Source) Haruhito Takeda, *Imperialism and Democracy*, p.274

Business Enterprises Affiliated with Suzuki Shoten

Direct Affiliates			Affiliated Companies		
Company	Date Established	Paid-in Capital (10,000 Yen)	Company	Date Established	Paid-in Capital (10,000 Yen)
Tenma Textile	1887.3	524	The 65th Bank	1878.11	625
Nippon Flour Mills	1896.9	1,230	Nihon Cement	1888. 3	500
Kobe Steel	1905.9	2,000	Tokyo Wool	1906.11	1,600
Nihon Commerce	1909.2	500	Toa Cigarettes	1906.11	580
Roka Warehouse	1917.6	500	Toyo Sugar Manufacture	1907. 2	2,203
Teikoku Artificial Silk	1918.2	875	Teikoku Beer	1912. 5	550
Teikoku Coal	1919.5	1,000	Korean Railway	1916. 4	1,765
Godo Fat Glycerin	1921.4	500	Nihon Camphor	1918. 2	675
Claude Nitrogen Industry	1922.4	1,000	Shinetsu Electricity	1919. 5	3,200
Honen Cooking Oil Manufacture	1922.4	1,000	Kokusai Steamboat	1919. 7	7,715
25 Others		2,670	Dai-Nippon Celluloid	1919. 9	1,000
			Asahi Petroleum	1921. 2	930
			18 Others		2,524
(Total of 35 Entities)		11,799	(Total of 30 Entities)		23,867
Grand Total of 65 Entities: 35,666 *Entities of paid-in capital of 5 million yen and more					
<p>Synopsis of Suzuki Shoten Affiliated Major Companies, drawn from Yoshio Ando, ed., <i>Directory of Modern Economic History of Japan</i></p>					

- Taiwan Bank's loan to Suzuki Shoten, about 60 million yen in 1918-19, snowballed to 280 million in December 1926, further to 350 million right before the financial crisis, which catered for 80 percent of Suzuki's total debt loan.
- The way Suzuki borrowed money was to sell "the single name bill" through bill brokers, and any shortage in settlement fund incurred thereafter was accommodated by Taiwan Bank. But the reckless management by Suzuki in this method created a sense of vigilance, and rollover and relief funds converged on Taiwan.

- By the spring of 1927, the relationship between these two proceeded to the extent to be called “unsavory ties”. The bank, in order to keep previous claimable assets intact, could not steadfastly turn down small amount of additional loans and slithered down beyond its depth.

Taiwan Bank's Decision at March-end

- The decision by Taiwan Bank at the end of March was made without a prior consultation with Finance Minister Kataoka or Bank of Japan.
- For Taiwan Bank, a sense of vigilance on lenders' part became stronger in the call money market that put the bank in a tougher position to manage cash flow. An additional prospect was, "If Suzuki's loans borrowed from banks other than Taiwan should face swift recoups, and Suzuki should proceed as per the conventional principle, naturally Taiwan would have no choice but to assume the payment."
- While it was unthinkable that Taiwan Bank would have remained intact when Suzuki Shoten had fallen into bankruptcy, the bank concentrated its hopes on the finance minister's counterreply in the House of Lords deliberation regarding the earthquake-bill draft laws: "Even if Suzuki Shoten went bankrupt, there should be no influence on the presence of Taiwan Bank."

Repercussions of Taiwan Bank's Decision

- This decision of Taiwan Bank, the breakup with Suzuki Shoten, while successful as its own life-sustaining means, became the cause of the mess unparalleled in the history of the financial circles.
- As the news made the rounds on April 1 about the breakup of Taiwan Bank and Suzuki Shoten, the withdrawal of the call money to Taiwan Bank started concurrently,
- and on the 5th, Suzuki Shoten announced that it would voluntarily put an end to any new transactions.
- Accordingly, deposit withdrawals from banks considered to be deeply related to Suzuki Shoten expanded rapidly. On the 8th, The 65th Bank in Kobe faced the suspension of payment, and on the 13th Bank of Japan turned down additional loan to Taiwan Bank.

Privy Council's Denial of Imperial Decree Draft

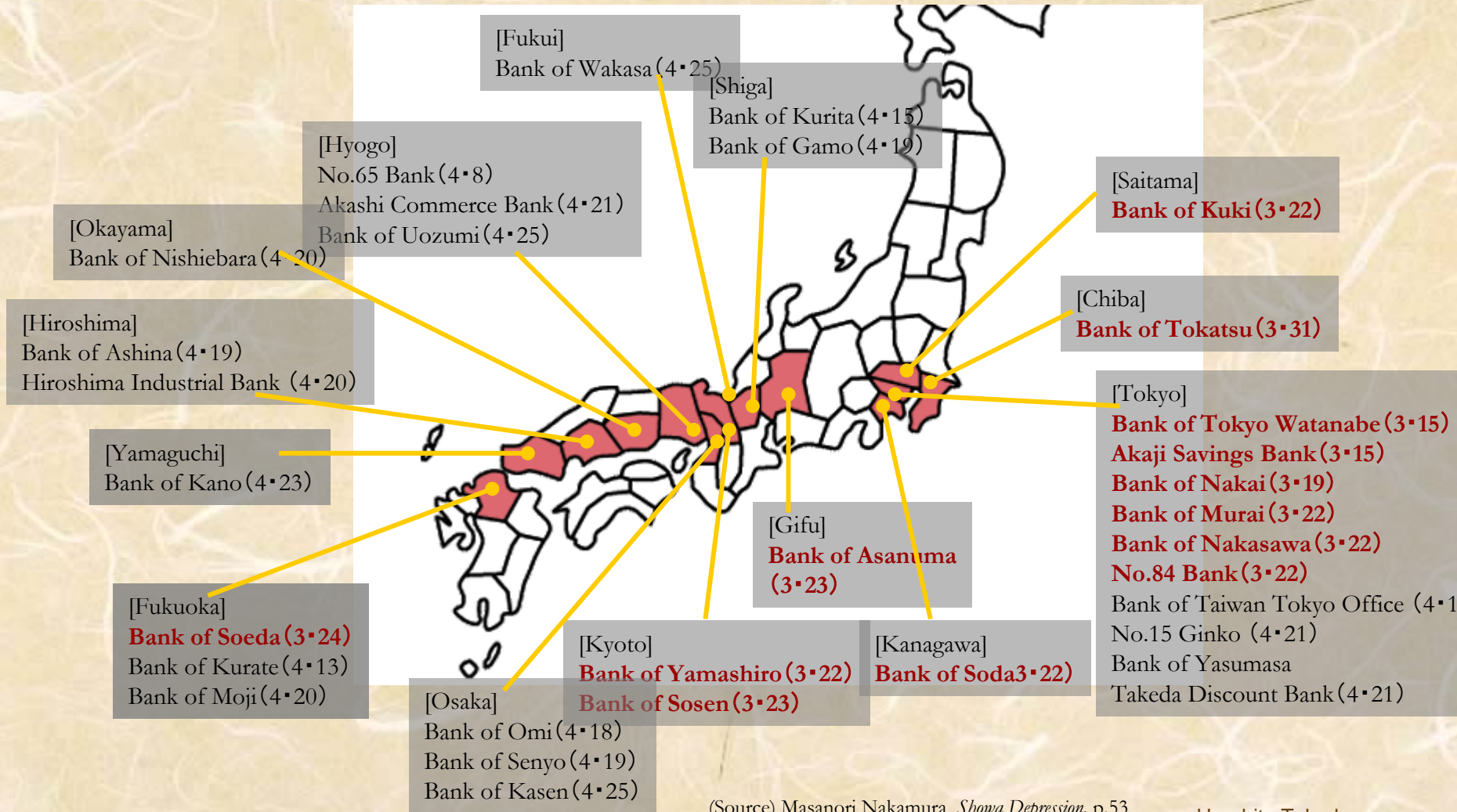
- In order to find a way out of the deadlock, the government elected a measure to issue an urgent Imperial ordinance approving a relief loan to Taiwan Bank up to 200 million yen.
- But the privy Council, led by Miyoji Ito, etc., turned down this Imperial Decree.
- This denial was contrary to the expectations of the government and Bank of Japan.

Because of this, Bank of Japan stood off a subsequent dialogue with top managements of the finance ministry/commercial banks, and rejected a loan of 28 million yen, money urgently required.

→Escalated to the nationwide financial crisis.

Financial Crisis and Shut-Down/Collapsed Banks

Names of banks shut-down/collapsed: **Bold face** to show ones incurred in March and fine writing in April, both in 1927. Dates incurred are indicated in parenthesis.



(Source) Masanori Nakamura, *Shōwa Depression*, p.53

Haruhito Takeda

- Wakatsuki Cabinet resigned en masse, and the cabinet of Giichi Tanaka was established on the 20th.
- On the 18th Taiwan Bank announced the suspension of operation, and so did Ohmi Bank.
- On the 21st The 15th Bank suspended its operation.

The shut down of this bank, founded by powerful peers and known as the safe of Imperial Household Ministry, engendered the financial ailing of the business group, including Kawasaki Shipbuilding, led by Kojiro Matsukata.
- Influential banks suspended their operations one after the other, and crushing withdrawals raided them including ones not yet come down to the closedown status, which had Bank of Japan lent out funds daily in order to comply deposit withdrawals. BOJ's lending, at 120-odd million yen at the beginning of April, grew twice as much exceeding 240 million. The safe of BOJ becoming empty, old banknotes destined to be thrown into fire were wheeled out. Even those ran short, and "blank-back" banknotes of 200 yen and 50 yen with prints on only one side, had to be prepared.

6-5 Moratorium

- Starting on the 20th when the new cabinet of Giichi Tanaka was formed, an emergency countermeasure was prepared under the leadership of Finance Minister Korekiyo Takahashi.
- The essential features were to execute moratorium (payment deferral order) throughout the country by the emergency Imperial ordinance, and, for the preparation of its issuance, and to suspend operations of all banks simultaneously across the nation for two days of the 22nd and 23rd.
- Facing with things getting worse, Privy Council simply gave the go-ahead for issuing the emergency Imperial ordinance.
- With the execution of the moratorium, the financial crisis which caused the nationwide run on banks calmed down, and depositors in a state of panic gradually recovered their tranquility.
- During this time, private banks forced into the suspension of operations, starting with Tokyo Watanabe Bank on March 15, ran up to 29 by the end of April, most of whose deposits were kept in a frozen state until the 1927 end. Furthermore, of the deposits in the banks shut down, i.e. bankrupted, a significant portion of money was never paid back to depositors the whole way.

- Ratio of deposit paid back in shutdown banks

- Souda Bank 50.5 %
- Nakai Bank 62.2
- Murai Bank 58.5
- Nakazawa 55.0
- 84th Bank 56.0
- Ohmi Bank 66.9

(Source) Takahashi, Kamekichi, *History of Changes in Financial Circles in Taisho and Showa Times*, Vol. 2, p.666

6-6 Influence of Financial Crisis

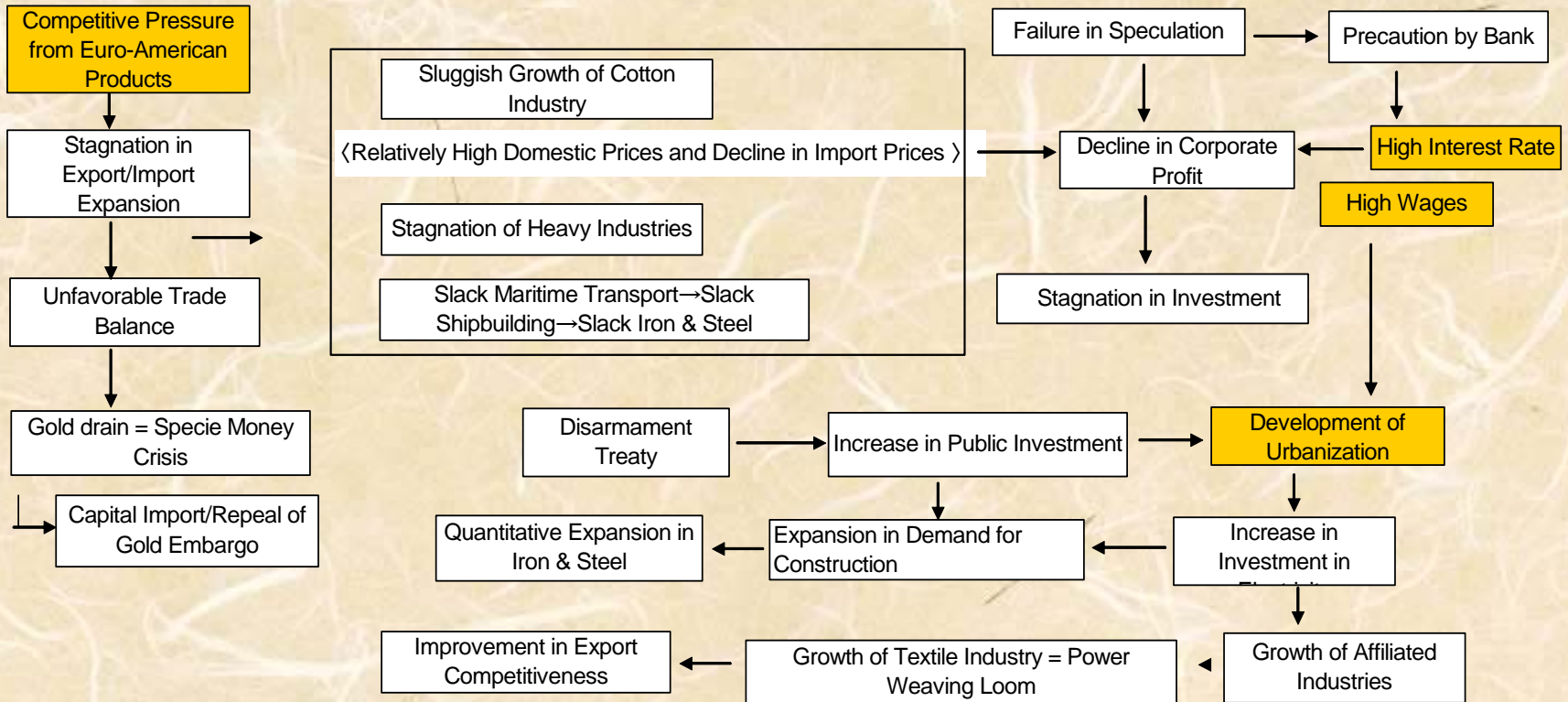
- Deposits shifted from bank deposits to postal savings, or from medium and small banks to large ones affiliated to Zaibatsu, boosting concentration to big banks.
- Many of medium and small banks either discontinued or consolidated business, and commercial banks totaled up to 1420 at the end of 1926 showed a drastic decline to 881 at the same timing in '28, and further to 782 at the closing of '30.
- Such developments in consolidation came about under the influence of the instituted Banking Act which was proposed at the same time with the earthquake-bill draft law. From then on, alongside the pretext for protecting depositors, the government further strengthened a financial structure with its great regulatory/supervisory authority.

Ruins of Second-rate Zaibatsu

- With the financial depression, Suzuki Shoten got into the complete liquidation. 65 companies, Suzuki's directly-affiliated concerns of which total paid-in capital amounting to 360 million yen, started on their individual courses toward business reconstructions including Kobe Steel, Nippon Flour Mills, and Nihon Commerce.
- Kawasaki-affiliated businesses involved in the bankruptcy of The 15th Bank also needed reconstruction measures. While they didn't go down to the point of bankruptcy, institutional banks of second-class Zaibatsu, such as Fujita Bank (Fujita Group) and Furukawa Bank (Furukawa Partnership Corp.), were badly hurt by withdrawals, hence heading off to the liquidation of businesses.
- The financial depression exposed managerial problems held by second- and third-rate Zaibatsu groups and entrepreneurs that started late and grew rapidly during WWI, brought about a significant progress in the arrangement of financial circles, and dissolved a high interest rate which constituted a part of contributing factors of a "micro depression".

- Sudden changes of tone were not limited to Zaibatsu. As second-rate Zaibatsu corporations were brought to ruin, the position of the three powerful major financial cliques, Mitsui, Mitsubishi and Sumitomo, became firmly established. The term “Zaibatsu” originally meant just a “person of great wealth”, but powerful entrepreneurs who dominated over the Japanese economy were generically purported as Zaibatsu. Possessing equity shares of large corporations in a sealing-off manner by hands of families/kin, they had control over pyramidal multilateral businesses in which subsidiary and sub-subsidiary companies were ranged. Mitsui Partnership Corp., Mitsubishi Limited Partnership, and Sumitomo Limited Partnership were the holding companies at the peaks of these organizations of the powerful Zaibatsu. The typical shape of these cliques was completed in this time.

Chart 1-2 Economic Framework in The 1920s



(Source) Haruhito Takeda, *Business Cycle and Economic Policy*