

# Under-Liquidity and Monetary Policy in Japan\*

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## I

One of the peculiar features of the Japanese monetary system and monetary policy in recent years as compared with those of other advanced countries is the prevalence of direct control measures such as credit rationing at the discount window of the Bank of Japan, the fixing of almost all rates of interest by, or under the direction of, the monetary authorities, or the regulation of new issues of bonds virtually on a quota system. In Japan, because of the absence of an open market in such short-term securities as Treasury bills and acceptance, the Bank of Japan depends on the discounting of commercial bills and the making of loans as the principal means of extending central bank credit to the banking system. When the monetary supply needs to be tightened, the Bank of Japan announces that the Bank will enforce a stricter screening at the discount window and allot funds only to "really productive" purposes, without or before the change in its discount rate. Also, in such a case, the Bank officially requests that commercial banks be more "selective" when making loans to their customers and tighten "self-control" in cooperation with the Bank of Japan's policy. The Bank of Japan's reliance on direct controls and persuasion rather than on flexible changes in the rates of interest is reflected in the fact that in the last ten years the Bank's discount rate has been changed only very slightly and much less often than the central bank discount rates in Britain, the United States or West Germany.

Another distinctive feature of the Japanese money

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market is the dominance of commercial bank loans in industrial financing. Not only inventories and other working capital, but also a large part of new investment in plant and equipment is financed by loans made by commercial banks. In 1959, the composition of the total outside supply<sup>1)</sup> of funds to all industries for new investment in plant and equipment, which amounted to 1,305 billion yen, was as follows: loans made by commercial banks and long-term credit banks, 34.5 per cent; loans made by other private financial institutions, 29.6 per cent; and new issues of stocks and bonds, 11.4 and 3.9 per cent, respectively<sup>2)</sup>.

The dominance of bank loans in industrial finance is commonly referred to as *over-borrowing*, and is paralleled by what is called *over-loan*. While *over-borrowing* means "too much" dependence by firms on commercial banks, by *over-loan* is meant "too much" dependence by commercial banks on the central bank credit as a source of funds. At the end of 1959 when the banknotes issue totaled 1,029 billion yen, the Bank of Japan's discounts and loans were 63 and 275 billion yen, respectively. The supply of money in the form of *over-loans* is regarded as undesirable by a majority of Japanese economists and particularly by the monetary authorities.

In an earlier paper, we discussed some of these peculiarities of the Japanese monetary system and argued from the viewpoint of welfare economics that

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1) Excluding investment from retained profits and depreciation reserves.

2) Based on *Economic Statistics of Japan* for 1959, Bank of Japan, pp. 29—32. The remainder is supplied by the government through its Special Accounts and various governmental financial institutions.

in order to allocate funds optimally to various borrowers in the economy the functioning of competitive price mechanisms in the monetary market should be utilized to a greater extent than hitherto, and that most of the direct control measures currently undertaken should be gradually replaced by flexible interest rates.<sup>3)</sup> In this paper, our attention is focussed on the fact that the Japanese monetary market is short of liquid assets other than money. It seems to us that this fact, which we shall call *under-liquidity*, is responsible to a great extent for some of the peculiarities of the Japanese monetary market. The Japanese situation is in sharp contrast with the hypothetical situation in which an excessive amount of liquid assets is supplied to the monetary system. We believe that the American, and particularly the British, postwar situation is not far from our hypothetical one.

## II

Let us suppose that consumers and firms decide to hold various types of assets and liabilities in amounts such that their individual utility or profits are maximized over the long run. In making the decision, they take into account the current as well as future rates of interest of (or in case of a durable good, services rendered by) each type of asset, possible changes in the price level, the risks involved, the prospective difficulty or ease of liquidation, the durability of the asset if it is a durable good, and so on.<sup>4)</sup>

In the following, financial assets are classified into four broad categories; (1) "money", (2) highly liquid short-term financial assets which may be called "bills" for convenience, (3) less liquid financial assets, and (4) "equities" in which we include all kinds of durable goods and the claims to them. In the Japanese financial system, "money" includes currency and current deposits (checking accounts); "bills" include commercial bills, short-term government

bills, call loans, and ordinary deposits,<sup>5)</sup> and possibly also time deposits and various savings accounts; less liquid financial assets include loans made by financial institutions to their customers. Bonds issued by the government, public and private corporations and long-term credit banks are intermediate in character, depending upon their liquidity. Government bonds may be almost as liquid as other highly liquid assets, particularly when their prices are more or less stable. On the other hand, under the present market conditions, the degree of liquidity of corporate bonds seems closer to that of commercial bank loans than to the highly liquid assets listed above.<sup>6)</sup>

Now we shall define the conditions of over- and under-liquidity of the financial market. *Over-liquidity* or *under-liquidity* is a situation in which more than, or less than, an "optimal" amount both of money and bills, or of bills alone,<sup>7)</sup> is supplied to the market. The "optimal" amount of money and/or bills to be supplied is not easy to define. In the first place, when a market equilibrium<sup>8)</sup> is reached in the

5) Ordinary deposits in Japan can be drawn on demand, but no checking privilege is given to the customer. The checking account is rarely used among private individuals in Japan.

6) There is no open market in Japan in which corporate bonds are traded, and a large part of the bonds are purchased by commercial banks (including long-term credit banks), mostly until maturity. 78.4 and 66.5 per cent of the bonds newly issued during 1959 by public corporations and private industrial corporations, respectively, were purchased by commercial banks, while private individuals' purchases of these bonds were very small (see *Economic Statistics of Japan, 1959, op. cit.*, p. 175). On the other hand, as noted earlier, banks advance loans for new investment in plant and equipment, making commitments for a periods of considerable length. For these reasons liquidity of bonds and bank loans differ less in Japan than in most of other advanced countries.

7) The definitions of over- and under-liquidity here are, therefore, different from those of Triffin, who is primarily concerned with the relationship between money (and short-term government bills) and GNP. See Robert Triffin, *Europe and the Money Muddle*, New Haven, Yale University Press, 1957, especially pp. 58—70.

3) Ryuichiro Tachi, and Ryutaro Komiya, "Monetary Policy in Japan: Analysis and Proposals" (in Japanese), *Keizai Hyoron* (Economic Review), April 1960, pp. 177—228 (reprinted as No. 3 of Tokyo Center for Economic Research Reprint Series).

4) The last two characteristics are usually referred to as the liquidity of the asset.

financial market, consumers, firms and financial institutions are optimizing their holdings of the above four types of assets (and liabilities) at the going interest rates. This Pareto optimality is undoubtedly a necessary condition of optimal liquidity. If, by law or by administrative decisions, a certain type of financial transaction is directly controlled, or if the rate of interest on a certain type of financial asset is fixed arbitrarily, some individuals or firms will be prevented from making their optimal choice of assets at the prevailing interest rates, and hence there will result a misallocation of financial resources. In the second place, however, the government supply of liquid assets such as short-term government bills and long term national bonds cannot be considered as endogenously determined within our monetary equilibrium system, since the government has no clear-cut optimizing criterion such as the consumer's utility index or entrepreneurial profits. Clearly, the optimal amounts of government-supplied bills and bonds cannot be defined without stipulating some social welfare function with which we will not be concerned here. Here we consider, rather loosely, the optimal amount of government-supplied liquidity as that amount which enables the monetary system to function efficiently in achieving such objectives of monetary policy as the stabilization of the domestic purchasing power of the currency and optimal allocation of financial resources.<sup>9)</sup> When the supply of bills including those supplied by the government exceeds, or is short of, this optimal amount, we say that we have a situation of over-liquidity or under-liquidity, even if the demand and supply of private individuals and firms are equal.<sup>10)</sup>

8) It is assumed for simplicity that the equilibrium is a competitive one: monopolistic elements, except possibly the behavior of the government in the financial market, are not so important as to invalidate our conclusions.

9) It is admitted that this is a vague and unsatisfactory definition. We hope to elaborate on this point in a later article.

10) It may be noted that the relation between the actual and optimal rates of interest is no measure of under- or over-liquidity. In an under-liquidity situation the rate of interest on bills may be higher or lower than the rate which would prevail

Thus we will not be concerned, in defining optimal liquidity, with the favorable or unfavorable, direct, "real" effects of a given supply of government bills and bonds, i. e., effects on income distribution, on incentives to work, save, or take risks, or on allocation of resources, which have recently been hotly debated between Meade and Hansen.<sup>11)</sup>

Over-, or under-liquidity is therefore related to the supply of money and bills. When money is over-supplied inflationary pressures, and when it is under-supplied deflationary tendencies, will result. However, since the problem of inflation or deflation, or the problem of supplying the optimum amount of money to the economy is very often discussed,<sup>12)</sup> we

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when a market equilibrium is established with the government supplying the optimal amount of government bills and bonds. If the monetary authorities arbitrarily fix too high a rate of interest on bills privately issued, new issues of bills will be unduly discouraged and there will be under-liquidity with a higher than optimal rate of interest and with an excess demand for bills. On the other hand, if the government does not supply sufficient amount of government bills and bonds in face of an increasing demand from the growing economy, the demand and supply by private financial institutions and the public will determine a lower market rate of interest than the optimal rate. Such government interventions as the rationing of new issues of liquid assets under a pegged rate of interest by financial and other corporations will have a similar effect.

Under conditions of over-liquidity too, the rate of interest on bills may be higher or lower than the optimal rate. An attempt to sell an excessively large amount of government bills and bonds in the open market raises the rate of interest above, while compulsory sales of a large amount of national bonds to the public, which were enforced during the war in some countries, keep the rate of interest below the optimal rate.

11) See the interesting discussions in J. E. Meade, "Is the National Debt a Burden?", *Oxford Economic Papers*, n. s. Vol. 10, No. 2 (June 1958), pp. 163—183, and Alvin H. Hansen, "The Public Debt Reconsidered: A Review Article", *Review of Economics and Statistics*, Vol. 41, No. 4 (November 1959), pp. 310—79.

12) Our own discussion of this problem is presented in "Monetary Policy in Japan; Analysis and Proposals", *op. cit.*, especially pp. 180—183, 190—191

will be somewhat more concerned with the optimal supply of bills than that of money in discussing over- or under-liquidity in the following.

### III

Before discussing the condition of under-liquidity, let us first consider that of over-liquidity. Over-liquidity arises, for example, when the government issues bills and bonds to consumers and financial institutions who are unwilling to keep such a large amount at the low rate of interest fixed by the government. If holders of government bills and bonds are allowed to adjust their asset holdings freely, there will naturally be a movement away from bills towards less liquid financial assets and equities (and durables), and the prices of these assets will tend to rise. This means a lower rate of interest on less liquid financial assets such as loans and a general price increase. Since there is an excess-supply of bills in the market, there will be a strong pressure to raise the interest rate on bills, which will be only partly alleviated by the movement described above.

The situation at the end of the war in almost all countries is a typical case of over-liquidity. During the war, a large stock of liquid assets, especially low yielding government bills and bonds and also bank deposits, was accumulated in the hands of consumers and financial institutions. On the other hand, producers' and consumers' durable (and nondurable) goods were in acute shortage, while a backlog of technological innovations was accumulated. The margin between the marginal efficiency of capital and the general level of interest rates was, therefore, much wider than under normal conditions. If direct controls of various forms enforced during the war were to have been abolished immediately after the war, consumers, firms and financial institutions would have quickly adjusted their asset holdings. This implies an immediate rise in the price of equities and hence increases in new investment in plant and equipment and purchases of consumers' durables, developing general inflationary pressures.

The general effect of over-liquidity is, therefore, not much different from that of an over-supply of

money, or an inflation. This is only natural since bills and money are mutually substitutable at least as a store of value. Holding of bills may involve capital losses if the rate of interest rises, but the losses will be very small if the period of maturity is short and the change in the rate of interest is limited. Thus an increase in the supply of bills will free for active uses that part of money which has hitherto been held as idle balances, and hence raise the velocity of circulation of a given total supply of money. The policy to counteract the adverse effects of over-liquidity is, then, very similar to general anti-inflationary measures. Immediately after the war, many countries adopted a variety of anti-inflationary measures to overcome inflationary tendencies of over-liquidity: (1) rationing of consumers' goods or new issues of stocks and bonds, to block the substitution from bills to other assets, (2) measures to achieve a high rate of capital accumulation and there by reducing the margin between the marginal efficiency of capital (the returns on equities) and the rate of interest, e. g, borrowing or receiving of grants from abroad or tax privileges for capital accumulation, (3) confiscation of liquid assets, by "currency reforms" or by capital levies, (4) a surplus budget to reduce the total stock of government-supplied bills outstanding, (5) a rise in the rate of interest on bills increasing the attractiveness of liquid assets relative to capital goods, and so on.

The last of these anti-inflationary measures, however, encounters a special difficulty when applied to over-liquid situations. While it is the least discriminatory of all and the most acceptable under the normal peace-time conditions, it implies a higher interest burden on those issuing the bills, which is usually the government. Unless matched by increased tax revenues, it adds to the inflationary pressures. Also in a country whose balance of payments is threatened from time to time, the increase in the interest payments on foreign short-term capital constitutes a difficulty. Therefore, under conditions of over-liquidity, the monetary authorities are confronted with the difficult, double task of suppressing the inflationary pressures of the excessively large amount of bills held by the public and keeping at

the same time the rate of interest on bills as low as possible.

#### IV

The situation of under-liquidity is brought about if government intervention keeps firms and financial institutions from issuing an optimal amount of liquid credit instruments which we have for convenience called bills, or if the government does not supply increasing amounts of money and government-supplied bills to the monetary system to meet the increasing need for liquidity in a growing economy. As pointed out by Gurley and Shaw, in the process of economic development, the growth rate of financial assets tends to exceed the growth rates of income and real wealth.<sup>13)</sup> In a growing economy, if new types of financial intermediaries are not permitted to develop freely, the efficiency of the financial system in diversifying risks and in mobilizing small individual savings is impaired and so is the efficiency of the economy. Also, if the amounts of money and bills issued by the government are not increased gradually, deflationary tendencies will develop sooner or later.

Let us consider a situation in which a sufficient amount of money and bills is supplied by the government to the monetary system, but this money-and-bills is composed primarily of money, only a very small amount of bills being supplied by the government. The question arises whether for efficient functioning the monetary system needs a certain amount of bills issued by the government in addition to those supplied privately, and whether it is necessary in this connection to distinguish between money and bills.

It is our view that the monetary system needs a certain amount of government-supplied bills for efficient functioning. It is important for efficient financial operation that a wide choice in credit instruments of different liquidity be available to the public and financial institutions. In the process of economic development various types of financial intermediaries evolve. This is similar to the diversifi-

13) See John G. Gurley and E. S. Shaw, "Financial Aspects of Economic Development", *American Economic Review*, Vol. 45, No. 4 (September 1955), pp. 515—538, especially 518—19.

cation of products in general and increases the flexibility and price-, or interest-, elasticities of the financial system.<sup>14)</sup> Among the various types of financial assets, the most liquid of all is the short-term government bill which is perhaps entirely free from the risk of default. Since no private institution can supply an asset with such a high degree of liquidity, the monetary system will be short of the most liquid means of short-term credit, unless the government supplies government bills and bonds just as it does money. Hansen seems to have this in mind when he says:

Modern nations have by now had long experience in developing far more efficient monetary systems than ever before, largely on the basis of national debt,.... There are good reasons for believing that a country like the United States with a GNP of 450 million could not function as effectively as it in fact now does without something like the high degree of liquidity<sup>15)</sup> which we now enjoy.<sup>16)</sup>

One of the most important advantages of having a large amount of government-issued liquid assets, particularly short-term government bills, in the monetary market is that it enables the central bank to rely on open market operations as its principal weapon of monetary policy. By extending and contracting its credit to the monetary system through open market selling and buying of government-issued liquid assets, the central bank can adjust the money supply from time to time more quickly and smoothly than through other instruments of monetary policy.

In this connection, there is an argument in Japan that if the amount of the government bills and bonds available in the market limits the extent of the Bank of Japan's market operations, the Bank may buy and sell gilt-edged securities such as bonds issued by first-class private corporations, public corpo-

14) The point is emphasized by Gurley and Shaw, in their paper, "Financial Aspects of Economic Development", *op. cit.*, p. 520.

15) Namely, a large amount of national debt outstanding.

16) Hansen, "The Public Debt Reconsidered," *op. cit.*, p. 375.

rations and long-term credit banks.<sup>17)</sup> However, even in the absence of default risks the prices of securities fluctuate much more widely than that of the short-term government bills when the rates of interest change, and the central bank will incur a substantial capital loss by engaging in market operations.<sup>18)</sup> This is a sort of unnecessary subsidy to the holders of these securities. Also, which securities to buy and which to sell present a problem quite alien to the central bank.<sup>19)</sup> The bank of Japan will enjoy an important advantage if it can buy and sell a sufficient amount of short-term government bills in the open market.

### V

In Japan, and in a number of other countries too, a large amount of liquid assets which were held by

17) See, for example, discussions by Toshihiko Yoshino in "A Symposium on How to Achieve a High Rate of Economic Growth", by eleven panel economists, *Economist* (Tokyo, in Japanese), May 17, 1960, p. 55.

18) If the central bank is to tighten the money supply in a boom and to ease it in a depression in order to stabilize business fluctuations, it must sell gilt-edged securities when the rate of interest is generally high, and hence when their prices are low, and buy when the prices are high.

19) As a measure to control directly the new issues of corporate bonds, the Bank of Japan had until recently a system of screening corporate bonds qualified as collaterals of central bank advances, before they were floated. Since, as mentioned earlier, in Japan a large part of corporate bonds are purchased by commercial banks which in turn use the bonds as basis for loans from the central bank, if the Bank of Japan declines the qualification as collaterals, no one buys the bonds. This means that no bonds can be issued unless qualified. Thus the Bank of Japan directly controlled the new issues of bonds. The system itself was abolished in 1955, but a committee organized by commercial banks and underwriters still regulates the bond flotation in the same spirit.

The system is an extremely discriminatory way of regulating flotations and impairs the working of the competitive market mechanism in the financial field. We have a basic objection to this kind of direct controls. Open market operations in privately issued securities may present a similarly awkward problem for the central bank.

individuals and financial institutions at the end of the war has been literally forfeited through the process of hyper-inflation.<sup>20)</sup> Also, the currency reform together with the capital levy contributed to the reduction of excessive liquidity.

Another factor responsible for the condition of under-liquidity which, we believe, is now prevailing in Japan is the unprecedentedly high rate of growth of the Japanese economy in recent years. Apart from the reconstruction period which immediately followed the war, real GNP increased at an average rate of 8.9 per cent from 1950 to 1955 and 6.3 per cent from 1955 to 1958. The Japanese economy seems to be in a sustained prosperity in the last few years, the growth rate even in 1958, a year which is considered as one of recession, being higher than 4 per cent. When the economy grows at this rapid rate, unless the government and monetary authorities are bold enough to supply the monetary system with adequate liquidity, it is almost inevitable that tendencies of under-liquidity develop.

It seems to us that the Japanese monetary system is not entirely free from deflationary tendencies arising from under-liquidity in the sense of an inadequate supply of money.

In the present institutional setting, the Bank of Japan supplies money in one of the following three ways; (1) by purchasing government bonds and bills either directly from the government or from the public; (2) by increasing gold and foreign exchange reserves; (3) by advancing loans and discounting commercial bills. It is, however, almost impossible and also undesirable to accumulate gold and foreign exchange reserves at a rate high enough to sustain the rapid growth of the Japanese economy, although in recent years increases in gold and foreign exchange reserves have played a major role in increasing the money supply. Therefore, if in the future the monetary authorities regard (as in the

20) The Bank of Japan wholesale price index with the prewar base (the average of 1934 through 1936) as 100 rose rapidly after the war: 350 in 1945, 20,876 in 1949, and 34,253 in 1951. Thereafter, the price level has been stabilized, although a slightly rising trend is observed in the retail price index.

past) the supplying of money through the Bank of Japan's loans and discounts as undesirable and to be gradually reduced, deflationary tendencies would develop sooner or later. The only way to avoid such deflationary tendencies seems to be to sell a sufficient amount of government bills and bonds to the public which can then be bought by the Bank of Japan through its open market operation.<sup>21)</sup>

Let us now turn to the supply of liquid assets other than money, which we called bills, in Japan. Table 1 summarizes the pattern of the increase in the supply of liquid assets in recent years held by the public and financial institutions. It is seen that in the process of inflations the amounts of liquid assets other than money were reduced greatly in real terms. In 1951, the year in which the long inflation was at last terminated, the supply of money was 231.5 times larger than in the prewar years, but all other types of liquid assets was less than one hundred times as large as in prewar years. Especially, the supply of government bonds and bills and corporate bonds was only 43.1 and 38.9 times as large as the prewar levels, respectively. By 1959, such extreme under-liquidity had been relieved considerably. Between 1951 and 1959, the supply of money has been

prewar years. Particularly the amount of government obligations was very small: in 1957 the ratio of government obligations to national income is 0.09 in Japan, 0.12 in West Germany, 0.74 in the United States and 1.55 in the United Kingdom.

It is not our contention that the amounts of various liquid assets should be increased at the same rate as the money supply. Nor is it our contention that the prewar composition of the total liquid assets represents some normal condition to be aimed at. The relative changes in indexes such as shown in Table 1 are no measure of under- or over-liquidity. It only gives some idea as to the tendency of under-liquidity or the shortages of liquid assets in the Japanese monetary system. It may well be argued that in examining the liquidity condition in the monetary system, it is important to see how various types of liquid assets function as credit instruments. We have an impression, in this context, that even in prewar years the Japanese monetary market might have been in a conditions of under-liquidity.

It may be noted that under current conditions government bills and bonds and corporate and bank bonds, of which the amounts are quite small as compared with that of money supply or deposits and

Table 1 The Increase in Liquid Assets in Japan: 1934-1959.<sup>a</sup>

	Average of 1934-36	1944	1951	1959 <sup>b</sup>
(1) Cash and Deposit Currency	1	8.6	231.5	476.9 (1,375)
(2) Deposits(excluding checking accounts)and Savings	1	6.4	89.2	554.8 (12,169)
(3) Government Bills and Bonds(except those held by the Bank of Japan)	1	12.0	43.1	53.1 <sup>c</sup> (223)
(4) Bonds Issued by Private and Public Corporations	1	3.8	38.9	298.5 (799)
(5) Bonds issued by Long-Term Credit Banks	1	5.9	57.7	428.3 (823)

Sources: All figures are based upon The Bank of Japan, *Economic Statistics of Japan*, 1951 and 1959, Tokyo.

Notes: a. The index of the amount of each type of liquid assets with 1934-36=1.

b. Figures in parentheses are the absolute amount of assets at the end of 1959 in billions of yens.

c. For 1958. The figure for 1959 is not yet available.

only doubled, while deposits (other than checking accounts) and savings have increased sixfold, corporate bonds more than sevenfold and long-term credit bank bonds about eightfold. Yet, except for deposits and savings which are liabilities from the point of view of financial institutions, no type of liquid assets has been increased as much as money since the

savings, are not functioning as smoothly as they should as credit instruments. The fact that the interest rate on short-term government bills is fixed at an arbitrarily low level prevents them from being purchased by commercial banks and other financial institutions.<sup>22)</sup> Also, discriminatory regulations on new issues of corporate bonds prevent some corpo-

21) For further discussion on this subject, see "Monetary Policy in Japan", *op. cit.*, pp. 211-214.

22) At present when short-term government bills are issued, usually all of them are bought and

rations from issuing the desired amounts, while the rigid fixing of the rate of interest on bonds often below the rate determined at a market equilibrium make them unattractive to the public and financial institutions. Partly because of these interventions there is no open market for bonds in Japan, and bonds are not as liquid in Japan as they are in other countries.<sup>23)</sup>

## VI

Some of the people advocating various measures to normalize the monetary system seem to neglect the under-liquidity condition underlying the present Japanese financial market.<sup>24)</sup> As our concluding remarks, we shall list some of these proposals and comment briefly on each of them.

(1) "Normalization of the so-called 'over-loan' condition i. e., too much dependence of commercial banks on the central bank loans as a source of funds." A reduction in the Bank of Japan's loans to commercial banks will give rise to deflationary tendencies, unless compensated by other means of increasing the monetary supply.

(2) "More reliance on the open market operation as a tool of monetary policy." As discussed earlier, a sufficiently large amount of liquid assets must be supplied to the market first, before the Bank of Japan can engage in open market operations as a principal tool of monetary policy. Furthermore, unless the amount of government bills issued is increased at a fast enough rate, all government bills will be

held until maturity by the Bank of Japan, since no one is willing to buy at such a low rate. Some people are proposing that the government bills held by the Bank be sold to commercial banks at a higher rate than the official fixed rate. However, to sell the government bills to private financial institutions at the market rate of interest from the beginning is clearly a more direct and satisfactory solution.

23) See footnotes 6 and 19 above.

24) A notable example of such proposals is *Proposals for Normalization of the Monetary Market* (in Japanese), Tokyo, June 1959, by a six prominent economists, H. Arisawa, Y. Wakimura, H. Inaba, J. Enjoji, K. Tsuchiya and T. Fukura.

bought by the Bank of Japan sooner or later. It should be noted that the total amount of all kinds of government bills and bonds held by the public at the end of 1958 was around 220 billion yen, an amount much smaller than the Bank of Japan loans which amounted to 330 billion.

(3) "Improvement in the liquidity position of the commercial banks." Japanese commercial banks are very often blamed for their illiquidity or 'over-loan'. But unless the supply of liquid assets is increased, clearly commercial bank cannot increase their holdings of liquid assets. Among the types of liquid assets listed in Table 1, deposits and savings are liabilities of financial institutions. If the supply of government bills and bonds is limited or the rates of interest on them are very low, and if the amount of corporate bond flotation is rigidly controlled, financial institutions cannot help but increase their holdings of less liquid assets, particularly loans, or must stop accepting deposits.

(4) "Encouragement of flotations of bonds." While we believe that the current direct controls on bond flotations are largely unnecessary, we do not think that financing through bonds should be particularly encouraged in preference to other forms of credit. For example, we object to the proposal for prohibiting time deposits with one year maturity<sup>25)</sup> in order to attract more funds to the bond market. The reason for our objection is that direct financing through bonds and indirect financing through bank loans should compete freely with each other and that the more diversified the types of financial assets, the more improved will be the efficiency of the financial system. Japanese individuals have long had a habit of depositing their annual or monthly savings in commercial banks, which invest these savings into the industry. To prohibit a certain type of financial transactions which has hitherto played an important role is undesirable, as it goes against the general trend of diversification of financial assets which we emphasized earlier.

25) See *Proposals for Normalization of the Monetary Market*, *op. cit.*, p. 8.