THE CREATION OF THE BANK OF JAPAN—ITS WESTERN ORIGIN AND ADAPTATION

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I

It is an undeniable fact that Japan's modernization process, which ensued from the Meiji Restoration, began with the adoption of many organizational structures from the advanced countries. Japan's political, economic, and military systems were especially influenced through this process. The introduction of the central bank system was not an exception. The analysis of the archives of those days, however, reveals that the Meiji government did not introduce these models from the advanced countries without specific goals in mind. The analysis indicates that the criteria used to select a system was that of administrative supremacy. Those models which best suited this goal were adopted, and then only when they were thought to be absolutely necessary. This point should not be overlooked. This short treatise will attempt to illustrate this assertion.

With the only exception of the defeat suffered in World War II, the Meiji Restoration brought about a great political reform in the history of modern Japan. It abolished the feudal system which had existed for approximately 260 years during the Tokugawa period and clearly marked the beginning of the modernization of Japan's economy toward capitalism. The Meiji government abolished the old administrative districts and divided the entire country into newly organized prefectures (*haihan chiken*) in order to eliminate the feudalistic *han* ("fief") system. The government also abolished the feudal stipends (*chitsuroku shobun*) and carried out a land tax reform.

The government's reforms did not end with the abolition of these feudalistic social and economic systems. It is well known that the government took a positive leadership role in importing and implanting modern production techniques and systems from advanced Western countries. Promotion of the so-called primitive accumulation of capital guided by those government policies was thought to be the most effective way to counter the invasion of foreign capital which occurred in Japan with the opening of its ports to foreign countries.

Once the importation of modern production techniques and systems was adopted as the basic policy of the new government, the stabilization of a chaotic Tokugawa currency system was seen as one natural step toward implementing this policy. The establishment of a sound currency system was the essential prerequisite for the formation of capitalism, since the growth of industrial capital could not be achieved without national unification and the maintenance of a stabilized currency. With the aim of promoting national prosperity and defense and of fostering national industries, the new government carried out currency reform as its first act. This is clearly evident from the fact that the New Currency Act (*shinka jōrei*) was promulgated as early as May 1871.

The young Meiji government, whose financial foundation was still unstable, found the task of establishing a sound national currency system beyond its capability while having to wrestle with the twin tasks of suppressing the old feudalistic powers and promoting modern industries. While preparing legislation for a national currency system, the government was forced by financial needs to resort to the issuance of inconvertible *dajōkan satsu* ("cabinet notes") and several other kinds of inconvertible notes. It further allowed the national banks to issue inconvertible national bank notes despite the fact that national banks were established to promote private financial facilities and to withdraw inconvertible notes from circulation. This contradictory behavior by the government ultimately undermined the desired currency system.

This contradiction was most clearly revealed during the outbreak of Seinan War (the Satsuma insurrection) in February 1877. The government was forced to issue inconvertible government notes totalling 27 million yen and allow the national banks to issue inconvertible bank notes totalling 15 million yen in order to meet military expenditures. This resulted in a typical inflationary situation, with a 69 per cent margin between the value of silver coin and paper money, a 100 per cent increase in the price of rice, an adverse balance of trade, an outflow of specie, a hike in interest rates, rampant speculation, etc.

The government of that time, however, was not fully aware of the fact that the inflation was caused by the issuance of vast amounts of inconvertible paper money. The government supported the then popular but mistaken idea that the cause of the wide margin between the value of silver coin and paper money was the increase in the value of silver coin. The government, therefore, exerted more efforts toward checking the rise in the value of silver coin than toward withdrawing the inconvertible paper money. This was no more than a stop-gap measure, for the true restoration of the value of paper money could be effected only by withdrawing the inconvertible paper money.

It was only after the appointment of Masayoshi Matsukata as minister of finance in October 1881 that the true nature of the adverse effects of issuing inconvertible paper money was realized and its full-scale withdrawal was put into practice. In June 1882, the Bank of Japan was established. Its central and most pressing task was nothing other than the withdrawal of the inconvertible paper money, which was urged by Minister of Finance Matsukata.

In establishing the Bank of Japan, Matsukata took Western central bank system as a model. This may have been due to the fact that Matsukata had the opportunity of visiting France in February 1878, when he was vice-minister of finance and was appointed concurrently to the vice-presidency of the Paris Exhibition Secretariat. His visit to France was ostensibly for the purpose of taking charge of the secretarial duties for the exhibition. However, taking this opportunity, he visited various countries in Europe and learned much about their national finance and monetary systems and policies. His idea of establishing the Bank of Japan doubtlessly came from his survey trip to Europe.

When Matsukata visited France, the minister of finance was Léon Say. He answered many questions Matsukata raised about national finance and economy and gave Matsukata many good suggestions. Léon Say, a grandson of the famous classical economist, Jean-Baptiste Say, was an economist as well as a statesman and published many books on national finance and economy. Particularly, he emphasized the necessity for a stable currency value and suggested the establishment of a sound currency system and the creation of a central bank system, both of which strongly appealed to Matsukata. The appendix to the *Matsukata-haku zaisei ronsaku shū* [Collection of Count Matsukata's essays on national finance policies] contains Matsukata's letter of November 1883, addressed to Léon Say, who was then a member of the French Senate. A portion of the letter reads as follows:

> As you may remember, it has been four years since I parted from you in 1879. I am still thankful for the kind consideration you gave me during my stay in your country. I particularly benefited from your many useful suggestions on national finance....Now as minister of finance, I am assuming the heavy responsibility of administering Japan's national finance and am trying my best, day and night, to put into effect what you kindly suggested. I deeply fear, however, that I might fail in fulfilling my duties and repaying your kindness....As for the matter of national finance, I am not aiming at for soft currency but intend to adhere to the principle of hard currency. Therefore, I am not the least satisfied with the present situation. This indicates that I am and always will be faithful to what you have taught me. [2, p. 622]

In February 1880, a little more than one year after Matsukata returned home from Europe, he was transferred from vice-minister of finance to minister of home affairs. If he had been appointed minister of finance at that time instead, the Bank of Japan might have been established before 1882. Matsukata was appointed councilor of state and minister of finance as a result of the government change in October 1881, when the opinions of the cabinet members were divided as to the timing for the establishment of the Constitution and the opening of the Diet, and, as a result, Councilor of State Shigenobu Ōkuma, who held actual control of the national finance, and his adherent, Minister of Finance Tsunetami Sano, both resigned their posts. Consequently, the establishment of the Bank of Japan had to be delayed.

Matsukata began to concentrate his efforts in seeking to realize his idea of establishing a central bank as a step towards the withdrawal of inconvertible paper money and the introduction of a stable currency. On March 1, 1882 (i.e., within half a year after he assumed the post of minister of finance), he presented to Prime Minister Sanjō the "Nihon ginkō sōritsu no gi" [Proposal to found the Bank of Japan], along with an annex entitled the "Nihon ginkō sōritsu shishu no setsumei" [Explanation of the reasons to found the Bank of Japan], and urged the realization of the proposal.

The proposal "Nihon ginkō sōritsu no gi" was the basic document relating to the establishment of the Bank of Japan, but its content was very abstract. The "Nihon ginkō sōritsu shishu no setsumei," a reference annex, was far more concrete in content. If one reads this document carefully, one can get an idea of what the government expected from the new central bank at the time. From this perspective, the "Nihon ginkō sōritsu shishu no setsumei" can be divided into the following five parts: (1) preamble, (2) reasons for establishing a central bank, (3) reasons why the situation does not allow the new central bank to issue convertible bank notes for the time being, (4) outline of the Bank of Japan Act (*Nihon ginkō jōrei*), and (5) necessity for establishing industrial banks and regulating savings banks. Let us take up the preamble first.

> As far as the government is concerned, nothing is more important than national finance. National finance is the most essential foundation of government. The prosperity of the nation and the welfare of the people depend entirely upon the success or failure of a national finance policy.
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> The analysis of the present situation of our national finance reveals that finance is always tight and the distribution of funds is not being carried out smoothly. The people are therefore suffering from a shortage of capital, with interest rates escalating. Consequently, private financing is becoming tighter. In addition, exports and imports do not balance each other, with the result that the outflow of gold and silver money increases year after year. The margin between specie and paper money has become so wide that specie can no longer function as currency. Because of the above-mentioned conditions, manufacturers and commercial firms are all being hindered in their business activities by the shortage of capital. It is not an exaggeration to say that our national finance is now in a serious situation. [3, p. 439]

In this paragraph, Matsukata mentioned that the stability and progress of the national economy could be achieved only by sound national finance, but that the economic conditions of the time were far from ideal. The economic confusion referred to in this paragraph was, to put it another way, simply the aggravation of inflation. If the issue of inconvertible paper money increases when government payments exceed revenue and commodity prices go up, it is natural that the balance of payments becomes unfavorable and credit becomes tight.

> A bank's proper function should be the facilitation of financing and the assistance of national finance. In our country, however, while national banks numbers more than 260 and their total issue of paper money amounts to as much as more than 34 million yen, our national finance confronts difficult conditions at present. What is the reason? Looking at the background of the establishment of our national banks, the government first established exchange companies in 1869 in order to handle tight credit during the early stages of the Restoration era. The exchange companies, however, failed to function properly. After the exchange companies revealed more defects than merits, the government enacted the National Bank Act (*kokuritsu ginkō jōrei*) of 1872, following the model of the United States. Later, in August 1876, the government had to amend the act. This was because the people in charge of preparing the act were so hurried that they had no time to study adequately the practices of the banking systems in Europe and to pay attention to the lessons of the past while considering future possibilities. The banks thus

> established were far from ideal. This may have been the inevitable result given the situation at the time. [3, p. 439]

In this paragraph, Matsukata mentioned that one of the reasons why the national banks, though many in number, failed to facilitate credit was that the U.S. system which had been introduced without any modification could not deal with the conditions prevailing in Japan. In view of the fact that Matsukata visited Europe, it is interesting to note that the above remarks clearly indicate his critical feeling toward the adoption of the U.S. system without taking into account the "practices of the banking systems in Europe."

> Nowadays large national banks are capitalized at around 400,000 or 500,000 yen and small ones at less than 50,000 or 60,000 yen. They stand alone and do not influence each other. They do not help each other. The result is that a bank which is capitalized at 50,000 yen can function only up to its capacity of 50,000 yen and one capitalized at 100,000 yen can function up to 100,000 yen. They cannot thus expand the use of their funds. Their interest rates, therefore, cannot be lowered. They may not be able to facilitate credit and contribute to the sound management of national finance, even if they want to do so. In Japan's previous feudalistic period, a great number of feudal lords governed their own districts, and they maintained hundreds of small governments throughout the country. Now that the central government and local administrative bodies have been established, they are mutually related and the affairs of the state are coordinated and administered centrally. Our banks, however, seem to have remained in a feudal state. They are separate from each other. Most of them are absorbed in maintaining their own standing and too busy to cooperate with other banks. While local administrative bodies are organized nationally, the financial feudalism does not cease to exist. This might be the reason why the modernization of our national finance cannot parallel the progress of the government. In order to improve our financial aspects, there is no choice but to establish a central bank which will act as the center for national finance and help harmonize the activities of banks all across the country in an effort to modernize national finance and to rid ourselves of the present feudalistic system along the lines of the local administrative system. [3, p. 439]

This paragraph may be interpreted to mean that the national bank system, which was modelled after the U.S. system, did not have a central bank and failed to regulate financial matters on a national basis. At the conclusion of this paragraph, Matsukata emphasized the adoption of a central bank in order to remove feudal characteristics from national finance.

> If you study the motives of the European countries which have established central banks, you will find that, although these countries faced different conditions, their motives were the same, i.e., the facilitation of credit to aid national finance. The importance of finance to the people is analogous to blood circulation in the human body. The heart collects and distributes blood to all parts of the body. The central bank is the heart of a country's finance. Without a central bank, how can the distribution of goods of a country can be facilitated effectively? How can credit be centralized and distributed? This is the real reason why every European country has established its central bank. [3, pp. 439–40]

This paragraph points out the vital necessity of a central bank for the sound management of the national economy. Matsukata mentioned the words "European countries" several times. This may suggest the kind of financial system he had in mind.

> Japan's conditions are, needless to say, different from those of European countries because of a different historical background. However, both Japan and Europe face similar financial difficulties in such areas as the shortage of specie, an increase in interest rates, a decline in paper money value, a deadlock in financing, unsatisfactory functioning of national banks, unbalanced trade, and a restricted circulation of bills and notes. The writer, Masayoshi, sincerely hopes that a central bank be immediately established and will develop steadily, gain credit, and serve as a center of nation-wide finance, with an ultimate goal to facilitate credit and ease the financial crisis. [3, p. 440]

This is the conclusion of the preamble, which emphasized the necessity for the immediate establishment of a central bank.

In drafting the Bank of Japan Act, Matsukata followed the model of the National Bank of Belgium Act. The reason why he followed the Belgian model is quite important in understanding the characteristics of the Bank of Japan.

We can let Masayoshi Matsukata, founder of the Bank of Japan, explain this in his own words by quoting from the draft of his "Shinkō zaimu keiei no ippan" [Lecture on one aspect of financial management], delivered before the crown prince toward the end of the Meiji era:

> In 1878, I went to France to perform my duties as the vice-president of the secretariat of the Paris Exhibition. At the time, the French finance minister was Léon Say, a leading economist of the time. I discussed matters of finance and economy with him several times and became aware of the necessity for establishing a central bank for the purpose of facilitating credit and for relieving the national financial situation. This is because the importance of finance to the people is analogous to blood circulation in the human body, for the central bank is the heart and works to circulate blood throughout the body. I, therefore, told him that I wished to study the Banque de France. He told me, however, that the Banque de France was established long ago and that its system and management methods were controlled by traditional rules which were difficult to understand. He recommended the study of the Banque Nationale Belge, which was established quite recently and was consistent in organization and structure. I ordered someone to stay in Belgium and study the detailed workings of the Banque Nationale Belge. Three years later, I was familiar with the details of the bank.

The person who was ordered to Belgium by Matsukata was Wataru Katō, an official of the Ministry of Finance. He stayed in Brussel from 1878 to 1880 and studied the act and the articles of the National Bank of Belgium and learned about the practical aspects of monetary policy management in great detail. He reported the results of his stay in Belgium to Matsukata.

The question is why Matsukata followed the National Bank of Belgium model in establishing the Bank of Japan. It is generally believed that Matsukata accepted the suggestion of Léon Say. Say's suggestion was based on the fact that the bank was established comparatively recently and that its system blended the good characteristics of other countries' banking systems. This point is referred to in the above-quoted "Shinkō zaimu keiei no ippan." The "Nihon ginkō sōritsu shishu no setsumei" also mentions at length the reasons for adopting the model of the National Bank of Belgium.

> In Belgium, banks such as Société Générale, Banque de Belgique, Liège Banque, and Frandle Banque had, at one time, been entitled to issue paper money. Thereafter they committed frequent errors in their operations and subsequently had their right to issue paper money suspended. At this point, the minister of finance at the time was anxious about depressed state of national finance and established the Banque Nationale Belge in 1850. The bank took charge of withdrawing the inconvertible paper money already issued. This resulted in a tremendous boost to commerce and contributed greatly to the restoration of national finance. It is to be noted that the Netherlands followed the model of the Banque Nationale Belge in reorganizing the Amsterdam Bank....In establishing our central bank, we must see that the central bank is appropriate for the conditions prevailing in our country. To do this, we must take into consideration such elements as our cultural and social environment, the demands of farmers and merchants, the stage of development in industrial production, etc. At the same time, we must select the good aspects of the systems of European countries and adopt them eclectically in such way that the entire machinery of our central bank be organized into completely an efficient system. Looking over the current systems of the European countries, we can find no systems comparable to those of the British and the French in terms of briskness in operation and largeness in scale. When it comes to complete organization and efficient operation system, however, no central bank of any other country can compete with the Banque Nationale Belge. Since the bank was only recently established, it was able to organize itself after studying the record of the British, French, Austrian, and American systems and after evaluating their merits and demerits. The bank could thus adopt the best features of their systems and avoid their weaknesses. This is the reason why the bank is so completely organized. This bank system has won the admiration of people in charge of national finance in many countries, and the Amsterdam Bank modelled itself on this system. In formulating a central bank for Japan, if this model of the Banque Nationale Belge is followed, with full consideration being paid to Japanese customs and practices, we may be able to create a central bank which is suitable to our national characteristics and is complete in banking system. Keeping the above in mind, I have drafted the Bank of Japan Act and the articles of the Bank of Japan, modelling them after the Banque Nationale Belge and taking full account of Japanese customs and practices. [4, pp. 177–201]

In view of the importance of this event, we should not take Matsukata's story at face value. Let us examine the contents of his explanation in greater detail.

First, was it true that the Banque Nationale Belge (National Bank of Belgium) was "only recently" created at the time? The National Bank of Belgium was established in 1850 and the Bank of Japan in 1882. Thirty-two years had elapsed during this period, and the expression "only recently" is, therefore, not correct. During this period, other central banks were established, while some banks were reorganized to be central banks. For example, the Russian Imperial Bank was established in 1860, the Central Bank of Denmark in 1872, and Reichsbank of

Unified Germany in 1875. It is true, however, that the National Bank of Belgium was established later than the central banks of Britain and France. In addition, it should be noted that although the act for the National Bank of Belgium was enacted in 1850, its articles were actually instituted in 1872. The reason that the Bank of Japan was modelled after the National Bank of Belgium does not seem to be based solely upon the fact that it came into being after the British and French central banks.

Second, let us examine whether or not the system of the National Bank of Belgium did indeed consist of "the best features" of other systems and have a "completely organized" system. Whether it was "complete" or not is a subjective question and must be left to the researcher to decide for himself. However, we can establish which aspects of the Bank of Japan were modelled after the National Bank of Belgium system.

A comparison between the Bank of Japan Act and the bank's articles which were enacted in 1882 and the National Bank of Belgium Act and the bank's articles reveals the similarities and differences between the two institutions.

The similarities can be listed as follows:

(1) The operations of both center on commercial financing but participation in industrial financing is forbidden.

(2) Government licensing is required for holding public debts and for the amount and interest rates on loans secured through public debt.

(3) Both are responsible for government funds.

(4) Both are joint-stock companies with chartered periods of operation.

(5) Both are permitted to set aside a portion of their surplus as a legal reserve fund for covering losses and for covering a shortage of dividends.

(6) Whenever the government finds it necessary, it may order the bank to establish branch offices.

(7) The governor of each bank is appointed by the head of the government.

(8) Both have a system which provides for a directors meeting, an auditors meeting, and the bank's general meeting.

(9) Both have a discount committee.

(10) Both have a system whereby the government appoints the supervisor.

(11) The governor of each bank is authorized to suspend a decision made at the directors meeting and refer the case to the government.

(12) Both banks are required to submit a monthly report to the government.

(13) The establishment and amendment of the bank's articles are subject to licensing by the government.

(14) The government has the authority to supervise the bank and to suspend any action of the bank which the government considers unfavorable.

The following are the differences between the two banks:

(1) The chartered period of operation is twenty-five years for the National Bank of Belgium, and thirty years for the Bank of Japan.

(2) In Belgium, the private sector provides all subscriptions to the bank; in Japan, half of the capital is provided by government subscriptions.

(3) In Belgium, the maximum limit for the issuance of bank notes is set by the bank act; in Japan, the limit is stipulated in a separate act.

(4) In Belgium, the selection of the directors is subject only to the decision of the general meeting of shareholders, while in Japan the government appoints the directors from among the persons nominated by the general meeting of the bank.

(5) In Belgium, the vice-governor is appointed by the king from among the directors, while in Japan, the vice-governor is appointed by the government, but separately from the directors.

(6) In Belgium's case, there are stipulations providing for the dismissal of the governor and the payment of any net surplus to the government; there are no such stipulations in Japan.

Briefly, the common features of the two banks can be summarized into the following points. Except for the principle of attaching importance to commercial financing, the most remarkable common feature is that the government has strong authority in supervising the central bank. It should be noted in this connection that the study of foreign central banks which was conducted by the Meiji government at that time was very extensive and included the Bank of England, the Bank of France, the National Bank of Belgium, and the central banks of Germany, Austria, Hungary, Italy, and the Netherlands, as given in "Nihon ginkō sōritsu shishu no setsumei." Léon Say's suggestion might have had some influence on Masayoshi Matsukata's decision to model the Bank of Japan after the National Bank of Belgium, but it is more likely that the decision was based on the coincidence between what the bank offered and what Matsukata wanted—a strong government administration which was almost free from parliamentary control.

When compared with other European central banks on this point, the present act and articles of the National Bank of Belgium (1939) reveal that the government's power over the bank was considerably strong. For instance, the minister of finance is empowered to supervise all aspects of the bank's operations. If he found any action taken by the bank to be in violation of the provisions of the act or articles or to be against national interests, he could disapprove such actions (Article 29 of the act). No such examples of such arbitrary government power can be found in other countries, with the only exception being the British government's power of direction over the Bank of England. One further example is the Belgian king's power not only to appoint but also to unconditionally dismiss and suspend the governor from office (Article 44 of the articles). A similar example is found only in Denmark. Finally, there is also a provision, peculiar to Belgium which states that the governor is entitled to suspend a decision taken by the bank which contradicts either the provisions of the act or articles or national interest and to refer it to the government for its decision (Article 62 of the articles). The above three provisions have all been in effect continuously ever since the establishment of the act for the National Bank of Belgium in 1850 and are part of its tradition.

II

A general review of the basic enactments of the central bank of various countries reveals that they usually include provisions for issuing bank notes as well as for their organization, business, and accounting. In this regard, the Bank of Japan Act has concrete, though brief, provisions for its organization, business, and accounting. However, concerning the issuance of bank notes, the so-called life line of the central bank, the act contains only abstract provisions and leaves the details to an enactment which was to be made separately from the Bank of Japan Act. This seems highly unusual. This ambiguous provision reads as follows:

> Article 14 of the Bank of Japan Act: The Bank of Japan is authorized to issue bank notes. A separate regulation shall be set forth and promulgated to decide when the bank shall issue bank notes.

The regulation mentioned above was the Convertible Bank Notes Act (*dakan ginkō ken jōrei*), which was promulgated on May 26, 1884, and became effective on July 1 of the same year. This was over two years after the establishment of the Bank of Japan Act on June 27, 1882.

For nearly sixty years from then to 1942 when the Bank of Japan Law (*Nihon ginkō hō*) which provided for issuing bank notes together with the organization, business, and accounting was enacted, there had been in existence a dual system of enacting central bank functions. The Bank of Japan Act provided for functions other than bank note issuance, and on the other hand, the Convertible Bank Notes Act provided for issuing bank notes. No other example can be found in the history of world central bank enactments. The most important reason for adopting the dual system of enactment for the Bank of Japan was that Japan's economy at the time was inflationary, with a considerable margin between the value of specie and paper money. If the Bank of Japan had started issuing convertible bank notes immediately upon opening for business, all convertible bank notes issued would have been converted into specie, which in turn would have prevented the circulation of convertible bank notes as originally intended.

The Convertible Bank Notes Act established in May 1884 notes, only very vaguely, the important relationship between bank note issuance and specie reserves.

> Article 2: The Bank of Japan shall be required to maintain an adequate amount of silver coins as a reserve for bank note issuance.

According to the Procedures for Convertible Bank Note Issuance (*dakan ginkō ken hakkō tetsuzuki*) which was promulgated on July 4, 1884, to serve as detailed regulations for enforcing the Convertible Bank Notes Act, the maximum limit for bank note issuance was fixed at 2 million yen. Any issuance in excess of the limit was subject to approval by the minister of finance. These procedures were revised on May 6, 1885, to the effect that the minister of finance may change the maximum limit for bank note issuance from time to time when necessary. Pursuant to the above revision, the Bank of Japan applied, on May 7 of that year, to the minister of finance for a step by step issuance of bank notes up to the maximum limit of 5 million yen, with silver coins totalling 2 million yen as reserve. Upon receipt of the minister's approval, the Bank of Japan issued on May 9, two days after the application, ten-yen convertible bank notes amounting to 1,210,200 yen for the first time in its history. This fact indicates that a very cautious attitude was taken toward convertible bank note issuance, though we are not quite convinced with the system that all the powers relating to bank note issuance was vested in the minister of finance. This unsatisfactory system of bank note issuance might have emerged partly from the fact that the ministry of finance at that time was not able to solve the contradictory necessities of preventing the recurrence of inflation and maintaining flexibility in issuing bank notes to cope with an economic panic. In this connection, the *Meiji zaisei shi* [History of national finance in the Meiji era] states the following:

> The most difficult problem in issuing bank notes is how to determine the ratio between reserves and the maximum limit of issuance. This is because the relationship between these two items is the key to the question of bank note issuance.... Excessive issuing brings about increases in commodity prices and credit tightness, which would result in economic panic....However, if the control on bank note issuance is too strict, bank notes fail to function properly and hurts the national interest. This is well known to those who are familiar with the history of British banks. [5, pp. 266–67]

There was, however, a more significant factor, to which we shall refer later.

As mentioned above, the Convertible Bank Notes Act was established in May 1884, and the Bank of Japan issued convertible bank notes for the first time in May 1885. The outstanding amount of convertible bank notes was as small as 2,640,000 yen at the end of May 1885, and 3,950,000 yen at the end of 1885, but this increased to 39,540,000 yen at the end of 1886 and to 53,450,000 yen by the end of 1887. Consequently, the ratio of the outstanding amount of convertible bank notes to the aggregate amount of outstanding paper money, including government and national bank paper money, came to have a considerable impact. The trial stage of convertible bank note issuance thus reached its completion. Thanks to the continued sound national finance policy taken by the government, convertible bank notes obtained a high credit standing, with the difference between the values of paper money and silver coins disappearing completely. In view of these circumstances, Minister of Finance Masayoshi Matsukata judged that the time was ripe for revising the unsatisfactory nature of the Bank of Japan's bank note issuance system stipulated by the Convertible Bank Notes Act. In July 1888, he submitted to the prime minister a *"Dakan ginkō ken jōrei chū-kaisei no kengi"* [Proposal for partial amendment of the Convertible Bank Notes Act]. After being debated by the Senate, this amendment was promulgated on August 1 of that year by Imperial Order No. 59, under the title, Partial Amendment of the Convertible Bank Notes Act (*dakan ginkō ken jōrei chū-kaisei*).

The Partial Amendment of the Convertible Bank Notes Act was, from a legal viewpoint, a revision of the act. In fact, however, the Convertible Bank Notes Act of May 1884 was vague in defining the vital aspect of convertible reserves, and the convertible bank note issuance under the act was no more than a trial effort. However, it was this amendment which actually introduced bank note issuance into Japan under an "elastic fiduciary issuance method." In other words, the period extending from the establishment of the act to its amendment can be considered as the preparatory period for the establishment of convertible bank note issuance. During the deliberations on the Amendment of the Convertible Bank Notes Act in the Senate on July 17, 1888, Minister of Finance Matsukata endorsed this viewpoint in his statement delivered before a Senate committee:

> The aim of revising the Convertible Bank Notes Act is, in short, to clarify the vague aspects of the current act. What is vague in the act is the amount of the convertible reserve. The current act only stipulates that an adequate amount of silver coins must be retained as a convertible reserve, but it does not define what is an adequate amount. The reason why the act did not stipulate the amount at its creation was that the future development of convertible bank note issuance could not be clearly foreseen at the time. There was, therefore, no assurance that the act would remain unchangeable. The prospects for the act at the time was that it would face the need for amendment sometime after its effectuation, i.e., when the act achieved definite results. The progress made since the effectuation of the act reveals that its goals have been achieved as expected, with even better prospects ahead. It has, therefore, become necessary for us to determine the definite amount of the convertible reserve and to clarify it legally. This is the aim of the amendment. [1, pp. 138–39]

Among the articles of the act which were amended, the most important one was Article 2, whose amendment reads as follows:

> (1) The Bank of Japan shall be required to retain gold and silver coins and gold and silver bullion as a reserve for convertible bank notes equivalent in value to the amount of notes issued.
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> (2) Other than the above issuance, the Bank of Japan is authorized to issue convertible bank notes up to the limit of 70 million yen against a reserve consisting of public debt certificates issued by the government, Treasury bills and other reliable securities and commercial bills. Of the said limit of 70 million yen, an issue of 27 million yen shall be put into effect gradually up to the amount of the withdrawn paper money which has been issued by national banks since January 1, 1889.
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> (3) When the Bank of Japan, based on market conditions, feels the necessity for increasing money in circulation, the bank may, after obtaining the approval of the minister of finance, issue convertible bank notes in excess of the limit prescribed in paragraph (2) against a reserve consisting of public debt certificates issued by the government, treasury bills and other reliable securities and commercial bills. In this case, the Bank of Japan shall pay an issuing tax of not less than 5 per cent per annum on the amount of such excess issuances, provided that the percentage shall be decided by the minister of finance according to circumstances.
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> (4) The Bank of Japan shall advance to the government an amount up to 22 million yen for the withdrawal of the paper money issued by the government at an interest rate of 2 per cent per annum. The interest rate shall be null and void from 1898.
>
> (5) The maturity period for and the amount of the annual repayment of the advance prescribed in the preceding paragraph shall be fixed by the minister of finance.

The stipulations in the paragraphs above are rather long for one legal article, but if paragraphs (4) and (5), which provides for the advance for the withdrawal of government paper money, are omitted, the remaining paragraphs stipulate a system of bank note issuance known as the "elastic fiduciary issuance method." These paragraphs served as the core of Japan's monetary system for the several decades leading up to the establishment of the present Bank of Japan Law in 1942. In view of the importance of the elastic fiduciary issuance method, its essential features stipulated in paragraphs (1) to (3) are summarized again as follows:

First, the Bank of Japan may issue whatever amount of convertible bank notes it wishes as long as it retains a specie reserve amount equivalent to the notes issued (i.e., specie reserve issues).

Second, the Bank of Japan may issue convertible bank notes up to 70 million yen aside from the specie reserve issues if the bank retains a reserve consisting of commercial bills, national debt, treasury bills and other reliable securities equivalent in amount to such an issuance (i.e., fiduciary issues).

Third, in a case when the Bank of Japan feels it necessary, the bank may issue convertible bank notes in excess of the above-mentioned limit of 70 million yen if it obtains the approval of the minister of finance and pays a special tax, namely, an excess issuance tax (i.e., excess fiduciary issues or excess issues).

Even now there is still debate concerning the selection of the bank note issuance system. Therefore, it is very important to understand why the Meiji government selected the elastic fiduciary issuance method. A portion of the *"Dakan ginkō ken jōrei kaisei riyū sho"* [Explanatory statement for the proposed amendment of the Convertible Bank Notes Act] clarifies the reason. Let us examine this part of the statement.

A review of the statement reveals that the Ministry of Finance made a comparative study of the bank note issuance systems of various countries, including particularly detailed ones on those of the European countries. It then classified the methods into four types—the "proportional reserve method" (*jumbi hirei hō*), the "issue-limit method" (*hakkō seigen hō*), the "limit-elasticity method" (*seigen kusshin hō*) and the "proportional elasticity method" (*hirei shinshuku hō*). The statement compared the merits and demerits of these four types as follows:

The first type, the "proportional reserve method," is defined in the statement as a method where "the amount of specie reserve is fixed at a rate proportionate to the amount issued" of bank notes. The statement points out that this method is defective in the following points:

> The proportional reserve method requires that a specie reserve be retained in the amount of a certain proportion fixed by the law (for example, one-third of the amount issued). Subsequently, in such cases where the amount of specie reserve in the bank decreases due to financial disturbances or an adverse balance of trade, the amount of bank notes in circulation in the market must be reduced by three times the reduced amount of specie reserve. This will aggravate the disturbances in the market. [5, p. 274]

In short, the statement points out that this method works unfavorably for the business community when the specie reserve is reduced from such factors as an adverse balance of trade and financial panic. It concludes as follows:

> In such countries as Italy and Spain, this method operates without any problem. This is, however, due to the cautiousness and expertise of the bankers and not because the method is flawless. The system cannot escape from the above-mentioned defects. [5, p. 275]

The second type, the "issue-limit method," is defined as "a method where no bank note issuance without specie reserves is allowed in excess of a fixed limit" and corresponds to the "fiduciary direct limit issuance method" using present terminology. The defects of the system pointed out by the statement are as follows:

> In cases of financial panic, the people's confidence in credit institutions disappears. The only institutions capable of retaining the people's confidence in national finance are the government and the central bank. Therefore, in such emergencies, the central bank will be required to boost the credit standing of other institutions through extending credit. The issue-limit method in such cases not only restricts the central bank's crediting capacity but also reduces the amount of bank notes in circulation. This will, needless to say, cause tremendous inconvenience. [5, p. 275]

The statement emphasizes that, in case of an outbreak of a run on a bank, the issue-limit method makes it impossible for the central bank to supply an adequate amount of bank notes and therefore cannot contribute to stabilizing the situation.

> Britain has adopted this system....In case of financial emergency...the letter of the law was sometimes ignored in order to let the Bank of England issue bank notes in excess of the limit. There were several actual cases where financial panics were overcome by such excess issuances....The reason why the British government had to adopt such an administrative measure was due solely to the incompleteness of the method. The idea of limiting convertible bank note issues which were not covered by specie reserve was correct, but the problem was that the method provided no means of meeting emergencies. This is the weakness of the method. [5, p. 276]

This issue-limit system was adopted in Britain by the Peel's Currency Act and was regarded as the most authentic model of bank note issuance systems, but Japan's Finance Ministry of the time did not consider it perfect.

The third type, the "limit-elasticity method," is defined by the statement as a system where "issuance without specie reserve is limited, and the ratio of specie reserve to the total issuance is fixed, but when necessary, issues in excess of the limit is permitted subject only to the payment of an issuance tax which aims at preventing unnecessary excess issues." If expressed in today's terminology, this system is a combination of the "elastic limit fiduciary issuance method" and the "proportional reserve method." The statement's comments on this system are as follows:

> The method is not completely free from the defects of the proportional reserve method, but it can be free from the defect of blocking bank note circulation. Moreover, the system of taxation on excess issues will naturally work toward returning the amount of issues to an amount within the limit once the financial market is restored to stability and interest rates return to the normal level. This system has been adopted by Germany and proves to be very satisfactory. [5, p. 276]

In other words, the statement says that this method contains the characteristics of the proportional reserve method and is therefore not quite free from this defect, but if this defect can be ignored, the system is excellent in other aspects.

The fourth type, the "proportional elasticity method," is defined as a method where "the ratio of the reserve to the issued amount is not fixed by the law but is determined from time to time elastically in order to meet prevailing market conditions." There is no precise term to describe this method. It may thus be referred to as a "proportional reserve method" which allows excess issues.

> In cases where the credit market sinks into a chaotic situation and requires a great deal of monetary issues, the central bank will be required to bolster the financing of commercial and industrial firms through utilizing its credits. In such cases, this issuance system allows the central bank to extend such credit. Compared with the issue-limit system, which cannot flexibly meet the changing conditions of the market, and the proportional reserve method, whose bank note issues must be reduced rapidly in cases of financial emergency, this "proportional elasticity method" is considered to be much superior. France, Belgium, and the Netherlands have adopted this method. [5, p. 276–77]

As an example of this "proportional elasticity method," reference is made to the Belgian bank note issuance system. The following are the relevant parts of the National Bank of Belgium Act and the bank's articles:

> Article 12 of the National Bank of Belgium Act states: The bank shall issue bank notes payable to the bearers. . . . The ratio of hard currency reserve to bank notes in circulation shall be fixed by the bank's articles. Article 35 of the bank's articles reads: The bank shall be required to maintain a reserve of hard currency in the amount equivalent to one-third of the total amount of bank notes and other debts payable on demand, provided that, with the minister of finance's approval, the ratio can be lowered to less than one-third up to a limit approved by the minister.

Judging from the two articles mentioned above, it is safe to say that "proportional elasticity method" is a "proportional reserve method" allowing for excess issues. This system was highly rated by the statement, the reason being that the system was flexible enough to lower the reserve ratio in case of a financial panic. It should be noted that Article 2 of the original Convertible Bank Notes Act, which reads "the Bank of Japan shall be required to maintain an adequate amount of silver coins as a reserve for bank note issuance," was based on the principle of the "proportional elasticity method." The statement, however, admits that the wording of this article was so simple and vague that it might have given the impression that the Bank of Japan was authorized to determine the ratio of specie reserves.

Following the comparative analysis of these four bank note issuance systems, the statement makes the following significant conclusions:

> In order to select a system which is most suitable to our country's conditions, we should take into consideration the merits and demerits of the four types mentioned above and carefully study the European countries' experiences. With this in mind, the ideal system must satisfy the following points:

> (1) The amount of convertible bank note issues covered by specie reserve shall not be limited;
> (2) The ratio of the amount issued against the reserve of securities shall be fixed by the law, but it may exceed the limit if market conditions so require. In other words, we should remedy the defect of the issue-limit method and make the best use of the benefits of the limit-elasticity method and the proportional elasticity method. [5, p. 277]

This "ideal system" was nothing but the so-called "fiduciary elastic limit issuance method." When this is compared with each of the above mentioned four types of bank note issuance systems, it resembles the "limit-elasticity method" and the "proportional elasticity method" in its flexibility. However, it does not include the characteristics of the "proportional reserve method" which are found in the "limit-elasticity method." In short, this ideal system cannot be so easily categorized into any of the four types. It is a new system designed specifically to suit Japan's situation and combines the merits of the four types. In Minister of Finance Matsukata's explanation (on July 14, 1888) during the debate on the Amendment of the Convertible Bank Notes Act in the Senate, he stated that the system combined parts of the British and German systems:

> Of the paragraphs in Article 2, the most important is paragraph 1, which reads "The Bank of Japan shall be required to retain gold and silver coins and gold and silver bullion as a reserve for convertible bank notes equivalent in value to the amount of notes issued"....For example, if convertible bank note issuance amounts to 10 million yen, a reserve of 10 million yen will be required. For your reference, I would like to tell you which country's system this is modelled after. *This follows the British model.* In this respect, the ratio of reserves to bank note issues is one-third or one-fourth in such countries as Germany, Italy, and Spain. Japan, however, decided to follow Britain's example because we wanted to strengthen the credit of paper money. Paragraph 2 stipulates that convertible bank notes may, in addition, be issued up to the limit of 70 million yen against a fiduciary reserve. What was the model we followed for this system? Though this system is considered to be a new system, it is by no means new. *Its precedent is found in the Bank of England.* Recently, the central banks of Germany and Italy also followed this example and adopted the fiduciary reserve method, with its fixed issuance limit....Paragraph 3 stipulates that when the Bank of Japan feels it necessary, judging from the conditions of the market, the bank may issue convertible bank notes against a reserve of public debt certificates, treasury bills, commercial bills, etc. This is a system which is most needed....*This is modelled after the system of the German Imperial Bank.* Since other European countries do not have this type of issuance system, they sometimes have to break the law in order to make such emergency issues.... This is why the German system is highly praised by businessmen of the world. Our country must follow this excellent example and prepare for such emergencies. (italics added) [1, pp. 139–40]

Concerning this point, it should be noted that the reason why Matsukata emphasized the adoption of the British system was that he had to respond to a number of questions centering on the possibility that the fiduciary elastic limit issuance system would not be strictly controlled in its operation. What the government actually expected from the system was the beneficial aspect of the German system, namely, the elasticity which allowed excess issuances. This point should not be overlooked. As already mentioned, the "Explanatory Statement for the Proposed Amendment of the Convertible Bank Notes Act" classified various bank note issuance systems of the world into four categories and criticized the issue-limit system adopted by Britain as "incomplete" or "inconvenient," while appraising the limit-elasticity system adopted by Germany as being "very satisfactory." A consideration of preparations against financial emergencies was, needless to say, a factor which supported the elastic aspect of the system, but the most fundamental factor seemed to be the basic philosophy running throughout the Bank of Japan Act, namely, strengthening administrative power and limiting parliamentary controls as much as possible. Elasticity or flexibility allows the evasion from detailed legislation—i.e., limiting the power of the Parliament, a legislative body—and the strengthening the power of the government, an administrative body.

III

After the promulgation of the Bank of Japan Act on June 27, 1882, the government made steady progress in preparing for the establishment of the bank, and, on October 6 of the year, appointed Shigetoshi Yoshihara (junior assistant to minister of finance) as governor of the bank and Tetsunosuke Tomita (senior officer of the Finance Ministry) as vice-governor. On October 10, the Bank of Japan head office began operations. As already mentioned, the Convertible Bank Notes Act was promulgated as an act separate from the Bank of Japan Act in May 1884, and pursuant to this act, the Bank of Japan first issued convertible bank notes in May 1885.

The Bank of Japan thus opened the first page of its long history. The establishment of the bank and the issuance of convertible bank notes are significant particularly from the viewpoint of the modernization of Japan's economy and the creation of the basic foundation for the full-scale development of capitalism. It symbolized a great epoch not only in fiscal and monetary history but also in economic history as a whole.

With reference to Japan's economic and social conditions before the establishment of the Bank of Japan, tax reforms brought about private ownership of land and removed the feudalistic restrictions imposed on farmers. Such factors as the issuance of vast amounts of government compensation bonds, nationalization of basic industries, aid to and protection of private industries, establishment of national banks, and excessive issuance of paper money, all induced the accumulation of monetary assets which could function as capital. On the other hand, the inflation caused by these factors resulted in compulsory, and unfair redistribution, which created a class of people who had no means of livelihood except for selling their labor. This accelerated the so-called primitive accumulation of capital. In the latter stage of inflation, national finance was brought to the verge of bankruptcy, the trade balance showed an enormous deficit, and the specie reserve suffered a rapid decrease. These circumstances made it impossible to maintain a sound monetary and banking system, a prerequisite for the full-scale development of capitalism.

In this regard, the establishment of the Bank of Japan worked to remedy these setbacks. The bank was given the mission of unifying all districts into a national market and to emancipate modern industrial capital from high-interest credit. One can thus see what the importance of the establishment of the bank was for Japan's capitalism. Since 1880 prior to the establishment of the Bank of Japan, government-run factories, with the exception of munitions factories, had been sold to politico-businessmen, who later became known as the zaibatsu. The economic policy which centered on government enterprises was clearly shifting toward increased importance being placed on the protection of private enterprises. This policy change was, of course, a part of the reorganization of the national financial system, but it also reveals that in the process of accumulating capital, the capitalists grew to such an extent as to be able to purchase enterprises from the government. The significance of the establishment of the Bank of Japan cannot be correctly understood without being aware of this background.

It should be noted in this connection that the governor and vice-governor of the bank, at its inception, were appointed from among Finance Ministry officials, and its directors from the Mitsui and Yasuda financial groups. It is also not to be overlooked that the Bank of Japan's credit was then supplied to the banks affiliated with these financial groups.

The establishment of the Bank of Japan doubtlessly laid the foundation for the capitalistic development of Japan's economy. Its establishment, however, was a practical measure introduced by the government as a step toward the restoration of the inconvertible paper money situation. Subsequently, the bank's capitalization and accumulation of convertible reserves were all supported by the government. This fact represents a peculiar feature in the development of Japan's capitalism. In short, the Bank of Japan, as an institution of modern capitalism, was established by government initiative and developed through government assistance in sharp contrast with the establishment of the Bank of England. The Bank of England obtained its privileged position as the central bank in compensation for its loan to the government, which came from monetary capital which accumulated in the cities independently from the government. The Bank of Japan is, of course, formally separated from the government since it was established as a private corporate body. The government-related aspects of the bank are, however, clearly revealed in the Bank of Japan Act. It was true that, with progress in the accumulation of private capital, administrative intervention in the activities of the Bank of Japan became relatively weak, but a general review of the bank's history shows that its activities could never be considered without some relationship with the government. The separation of the bank from any government ties, which Ukichi Taguchi (a noted scholar in the Meiji era) advocated at the time of the bank's establishment, has never been realized.

Although there are a number of reasons which are considered to be the major reasons for the Bank of Japan's link with the government, the author feels it necessary to point out one factor which has been hitherto ignored. This factor is the political standing of Masayoshi Matsukata, who was the key promoter of the bank's establishment. When the government changed in October 1881, Matsukata's post changed from minister of home affairs to councilor of state and minister of finance. This gave him the chance he needed to put into practice his long-cherished dream of establishing a central bank system. This government change was epoch-making. The significance of the government change was not limited to the fact that Shigenobu Ōkuma, who had not only been outside the Satsuma-Chōshū group but also a thorn in its side, was expelled from the cabinet. The change had a decisive impact on the entire cultural and social history of Japan right up to the end of World War II in that the change paved the way for the adoption of the German-style monarchism advocated by Tomomi Iwakura and Hirobumi Itō in Japan's Constitution, rather than a British-style parliamentary government or a party-cabinet government supported by Ōkuma. The German-style monarchism, needless to say, is characterized by the supremacy of the administrative power of the monarch which is free from the control of the Parliament. This resulted from the belief of the Meiji government that the development of modern capitalism in Japan could be propelled by leadership from above. It is, of course, not correct to call the Meiji government an absolute monarchy because it destroyed feudalism. It is, however, difficult to deny that the government did have some characteristics of an absolute monarchy in that the primitive accumulation of capital was promoted by the government and the Bank of Japan was established by the government itself.

The political philosophy of Masayoshi Matsukata, who played an important role in the Meiji government, which had a monarchical tinge to it, was reflected in the Bank of Japan Act and the Convertible Bank Notes Act. One example is the government's strong supervisory power. Most of Matsukata's published statements and papers relate to national finance, with few references to his political views. In 1880, in order to cope with the surging tide of the democratic rights movement and petition for the opening of the Diet, an imperial order was issued for each councilor of state to submit his recommendations on the establishment of the Constitution. However, Matsukata was then minister of home affairs and not a councilor of state. Matsukata submitted, on his own initiative, a recommendation entitled "Zaisei gi" [Proposals on national finance] to Prime Minister Sanjō, which, however, referred only to the subject title and not to the Constitution. Although Matsukata's opinions on the establishment of the Constitution is regrettably unclear, it can be presumed from his political behavior that he was a believer in the political philosophy of Iwakura and Itō.

The *Kōshaku Matsukata Masayoshi den* [Biography of Prince Masayoshi Matsukata] mentions that when Matsukata was assistant to the minister of finance, he ordered Tomotsune Kanmuchi, an official in the Agriculture Promotion Bureau, to study the constitutions of European countries. This part of the biography reads as follows:

> After the Imperial rescript had been issued in 1875 for the preparation of the

Constitution, the government, as a step toward a constitutional government, established the Senate and the Supreme Court and opened the Assembly of Local Officers. Later, in 1877 when the War of Seinan was suppressed, there prevailed radical opinions calling for democratic rights and some opposed the supremacy of the Emperor principle, the fundamental basis of Japan's national polity. Count Matsukata regretted such a trend in public opinion and felt it necessary to study the constitutions of European countries by keeping in mind such fundamental issues as monarchical succession, monarchical rights, and other characteristics of the monarchical system for the Imperial Constitution. He ordered Tomotsune Kanmuchi, an official in the Agriculture Promotion Bureau, to conduct such a study. [6, pp. 673–74]

This took place before Masayoshi Matsukata visited Europe as vice-president of the Paris Exhibition Secretariat. Another part of the biography also reads as follows:

As for the establishment of the Constitution and the opening of the Diet, Count Matsukata advocated gradualism and, as did Itō, believed that the cabinet was to be shuffled in such a way as to lay the foundation for constitutional monarchism as a long-range national policy. [6, p. 801]

That Matsukata leaned toward such a political direction can also be proven by the fact that he attended the meeting held at Iwakura's residence on October 10, 1881, when Ōkuma's purge was secretly deliberated by such people as Sanjō, Itō, Saigō, Inoue, and Yamada.

It was inevitable that Matsukata's cabinet, based on such a political philosophy, would collide with the Min-tō (People's Party) and would result in a dissolution of the Diet. This dissolution was later followed by a notorious event in which the government, through Minister of Home Affairs Yajirō Shinagawa, manipulated the subsequent general election.

The fact that the establishment of the Bank of Japan Act and the Convertible Bank Notes Act bear the imprint of Matsukata's political philosophy cannot be overlooked in studying the characteristics of the two acts which formulated the foundation of the Bank of Japan. This can also be compared with the fact that the old Imperial Constitution of Japan, established in 1889 and enforced in the following year, laid Japan's legal foundation as a modern capitalistic state, while at the same time giving Japan an absolute monarchical tinge which emphasized the supremacy of administration over legislation.

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