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The measurement of financial intermediation in Japan

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Abstract

In this paper, we examine the evolution of the Japanese financial structure, in order to challenge the expected incidences of the financial liberalization. We compute financial intermediation ratios for Japan (1979–2004) on a book value basis. According to our results, the intermediation ratio has remained quite stable, at around 85%. This stability is the result of two opposite trends: a decrease in credits and an increase in financial securities owned by financial (mostly, non-banking) institutions. These two trends are partly the consequence of the heavier weight of the Government in domestic external financing, which is traditionally less financed by credits than companies are. Besides, these two trends would not have appeared if we had used intermediation ratios in market value or other traditional indicators (Deposits/GDP, Loans to private sector/GDP, stock market capitalization/GDP, etc.). Our results provide evidence for a very close relationship between intermediate financings and market financings and tend to reject the hypothesis of the Japanese financial system's convergence toward a capital market-based system.

JEL classification : G10; G21; G32; G38

Keywords: Disintermediation; Financial system; Intermediaries; Capital markets

1. Introduction

During the 1980s and the beginning of the 1990s, the Japanese banking sector underwent a partial financial liberalization. Manufacturing firms gained in independence vis-à-vis banks more quickly than did savers. Consequently, banks stayed large, but they had to find new opportunities

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for loans as the banking regulation prevented them from redeploying their activity. Some of the Japanese banks were even reluctant to write off bad loans and enter into forbearance lending (Kobayashi et al., 2002).

For Hoshi and Kashyap (1999), the asymmetry in the liberalization process played a key role in the banking crisis and needed to be corrected by a deeper deregulation. The Japanese Big Bang initiated in 1996 was aimed at radically transforming the financial system toward a market-based system. Hoshi and Kashyap (1999) expected the Big Bang would lead ‘‘more firms to migrate to capital market financing’’, and would induce ‘‘a massive contraction in the size of the Japanese banking sector’’. Anderson and Makhija (1999) underlined, as a result of this financial liberalization, ‘‘a disintermediation evident in Japanese balance sheets’’. Such an analysis of the financial mutation incidences is not specific to Japan, but is often applied to many other countries (see, for instance, Allen and Santomero, 2001 and Rajan and Zingales, 2003a). Three points are generally considered.

The first one deals with the incidence of financial mutation on the relative importance of financial intermediaries compared to capital markets. A current view is that financial development is prejudicial to banks. Capital markets compete with banks on both sides of the bank’s balance sheet. On the assets side, the increase in claims undermines credit. On the liabilities side, the development of collective saving (which occurred relatively late in Japan) increases the cost of resources collected by banks. As a consequence, traditional banking firms should decline and there should be a necessary redeployment towards other activities such as financial engineering, risk management, etc. (Boot and Thakor, 2000). In the specific case of Japan, the decline of traditional banking would also be accompanied by a weakening of the main banking relationships.

The second point relates to the global evolution of financial systems. Nowadays, the majority opinion puts forward the idea of a standardization of financial systems toward a capital market-based system, in opposition to a bank-based system. Interestingly, the only empirical study specifically dedicated to this phenomenon (Schmidt et al., 1999) finds neither a global trend toward disintermediation nor a convergence toward capital market-based financial systems in the major European economies (France, Germany or the United Kingdom) at a general level.

The third question concerns the relative merits of bank-based versus capital market-based systems (for a comprehensive discussion on comparative financial systems, see Allen and Gale, 2000 and Levine, 2002). For a long time, the literature seemed to conclude in favor of capital market-based systems, at least for developed countries (Boyd and Smith, 1998). However, several recent studies using cross-country comparisons challenge this idea: although global financial development is a significant determinant of economic growth, there is no support for either the bank-based or market-based view (see Levine, 2005).

One major problem with this traditional approach is that financing structure is always a challenge to quantify (see, for a discussion, Beck et al., 2001). Consider, for instance, the Japanese case. While Japan is still referred to as an archetype of a bank-based system, Tokyo is one of the leading financial centers in the world; in 2003, Tokyo was ranked first in market capitalization of newly listed domestic shares. Moreover, the Japanese corporate bond market is small, but the Japanese Government Bond (JGB) market is the largest in the world. At first sight, one can interpret this as evidence of the convergence of the Japanese financial system toward a capital market-based system. But it seems more interesting to see it as evidence of a close connection between banks and capital markets in the financial system.