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**Part I**

**A bankrupt Shogunate,  
1859–1868 (sixth year of Ansei  
to first year of Meiji)**

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## Historical background, 1859–1868

The opening of Japan to the western powers in 1859, after a 230-year seclusion, was to prove fatal to the Tokugawa Shogunate regime. Shogunal concessions, agreeing to open Japanese ports to foreigners, aroused, especially among the influential feudal lords and their *samurai* subjects, bitter passions which were embodied in the slogan ‘Revere the Emperor, expel the barbarian’. This extremist slogan and movement, however, did not survive even the first half of the 1860s when two of the strongest domains, Satsuma and Choshu, reversed their anti-foreign stance. These two enlightened domains, situated in the far south-west of Japan where western things and influences entered Japan via Nagasaki, recognised the brutal reality, following the western powers’ bombardment of Kagoshima, the capital of Satsuma, and Shimonseki in Chosu territory, that ‘expel the barbarian’ policies were absurd. The union of the two domains, armed with some rudimentary western science, technology and, above all, modern weapons, gathered forces at an astonishing speed to lead the attack on the Shogunate from the autumn of 1867 to the spring of 1868. As the young *samurai* of Satsuma and Chosu and their allies had to shoulder all the burdens, including those of financial management, in a new administration (the Meiji government), an enormous amount of hitherto pent-up energy of young ex-*samurai* was released. For the time being, of necessity, the young oligarchs had no option but to rely heavily on the old merchant bankers.

# 1 Japanese merchant bankers: *ryogae*, 1859–1868

Prior to the arrival of the demanding foreigners on Japanese soil on 1 July 1859 there was a quasi-banking system operating in Japan. The *bakufu* government had earlier authorised certain merchants, *ryogae*, to trade in Edo (Tokyo) and Osaka. With the reluctant acceptance by the *bakufu* of treaty ports at Yokohama, Nagasaki, and Hakodate, at which foreigners had the right to reside and trade, the government licensed a handful of *ryogae* to operate in Yokohama and Nagasaki. Japanese and foreigners using silver Mexican dollars (which were the universal currency in the East at this time) made their financial arrangements on a day-to-day *ad hoc* basis, paying partly in cash and partly by barter. The fact that, before 1859, Nagasaki was the only port open to the Chinese and Dutch enabled various sorts of financial arrangements to develop there which provided valuable experience for the many young *samurai* who were to become powerful leaders in the new Japan after 1868.

The fundamental fact underlying the Japanese economic system prior to the upheaval consequent on the arrival of the foreigners was that taxes were paid in rice, in kind. Until 1873, when the system was abandoned, rice was the real currency. The commercial houses which had developed in Edo and Osaka, from which were to evolve the great present-day financial institutions of Japan, were essentially rice-handling agencies which had in the course of their business as collectors of rice taxes developed quasi-banking functions. It should also be remembered that in Japanese society at this time the merchant was socially of humble rank, classed only marginally higher than the peasant.

The standard coin available in Japan was the *ryo*. Within Japan there were coins and *han* or domains paper money in circulation; many of the coins were debased and much of the paper devalued. The *han* issued paper money, *hansatsu*, which circulated locally. The *bakufu* issued coins. There was little understanding of the inflationary danger of issuing more paper than was required and the least knowledge of Gresham's Law by which 'bad money drives out good'.

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The pre-banking scene in the Edo era, that is, prior to the advent of western merchants in Yokohama in 1859, was dominated by *ryogae* who were primarily merchants but who also offered a variety of banking services to approved customers. They could well, therefore, be called merchant bankers<sup>1</sup> in western terminology. The most important and influential *ryogae* were those based in the two great cities, Osaka and Edo, which were the commercial and consumer centres of Japan. Osaka's growth had been encouraged by its proximity (made easier by water transport) to Kyoto (the capital) where the Emperor lived in seclusion but in the company of a large and expensive court. Edo, now Tokyo, the eastern capital, was the power base of the Tokugawa Shogunate and as such had steadily grown both in importance and population.

There were two types of *ryogae*, the *hon ryogae* and *zeni ryogae*. The former were large merchants dealing in gold and silver coins while the latter were those lesser men who operated only with copper coins. During the last decade of the Shogunate regime more than 1,300 *ryogae* were trading in Osaka. They were led by *junin ryogae*, a council of the ten most opulent houses, who disciplined the whole merchant community in Osaka. *Hon ryogae*, headed by *junin ryogae*, supplied funds to the Shogunate government and to the domains and acted as agents for sales of goods, chiefly rice, in Osaka. Two celebrated houses in Osaka were Konoike and Sumitomo, both of which became important in banking in modern Japan and the latter of which also had a shop in Edo. In Edo some 750 *ryogae* houses were operating, the most notable of which was the house of Mitsui which had offices in Osaka and Kyoto and agents all over Japan, including Nagasaki. It should be noted that Mitsui also succeeded in making the transition to modern banking speedily. Those notable houses of *ryogae* in Edo and Osaka were commissioned by the Shogun's government, *bakufu*, to sustain the Shogunate system, most significantly by the making of direct loans to the *bakufu* and domains and the exchange of old coins for new at the time of recoinage. In the loans business, *ryogae* houses in Osaka were much more heavily involved than their colleagues in Edo. Some of the *ryogae* houses, notably Mitsui, regarded such lending as very risky and they believed that many merchants failed because of such loans.<sup>2</sup> When a further issue of new coinage was necessary, the *bakufu* specially appointed the prestigious *ryogae* houses, including Mitsui in Edo and Konoike and Sumitomo in Osaka. Mitsui was also privileged to handle the *bakufu*'s money in Edo, Kyoto and Osaka.<sup>3</sup> What is important in terms of present-day Japanese banking is to examine the role of the *ryogae* as antecedents of bankers today and to investigate that part of their business which was done on genuine banking principles.

The resources which the *ryogae* had at their command consisted of their

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own money and that entrusted to them by others. *Ryogae* operated with caution and circumspection. Even if father and son were operating independently, they would not disclose any details of their monetary transactions to each other. Whether or not a *ryogae* could increase his capital depended upon his willingness to pay interest on money deposited and his skill in negotiating an interest rate favourable to him as lender and yet satisfactory to his client as borrower. Japan had a very long history of paying interest on deposits, a practice which originated earlier in the business of the *doso* during the mid-fifteenth century.<sup>4</sup> It is, therefore, not surprising that interest payable on deposit became a very common practice during the Edo period. Of course enterprising *ryogae* offered rates of interest according to the length of time and the amount of deposits. By the mid-nineteenth century, towards the end of the Shogunate period, customers were offered two types of accounts, current and deposit.<sup>5</sup>

Innovation in deposit-taking at the very end of the Shogunate regime resulted in the establishment of two important proto-banking concepts. Deposit interest was directly related to the availability of interest previously levied on borrowers. Profit from such business came from the difference between deposit and lending interest rates and was in modern terminology the 'banking margin'. The idea was explicitly put forward by Zenjiro Yasuda, an important *zeni ryogae* merchant during the last decade of the Shogunate regime, who wrote:

We lend at the lowest at 5 sen and take money in at the highest at 1 sen 6 rin. Then you can earn 3 sen 4 rin if you loan out conservatively at 5 sen. If you like to be more aggressive, you can give at 8 sen 3 rin money which you have taken in at 1 sen 6 rin.<sup>6</sup>

Another important banking concept, based on a long experience of deposit management, was the deposit reserve ratio. *Ryogae*, proto-bankers in Japan, were well aware of how much deposit money could be set aside for withdrawals by depositors. An ex-*ryogae*, questioned in 1900 by a committee organised by the Osaka Chamber of Commerce, explained that:

We kept in our safe as much sum of deposits as possible. The sum was not less than one-fourth of the total deposits.<sup>7</sup>

On the basis of the two concepts the *ryogae* devised many methods, which enabled them to operate useful and profitable businesses.

In this type of banking two sorts of instruments were vital, the *ryogae*'s note and the depositor's order. The note was issued by the *ryogae* as a receipt for money deposited. It was the *ryogae*'s promise to return the sum deposited either on demand or with notice. The depositor had the right to issue an order signed by himself for any sum up to that of his deposits, and this was in fact a cheque in modern banking terminology. Both instruments

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were transferable as means of payment among merchants known to each other. Throughout the Edo era, the order was much preferred to the note mainly because it could carry any sum up to the amount of deposits, or even beyond, as will be discussed shortly. This wide circulation of the order had another advantage, because each time it changed hands the order was usually endorsed by the former bearer. Therefore in case of difficulty or insolvency, the liability could be traced through each endorser.

*Ryogae* usually allowed their customers to negotiate an overdraft. As another ex-*ryogae* explained:

When the issuer's account does not have sufficient funds, an order issued against this account will be stamped but will not be honoured. It is not the case that the *ryogae* has agreed to allow the issuer to overdraw his account. This overdrawn amount is called an unpaid balance.<sup>8</sup>

The overdrawn order was of course transferable too. As a result the order inevitably came into the possession of other *ryogae* with whom the original issuer was not necessarily in direct contact. In this case the transaction had to be concluded through exchanges between the two houses. The transfer of the overdrawn order effected three kinds of transactions. It was, firstly, a loan as the issuer was allowed to overdraw his account; secondly, a payment from a merchant to another; and, finally, the clearing of bills among *ryogae* as the order was eventually returned to the house of *ryogae* against whom it was initially issued.

The order and overdrawing were thus of vital importance for banker–customer relationships. Inter-*ryogae* relationships were also based upon these two facilities, for those of smaller resources, the ‘sons’, were usually dependent upon larger *ryogae*, the ‘fathers’, and this came to be called the father–son *ryogae*. This hierarchical relationship involved every house for no one could remain independent in such a system. It was a remarkably sophisticated financial world, as was explained:

A small *ryogae* X, having resources of only 10,000 *ryo* but having [over]drawn his account with his fellow *ryogae*, will have to issue another order against his friend *ryogae* Y. If Y has not sufficient sum to meet X's order, he then will have to overdraw his account with fellow Z, who, if having not enough, will in turn overdraw his account on fellow W. This overdrawing connection eventually reaches the father *ryogae* who settles transactions daily and prevents any inconveniences from arising. In one extreme case, a *ryogae*, with a basic resource of 10,000 *ryo*, issued overdrawn orders of 60,000 to 70,000 *ryo*.<sup>9</sup>

In this case, Y was the ‘father’ *ryogae* and X the ‘son’. The ultimate ‘father’ was the house coming at the top of this line. This relationship can easily be seen in modern banking, as present-day interbank lending operates on a similar basis. In reality the ultimate heads were the *jūnin ryogae* in Osaka

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and three houses of *hon ryogae* in Edo. The groups of 'fathers', the last resort for the 'sons', effectively played a role in central banking, probably without any pecuniary charges, as they guaranteed the payments and cleared the balances among themselves.

The roots of modern Japanese banking lie in *ryogae* business which had already embraced the concept of the deposit reserve ratio, allowing full use of surplus money. The surplus was utilised by being supplied to customers and fellow *ryogae* through allowing them to issue orders. Deposits in one *ryogae*, without really being transferred, formed another sum in another *ryogae*'s account. This was in fact credit creation, the core characteristic of modern banking. Both overdrafts and fictitious orders were typical examples of credit creation. Thus in business terms the parallels between *ryogae* and modern banking are not hard to find.

The link between *ryogae* and modern Japanese banking is very strong. Of the six great Japanese banking houses during the second quarter of the twentieth century, Mitsui, Yasuda, Sumitomo and Sanwa can claim direct descent. Konoike was one of the most celebrated *junin ryogae* in Osaka, establishing the Konoike Bank in 1897 and later merging with two other banks in 1933 to form Sanwa Bank. Sumitomo, or Izumi, an Osaka house which had, also in Shogunate times, opened an office in Edo, founded Sumitomo Bank in 1895. The house of Mitsui in Edo was, as early as 1871, calling itself Mitsui Gumi Bank and by 1876 had emerged as Mitsui Bank. Daiichi Bank, now Daiichi Kangyo, was a joint venture of Mitsui and other *ryogae* houses while being strongly supported by the Meiji government. Only Mitsubishi was an entirely new foundation, although the founder, Yataro Iwasaki, had learnt *ryogae* business as a clan businessman in Nagasaki<sup>10</sup> and it also absorbed some of the *ryogae* tradition from four banks with which it merged in the 1930s.

It should be noted that although the common people did not use the money merchants they had other financial facilities for their modern needs. Through the *mujin* or *tanomoshiko*, or in western terminology 'mutual loan association', the common people in the pre-modern period could obtain financial services. The *mujin* had its origins as early as the thirteenth century and lingered on well into the twentieth century when it adapted itself to the modern banking system. As we will see in due course, the *mujin* became an indispensable part of the Japanese banking system by the second quarter of the twentieth century.<sup>11</sup>

It was fortunate that the system of banking instituted by the *ryogae* merchants was available over the turbulent years of the Restoration. After 1868 Meiji officials attempted to find a way forward for Japanese banking. After several false starts and much experimentation, some of it disastrous, the Bank of Japan was founded in 1882, on which the modern Japanese

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banking system grew. But the ideas and principles upon which *ryogae* had relied were neither invalidated nor denied. Such was the situation in Japan as far as the banking system was concerned. It would, therefore, not be at all easy for the forthcoming western bankers to deprive *ryogae* of their long-standing customers.

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## 2 A bankrupt regime, 1859–1866

On 3 August 1858, a day before the proclamation of the successor to Iyesada, Shogun XIII, who was dying, a small, lightly armed British squadron under the command of James Bruce, Earl of Elgin and Kincardine, left Nagasaki for Edo.<sup>1</sup> A Dutch consul resident in Deshima in Nagasaki had informed the Japanese that the British had bombarded South China Canton<sup>2</sup> and were on their way to confront Japan, but it must be doubted that the *bakufu*, struggling for a way out of a grave political crisis, understood the implications of this information. What the Dutch consul really wished to convey was the fact that although the Americans had been the pioneers forcing their way into Japan, it was the British whom the Japanese had most to fear at that time. Even Lord Elgin, a modest man, would have been astonished and piqued to know that the *bakufu* government did not know who he was, or that he represented the then most powerful nation. The Japanese recognised that they had to negotiate to comply with his demands, that is all.<sup>3</sup>

On 12 August 1858, Lord Elgin on board the *Furious*, ‘from which the main-deck guns had been removed’,<sup>4</sup> penetrated deep into Edo bay, casting anchor off Shinagawa which was a mere four miles away from the seat of power at Edo castle. He was accompanied only by the *Retribution* and the *Lee*, together with a steam yacht – a gift for the Japanese Emperor. Elgin was supremely confident in himself and in the nation he represented and, without hesitation, he sailed north to the Bay of Tokyo. The American Townsend Harris had been forced to sign the treaty of 1858, of which he was so proud, on a spot off Koshiba, twenty-six miles south of Shinagawa. In 1853 the American squadron, led by Commodore M. C. Perry, had anchored off Uraga further round the Miura peninsula. Nevertheless Elgin’s position was not recognised in Japan. The *bakufu* government only knew that the foreigners were hammering at their gates, that they did not have the guns to scatter them, and that they had no option but to comply. The Japanese made five treaties ‘of amity and commerce’ in the space of ten weeks.

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The British party stayed in Edo between 12 and 26 August 1858, when Lord Elgin signed the British treaty. He then left. Was Elgin the only western signatory to a treaty with Japan to worry over the consequence of his actions?<sup>5</sup> On the Japanese side, by signing these foreign treaties, the government had signed its own death warrant. There was to be nearly a decade of confusion and upheaval out of which was to come the new Japan. The same day that Elgin cast anchor off Shinagawa, the *bakufu* began the search for the next Shogun. The list included two names from the three Houses, members of the Tokugawa family,<sup>6</sup> that is, Iyemochi Tokugawa and Yoshinobu Hitotsubashi.<sup>7</sup> The former won. It was Naosuke Ii who led the government in the crucial process of selecting the Shogun and of course in concluding the treaties with the westerners. All his policies aroused furious opposition in Edo. In Kyoto, the Emperor, isolated and ignorant of the reality of the threat from the West, angrily rejected all talk of foreign treaties. From mid-October 1858, a few days after the conclusion of the treaty with the French, the *bakufu* embarked upon a large-scale suppression of their opponents, later to be named after the Japanese era title, the Ansei purge. The purge continued throughout the year of 1859, and the *bakufu* arrested more than a hundred activists, of whom ten were executed. It was against this terrible background that the *bakufu* opened the three treaty ports of Nagasaki, Yokohama<sup>8</sup> and Hakodate to the westerners in July 1859.

In March 1860, a band of masterless *samurai*, mainly consisting of those who had deserted Mito domain and were infuriated by recent events, assassinated the regent minister, Naosuke Ii. The main stream in the administration which had believed that the *bakufu* could still survive recognised, with the death of Ii, that a fundamental change in their policies was essential. Searching around for compromise, the idea emerged of drawing the Shogunate closer to the court, an idea sometimes expressed by scholars in Japan. Fortunately for the *bakufu*, the idea had potential as the new Shogun – Iyemochi – was, at the age of fourteen, unmarried and pliable. The negotiations, which were ultimately successful, started immediately and continued for eighteen months. At the end of 1861 Emperor Komei, father of future Emperor Meiji, agreed to send his sister Princess Kazu to Edo to marry the Shogun. The wedding ceremony, a brief celebration in March 1862, did nothing to quell the disturbances and upheavals elsewhere in Japan.

Not unexpectedly the opening of treaty ports provoked trouble between xenophobic *samurai* and the westerners. In September 1862, a British merchant in a party on an afternoon excursion outside Yokohama, deliberately crossed the Satsuma procession and was killed by Satsuma warriors. There were two other British wounded. In the ensuing confrontation Satsuma refused to apologise, punish the murderers, or pay an indemnity. This