

## Special Issue on Contemporary Japanese Economy and Financial Markets

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Japan has been experiencing serious economic and financial difficulties since the 1990s. However, Japanese economy is still the second largest in the world, preceded only by the United States. Therefore, the performance of the Japanese economy significantly affects the world, particularly Asian countries. Furthermore, Japanese experiences in the 1990s are valuable for international readers because of the following reasons. First, Japan experienced serious financial crises in the 1990s. Unfortunately, Japan's non-performing loans were exceptionally large. Therefore, understanding what caused the disastrous financial situation in Japan and how Japan has tried to solve the financial crises is instructive for countries wishing to avoid these problems. Second, Japan is said to be the first country to struggle with prolonged deflation. With the end of Cold War, many countries are facing the risk of deflation nowadays. Therefore, how the Bank of Japan has conducted its monetary policy in the deflationary economy is an important example for all central bankers and those interested in monetary policy.

Now, it is notable that current Japanese economic and financial system is quite different from a decade ago. This special issue aims to discuss the current features of the Japanese monetary policy and financial system. Six papers consist of this special issue. Five of these papers cover banks, security firms, mutual funds, public financial institutions, and non-bank finance-related companies. And one paper deals with a current monetary policy issue. Here, we briefly summarize these papers.

Professor Kondo investigates how Japanese banks did change or did not change their lending behavior in the post bubble period. It is well known that Japanese banks as well as financial authorities failed to recognize in the early 1990s how serious the financial difficulties that Japan faced were. Consistent with this common argument, Professor Kondo finds that banks continued to lend huge funds to real estate companies and construction companies in the early 1990s in spite of the fact that the burst of the bubble economy had seriously damaged these companies. In the late 1990, however, banks changed

their lending behaviors and decreased loans to such financially troubled firms. This paper provides an evidence to show the sluggish response of Japanese banks to the burst of the bubble economy.

Professors Harimaya and Okuyama investigate how the cost efficiency of Japanese securities firms changed during the financial reform from 1999 to 2002. Their paper is unique in terms of the following reasons. First, they consider not only traditional securities companies, but also the online securities companies, which employ a quite different business model from traditional ones. Second, they estimate cost functions by using an advanced statistical technique. Namely, the generalized translog cost function, which can take zero outputs into consideration, is used. Third, as their sample period is the time that so-called Japanese Financial Big Bang was conducted, their research can shed light on the effect of this Big Bang reform on efficiency of securities companies. The paper finds that the economy of scale was observed for online firms, while it was only weakly observed for major firms. Also, about half of the online firms enjoyed product-specific economies of scale in terms of brokerage commissions.

Professor Fujiwara investigates the efficiency of the mutual funds. In the United States and European countries, so-called closed-end fund puzzle has often been observed. Unfortunately, as Japan prohibited the closed-end fund until 1998, there are few studies on the closed-end fund puzzle in the Japanese financial market. Professor Fujiwara overcomes this data unavailability by considering an Exchange Traded Fund (namely, the Nikkei 300 ETF). First, he finds that Japanese ETF's share price was sometimes significantly different from its fundamental value. Second, he finds that the non-arbitrage condition was not satisfied regarding the Nikkei 300 ETF. Finally, he suggests that the Investor Sentiment Hypothesis is consistent with the Japanese data.

One feature of Japanese financial system is the fact that public financial institutions play an important role. However, public financial institutions are criticized because of their inefficiency and their privileges as government institutions. Currently, the Koizumi Cabinet is making efforts to reform the public financial systems. In this issue, Professor Nishigaki discusses the recent reform of public financial institutions. He first explains the features of the traditional public financial system and its problems. Then he provides an analysis on the fundamental reform in 2001. Although he agrees that the 2001 reform was remarkable in terms of improving efficiencies and transparency regarding the public financial system, he maintains that there remain many issues to be solved. Particularly, he points out that although the change from direct loans to credit enhancing as a tool of public financial system is desirable, low ability of Japanese banks to screen potential borrowers and huge government debts will be obstacles in promoting this change.

Professors Uesugi and Yamashiro investigate the role that general trading companies (Sogo Shosha in Japanese) play in small business finance. They point out that, although banks have dominated Japanese financial activities, general trading companies hold significant amount of loans to small firms in

order to expand the non-financial business transaction channels. As the Japanese government currently attempts to decrease the economy's reliance on the banking sector, it is timely to understand how non-bank financing works in Japan. The authors find that although the trade credit components have changed significantly, trade finance is still used as a tool for promoting non-financial transaction business. That is, this paper provides an evidence to support the transaction view of trade credit. More interestingly, they find that although trading company finance and bank loans used to be substitutes in the 1970's, they are now complementary to each other. They discuss why this change occurs, but we admit that further research on this topic is very important because it will develop our knowledge on the specialty of banks.

Finally, Professor Kurihara investigates recent Japanese monetary policy. Struggling with unprecedented deflation, the Bank of Japan adopted several untraditional methods. Particularly, Professor Kurihara tries to empirically evaluate the effectiveness of the quantitative easing, which has been adopted since March 2001. In spite that some economists do not believe the quantitative easing policy is a cause of recent economic recovery, Professor Kurihara finds that the policy has been effective in terms of accelerating economic growth. Furthermore, he discussed how to conduct monetary policy in the 21<sup>st</sup> century.

Of course, only six papers cannot cover all important issues that Japan faces. However, we believe that these papers significantly contribute to the international understanding of contemporary Japanese economy and finance.