Public Banking in Germany and Japan's Fiscal Investment and Loan Program: A Comparison

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Abstract

The Japanese Fiscal Investment and Loan Progam (FILP) will be fundamentally changed in April 2001. We are comparing the pre- and post-reform Japanese system with the German system of policy-based finance and we have found that the German system is quite different. In the case of the Kreditanstalt für Wiederaufbau (KfW) and other German federal and state institutions, the loans are mainly made through private banks, while the Japanese government banks lend directly to companies or households. Our paper discusses the advantages and the disadvantages of these two systems. We also consider the guarantee systems, which supplement and substitute public sector loans, and it turned out that in Japan there are moral hazard problems within this framework.

Apart from this we also look at the role of public financial institutions outside their role in policy-based lending and investment. Here our focus is on postal savings in Japan and on the savings banks, which are both collecting a large share of personal savings, as well as on the Landesbanks in Germany. The cutting of the flow of postal savings and government pension funds to the FILP system, which is planned within the framework of the FILP reform, makes the Japanese system more market compatible and more similar to the German system of policy-based finance, but the differences in the ways of lending and in some other institutional parameters remain.

Keywords

banking, Fiscal Investment and Loan Program, Germany, guarantees, Japan, off-budget activities, policy-based finance, postal savings, public banking, public enterprises, public finance, public sector banks

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Introduction

Governments influence economic behaviour not only through the budget (taxation, explicit subsidies etc.) and through regulation. They also engage in a number of off-general-budget activities which should not be neglected when analysing the role of government. Through public enterprises and other institutions they participate directly in a number of business activities, some of which can and others of which cannot be provided by the market.

The role of the government in banking has recently received great attention in both Germany and Japan. In Germany it has mainly been the Landesbanks whose support through guarantees by the German states (*Länder*) has been subject to severe criticism by the European Commission. In Japan a fundamental reform of the Fiscal Investment and Loan Program to come into force in April 2001 was approved by the Diet in May 2000. The aim of this paper is to give an overview of the banking activities of the German and the Japanese governments and to compare them. In order to be able to assess their importance, we introduce them on the background of the relevant financial markets. We therefore start with a description of the German and the Japanese banking systems. Only then we start comparing the structures and the importance of public sector banks in the two countries. Special emphasis is laid on the sources of funds and their allocation including the financing of different levels of government. We also touch upon guarantee systems which supplement and substitute public sector loans. Loans from the European Investment Bank, which also extends loans to Germany, are outside the scope of this paper.

The German and the Japanese Banking Systems

The German system is a universal banking system. This means that most of the German financial institutions (from here on banks) offer commercial banking and securities companies services. Therefore, when entering the Japanese market, they usually established two subsidiaries (a bank and a securities company). Apart from universal banks there are also specialist banks in Germany, but at the end of 1998 the universal banks accounted for about two thirds of all assets of non-insurance financial institutions in Germany. The universal banks can be divided into three groups: private commercial banks, savings banks and cooperative banks. Specialist banks are the mortgage banks, banks with special functions, building and loan associations and others (see Fig. 1).

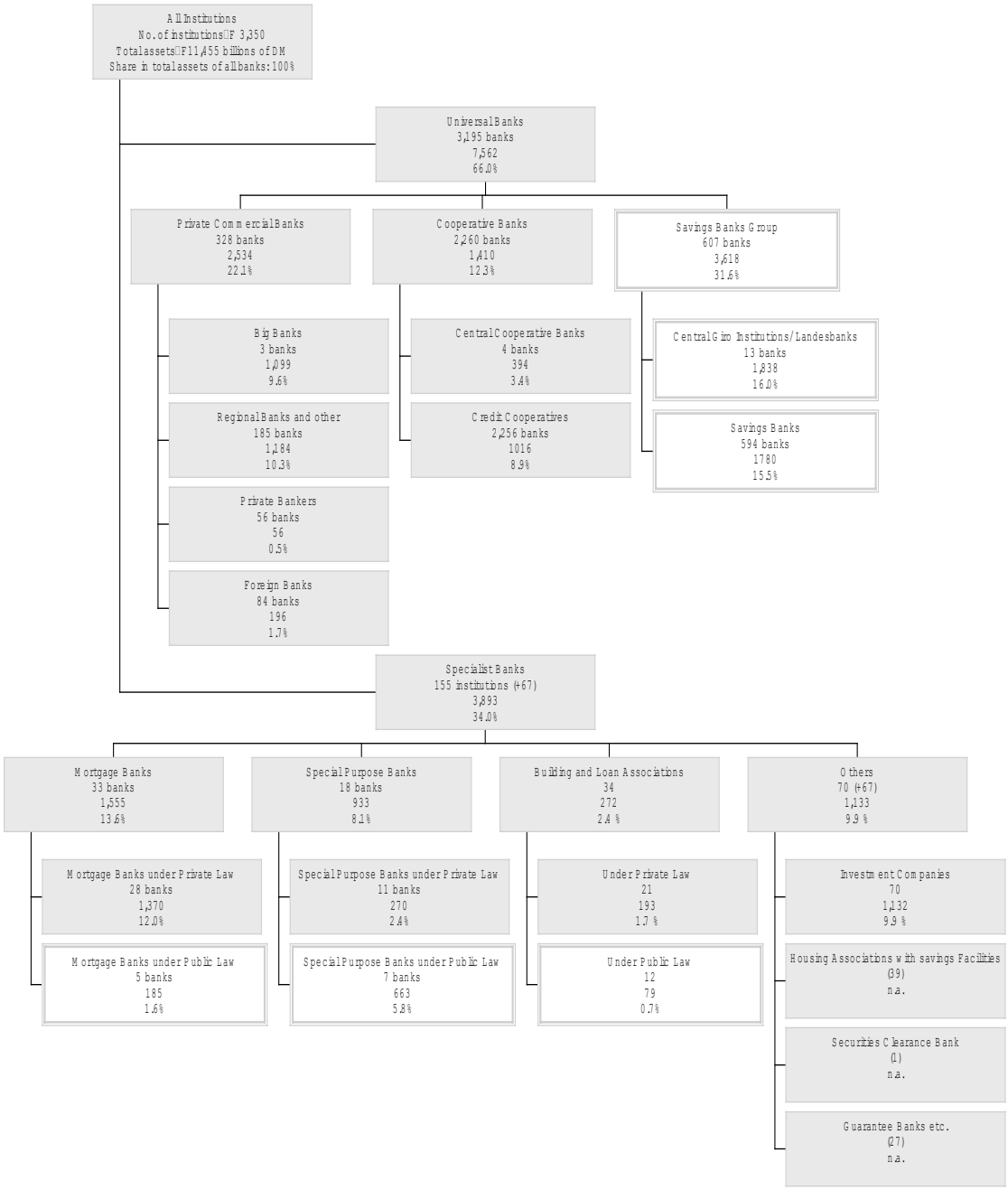
The Japanese banking system used to be a largely divided system. However, there is a strong tendency towards a de facto universal banking system, especially since the revision of the Banking Law in 1993 allowed banks[1] to conduct trust business through their trust banking subsidiaries and securities business through their securities businesses with permission of the Minister of Finance. Since then mutual entries among banking, trust and securities businesses have grown through the establishment of subsidiaries and through acquisitions. As in Germany, there are also cooperative financial institutions (see Fig. 2).

According to German law German banks are divided into three groups: banks based on private law, banks based on cooperative law and banks based on public law (banks based on public law are set off by a double line in Fig. 1). It is important to point out that among the specialist banks based on private law there are banks where the federal or state governments have a considerable influence on business activities through ownership rights (as in the case of Investitions- und Strukturbank Rheinland-Pfalz) or institutions that have been assigned public sector roles (e.g. Ausfuhrkreditanstalt). While the second of the two named institutions can still be considered a private financial institution, that is hardly the case for the first one.

In Japan the division is similar, but much clearer. The government financial institutions are established individually through special laws for each of them and before the recent rescue packages and the temporary nationalisation of the Long-Term Credit Bank in 1998 (and some other banks later on), there was no government participation in banks based on the Banking Law. There is government participation in another bank apart from government financial institutions — in the Central Bank for Commercial and Industrial Cooperatives (Shoko Chukin Bank), which was also founded on the basis of a special law. But apart from this bank and the recent changes, which have to be seen as measures to stabilise the Japanese financial system and which in the long run will probably be eliminated, there has been no direct central government intervention with the financial institutions outside the government financial institutions through ownership. Of course there were other forms of intervention by the government bureaucracy, such as through administrative guidance practices.

[1] Please note that the term bank (*ginkou*) in Japanese is limited to a much smaller range of institutions than in Germany. Agricultural cooperatives, for example, are not allowed to use this term in their names.

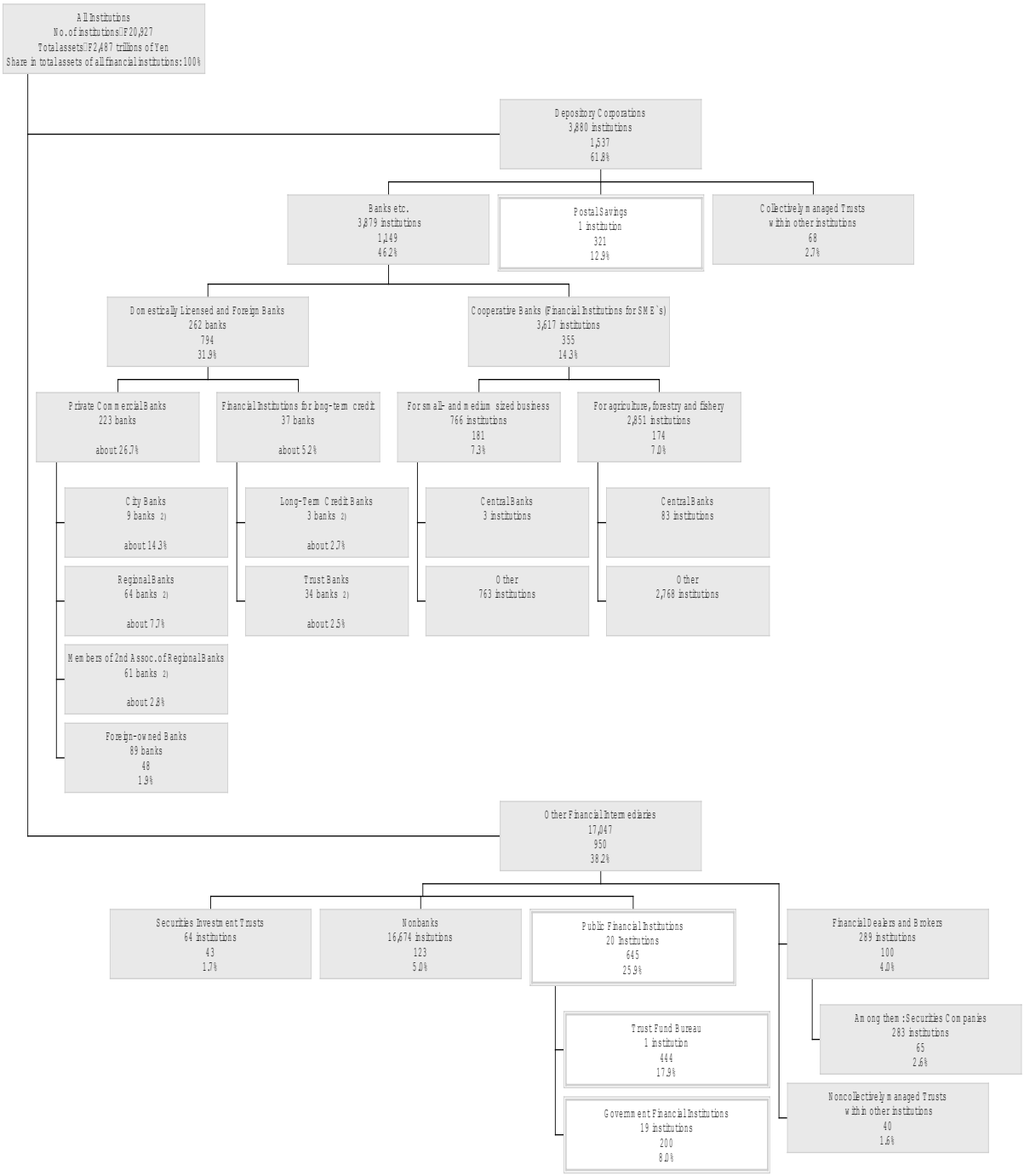
Fig.1 German Non-insurance Financial Institutions (as of 31.12.1998)



Source: Deutsche Bundesbank, Bankenstatistik, Kapitalmarktstatistik, Banken-Jahrbuch, estimate by the authors

Notes: 1) Excluding Deutsche Bundesbank (central bank) and subsidiaries of German banks abroad (The largest assets abroad are concentrated with the big banks, the regional banks, other private commercial banks, and the Landesbanks).
2) Special purpose banks under private law include the Postbank AG, Deutsche Bau- und Bodenbank, Deutsche Verkehrsbank AG, etc.
3) The total assets of mortgage banks under public law and special purpose banks under public law were estimated by adding total assets of each institution what slightly overstates their total assets.
4) The total assets of mortgage banks under private law and of special purpose banks under private law were estimated as the difference.
5) The building and loan associations under public law include nine institutions which are legally a part of a Landesbank.
6) Savings banks include six savings banks under private law.

Fig.2 Japanese Non-insurance Financial Institutions (as of 31.3.1999)



Source: BOJ Financial and Economic Statistics Monthly, Statistical Yearbook of Japan

Notes: 1) Excluding Bank of Japan (Central Bank) and Financial Auxiliaries (institutions that guarantee financial instruments, stock exchanges, clearing houses and foreign exchange brokers).
2) The numbers of domestically licensed banks (City Banks, Regional Banks, Members of the 2nd Association of Regional Banks) and of financial institutions for long-term credit are as of 31.12.1998.

Private Commercial Banks

The banks belonging to this group are all based on private law. In Germany the group consists of the big banks (until 1998 Deutsche Bank, Dresdner Bank and Commerzbank, starting from 1999 the Bayerische Hypo- und Vereinsbank is also included into this group), regional and other commercial banks, private bankers, and foreign banks. The big banks are well-known and there is no need to address them in detail. The regional banks and the other commercial banks take the legal form of joint-stock corporations, partnerships limited by shares or limited liability companies. But the grouping under regional banks does not necessarily mean that these banks are all small or only limited to a certain area. Among them there are quite a number of banks acting in the whole of Germany and even abroad, such as the BFG Bank or the BHF Bank. Private bankers are legally organised as partnerships or as sole proprietorships, but their numbers are decreasing. Since 1976 the Banking Act no longer permits the establishment of new banks as sole proprietorships. The importance of private bankers is declining, and starting from 1999 they have been included in the group regional banks and other commercial banks in the banking statistics of the Bundesbank.

In Japan this group includes the internationally renowned city banks (Tokyo Mitsubishi Bank, Daiichi Kangyo Bank, Sumitomo Bank, Fuji Bank, Sanwa Bank etc.). There are strong concentration tendencies among them and with other banks. As of May 2000, the 16 leading commercial and trust banks planned to form four financial groups — the Mizuho financial group (Industrial Bank of Japan, Daiichi Kangyo Bank and Fuji Bank), the merger of Sumitomo and Sakura Bank, the multiregional alliance of Sanwa and Asahi Bank and the Mitsubishi banking group consisting of the Tokyo-Mitsubishi Bank, the Mitsubishi Trust Bank and Nippon Trust (Handelsblatt 26./27.5.2000). Even if not all of these plans materialise (Asahi Bank, for example, has announced that it will not join the multiregional alliance), it is especially interesting that some of these mergers cross the borders of the large business groups (*keiretsu*). The two types of regional banks are also organised under the Banking Law but they possess historically different roots. While the regional banks are the remains of historical attempts of the government to have one regional bank per prefecture, the members of the Second Association of Regional banks stem from the "*mujin*" companies which were similar to the German building and loan associations in the sense that they first collected deposits and later made loans to persons who had previously deposited money with them. Then

the "*mujin*" companies developed into Sogo Banks which, starting from 1989, have gradually changed into ordinary banks.

Table 1 The Largest 20 Banks in Germany (at the End of 1998)

	Name of Bank	Total Assets (Millions of DM)	Type of Balance [1)]	Number of Employees (Yearly Average)	Bank Group [2)]
1	Deutsche Bank [3)]	1,225,530	KA IAS	75,306	Big banks
2	Bayerische Hypo- und Vereinsbank	901,119	KA IAS	39,447	Regional banks [4)]
3	Dresdner Bank	714,808	KA IAS	48,948	Big banks
4	Westdeutsche Landesbank	693,026	KA	14,072	Landesbank
5	Commerzbank	638,014	KA IAS	26,971	Big banks
6	Bayerische Landesbank	475,239	KA	7,259	Landesbank
7	DG Bank Deutsche Genossenschaftsbank	439,716	KA	11,872	Cooperative bank
8	Landesbank Baden-Württemberg [5)]	433,763	KA	9,931	Landesbank
9	Bankgesellschaft Berlin	369,141	KA	16,673	Commercial bank
10	Kreditanstalt für Wiederaufbau	315,014	EA	1,742	Special purpose bank
11	Norddeutsche Landesbank	297,130	KA	7,080	Landesbank
12	DePfa Deutsche Pfandbriefbank	236,038	KA	1,919	Mortgage bank
13	Landesbank Hessen-Thüringen	206,526	KA	3,015	Landesbank
14	Landesbank Schleswig-Holstein	196,159	KA	4,227	Landesbank
15	Landesbank Berlin	176,020	EA	7,693	Landesbank
16	Deutsche Hyp Deutsche Hypothekenbank	169,540	EA	1,174	Mortgage bank
17	Landeskreditbank Baden-Würtemberg [5)]	156,835	KA 1997	2,215	Mortgage bank under public law
18	Deutsche Siedlungs- und Landesrentenbank	143,717	KA	717	Special purpose bank [6)]
19	Hamburgische Landesbank	139,733	KA	2,134	Landesbank
20	DGZ Deka Bank - Deutsche Kommunal-bank	120,253	KA	1,677	Landesbanks group

Notes: [1)] KA stands for group balance and EA for single institution balance. KA IAS stands for group balance according to IAS standards

[2)] The bank grouping is the grouping according to the Banking statistics of the Bundesbank as of 1998.

[3)] The Deutsche Bank acquired Bankers Trust in 1999.

[4)] Starting from 1999 Bayerische Hypotheken- und Vereinsbank, which was formed as the result of the merger of Bayerische Vereinsbank and Bayerische Hypotheken- und Wechselbank in 1997, is included in the group of big banks. Like its predecessors it is a mixed mortgage bank (see below).

[5)] The Südwestdeutsche Landesbank, the Landesgirokasse Baden-Württemberg and the market part of the-Landeskreditbank Baden-Würtemberg have merged to form the Landesbank Baden-Würtemberg in 1998.

[6)] Starting from 1999 included in the group regional banks and other commercial banks. Merged with Postbank in May 2000.

Source: Banken-Jahrbuch 2000

Cooperative Banks

More than 70% of all German banks are cooperative banks, but when excluding the four central cooperative banks, all of them are small. Historically they emerged in the 18th century as a self-support cooperative organisation at a time when craftsmen, small businesses and peasants could not get enough capital from capital markets. For many years they were developing independently as credit associations for craft and industry (*Volksbanken*) and agricultural credit associations (*Raiffeisenbanken*), but in 1972 they merged into one organisation. Until 1974 they were allowed to extend loans only to their members. This is why the credit associations are traditional lenders to small

businesses. The savings banks and the private commercial banks have also entered the small business loan market, but the credit associations still have a considerable share of this market (more than 22% of lending to personal enterprises at the end of 1998). One reason for this is that owners and borrowers are identical groups. Therefore the credit associations are the banks with the closest personal relations to their customers. Perhaps thanks to these personal relations they also have good monitoring.

In Japan the division of cooperative financial institutions into institutions for small business and for agriculture, forestry and fishery still exists. The establishment of the first credit cooperatives at the turn of the century were inspired by the model of the German cooperative banks and, after the establishment of the first cooperative financial institutions, a law modeled on the German example was adopted in 1900. There have been many changes in legislation since. Nowadays the cooperative financial institutions consist of five groups: agricultural cooperatives, fishery cooperatives, credit cooperatives, credit associations and labor credit associations. In contrast to the other cooperative financial institutions, the credit associations (*Shinkin banks*) can freely accept deposits from non-members, but their business is limited to their (relatively small) local area of activity.

Both in Japan and in Germany cooperative financial systems are three-tier organisations with central cooperative banks, intermediate level institutions and the cooperatives themselves. In both countries thanks to their large numbers of branches they attract a considerable share of personal savings.

Postal Savings in Japan and their German Equivalents: The Savings Banks and the Postbank

Postal savings were established in Japan in 1875 based on the British model in order to encourage savings by the population. While banks concentrate their branches in urban areas, post offices are located all over Japan. Using the more than 24,500 post offices as branches for accepting deposits and other services, postal savings collect a considerable share of personal savings (19% as of 31.3.1999, for the structure of personal savings in Japan and in Germany see table 2). But it is more than this. Postal savings are offering a competitive product. *Teigaku* (fixed amount) savings account for 82% of all postal savings deposits (as of 31.3.1999). There are several factors apart from the numbers of

branches that explain the success of this product:

1) *Teigaku* savings have a fixed interest rate for up to ten years and are thus attractive when interest rates are expected to decline. Moreover, since withdrawals can be made without penalty after the first six months, they are often compared to a "put" option.

2) Postal savings enjoy a government guarantee.

3) The liberalisation process of interest rates of the private financial institutions was completed only in 1993 while the setting of interest rates for postal savings was done by the Ministry of Post and Telecommunication independent of the regulations for the private financial institutions. It was only in 1994 that the Ministry of Finance and the Ministry of Post and Telecommunications agreed that postal savings deposit rates would be set close to those of the private banks.

4) Along with the economy of scale resulting from the huge network of branches and the large volume of deposits, the post office also offers other services such as the traditional postal services and postal life insurance services. Therefore there exists an economy of scope while other institutions doing banking business are not allowed to do insurance business at the same time.

Also, postal savings enjoyed advantages through a de facto special treatment in income taxation of funds deposited with postal savings because of a lax enforcement of the limitations of the *maruyu* system, which allowed exemptions from income taxation of interest income from savings deposits, up to certain limits determined by the government until its abolishment in 1988.

Table 2 The Structure of Personal Savings in Japan and in Germany

	Personal Savings in Trillions of Yen	Percent		Personal Savings in Billions of DM	Percent
Cash and demand deposits	136.8	10.4	Cash and demand deposits	500.4	8.8
Time deposits	584.2	44.4	Time deposits	363.5	6.4
			Savings deposits	1193.5	21.0
			Deposits with building and loan associations	178.6	3.1
Insurance and pension reserves	363.9	27.6	Insurance	1261.1	22.2
Investment trust	25.2	1.9	Investment fund certificates	566.2	10.0
Bonds	57.2	4.3	Bonds	762.8	13.4
Shares and other equity	108.3	8.2	Shares	491.7	8.7
Other	40.7	3.1	Other	364.9	6.4
Total	1316.2	100.0	Total	5682.7	100.0

Note: Data for Japan is as of 31.3.1999 and data for Germany is as of 31.12.1998

Source: Bank of Japan Financial and Economic Statistics Monthly and Deutsche Bundesbank Monatsbericht

There have been several changes in the use of funds of the postal savings over time. Under the current system most of the postal savings funds are deposited with the Trust Fund Bureau of the Ministy of Finance and thus serve as the major source of funds for the Fiscal Investment and Loan Program which is subject to the authority of the Diet (for an overview over the current structure of the FILP see figure 5). In April 2001 this system will change to a system based mainly on direct funding of the institutions from the capital markets through guaranteed and non-guaranteed bonds supplemented by borrowing from the new Fiscal Loan Fund Special Account which will issue FILP bonds. Postal savings will then invest their funds themselves in the capital market[2] (for an overview of the new sytem of fiscal investments and loans see figure 7).

In Germany, as in Japan, the financial institution with the most savings deposits[3] is the Postbank, but its share is only about 5% of all savings deposits. Even though most institutions are small, in total the savings banks, which like the Postbank are present in all regions, collect in total 51% of savings deposits (see table 3). Thanks to a reduction of Postbank branches in the last years, the savings banks now have a considerably larger number of branches than the Postbank[4].

Savings deposits with savings banks accounted for more than 10% of total personal savings in Germany at the end of 1998. There are two reasons that can explain this. The first reason is a historical one. Postal savings were introduced in Germany only in 1939, after the annexation of Austria, by allowing the Austrian postal savings system to extend to Germany[5]. Although there had been earlier attempts to introduce a postal

Table 3 Savings Deposits in Germany by Banking Group as of 31.12.1998

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[2] Since 1987 postal savings already invest to some extent in the capital market. Technically this is, however, done through reborrowing of funds from the Trust Fund Bureau.

[3] Savings deposits (*Spareinlagen*) have a share of more than two thirds in bank deposits in Germany. Historically the aim of savings deposits has been to stimulate the collection of savings from individuals and §21 and §22 of the Banking Act try to prevent money that should be used for payment transactions or in business from being put into savings deposits. In more detail:
1) enterprises can have savings deposits only in exceptional cases.
2) transfers and cheque use are impossible from savings deposits.
3) without an advance notice of three months it is impossible to withdraw more than 2000 DM within 30 days from a savings deposit. In order to withdraw more, a notice of withdrawal has to be given three month in advance. In order to receive a better interest rate it is possible to agree to provide notice further in advance (e.g. six months).

[4] In Germany after the savings banks the cooperative banks collect most savings deposits. This is largely attributable to their large number of branches (at the end of 1998 the number of branches according to the groups of banks were: Savings banks: 18,921, credit associations: 18,388, Postbank: 14,703, big banks (big four): 4,357, building and loan associations: 3,206, regional banks and other commercial banks: 2,462, other groups: 961).
A response by the big banks has been the creation of a so-called "cash group" in spring 1998. This group formed by Deutsche Bank, Dresdner Bank, Commerzbank, Bayerische Hypotheken- und Wechselbank and Bayerische Vereinsbank (now HypoVereinsbank) is offering its customers free withdrawal at the approximately 6,000 ATM's of the four banks which is still low when compared to the number of branches of the savings banks, which however offer free withdrawals only within their area and outside it at other savings banks at a reduced rate.

	Savings Deposits in Billions of DM	Percent
Big banks	82.813	6.7
Regional banks etc	64.346	5.2
Private bankers	3.481	0.3
Savings banks	632.295	51.2
Credit associations	367.233	29.8
Postbank	62.576	5.1
Other banking groups	21.427	1.7
Total	1234.171	100.0

Source: Deutsche Bundesbank, Bankenstatistik

savings system in Germany (mainly in 1871 after German unification, in 1878-1885, and in 1928), they were not successful because of fears that postal savings would compete too much with the savings banks. In contrast to this, the savings banks are a very old system with the first institutions dating back to the second half of the 18th century. The savings banks were established in order to give the general public a chance to save in a secure way and to receive interest for it. Later the savings banks have developed more and more into universal banks, but up to now their main business is collecting savings from the people. With the population's savings rising, they started to make loans to industry, but this kind of business has been restricted to their locality. In exchange for this in every region (municipality, district) there can be only one savings bank. But the savings banks do not only have many branches, an old history and close relations to their local area. The savings deposited with savings banks are de facto guaranteed by the local governments[6]. This all encourages savings with the savings banks. But there also is another reason why savings banks collect more savings per branch than the Postbank; their branches are of better quality. While the branches of the savings banks are the similar to those of other banks and offer the full range of financial services including securities business — until 1990 postal savings were offering only savings and money transfer services.

Still, since the split-up of the three postal services in Germany (postal services, telecommunications and postal savings) was decided in 1990 and the name of postal savings was changed to Postbank, this bank has been entering new business areas and developing increasingly into a universal bank offering a wide range of financial services.

[5] Even before this German post offices were offering cash services (since 1872) and transfer services (since 1909).

[6] Nearly all savings banks are under public law, but there are also six savings banks under private law. The largest of them are what are called free savings banks ("*freie Sparkassen*") of the large cities of Hamburg, Frankfurt and Bremen. They differ from public law savings banks since they are not founded by local governments and do not receive the guarantees for their liabilities from them.

For example in November 1993 the Postbank offered the first investment fund and in March 1996 it entered the home loan market. In 1995 the Postbank was transformed into a joint-stock corporation (Aktiengesellschaft) with the government still owning 100% of its stocks. Privatisation and initial public offering were planned, but have been postponed on a number of occasions. Under the new government of the Social Democrats (SPD) the Postbank at the beginning of 1999 has become a 100% subsidiary of Postal Services which are still owned by the federal government, but whose privatisation is planned. Entering new areas of business is strengthening the competitiveness of the Postbank. However, until 1990 the Postbank did not have much lending and monitoring experience since its funds were mainly used for the telecommunications business, which had also been part of Postal Services. Even now this has consequences for the balance sheet: at the end of 1998, 56.5% of all assets of the Postbank were loans to other financial institutions and about another 21% were bonds. Apart from this there are very few loans (1.7% of total assets are loans to local governments, other loans are increasing, but are still at only 3.7% of total assets). In May 2000 the Postbank merged with the DSL Bank. While the Postbank will continue to concentrate on the business with private clients, the DSL Bank will be responsible for building financing for individuals and enterprises as well as for the emission of securities.

All in all both in its history and in its share in personal savings the Japanese Postal Savings are more similar to the German savings banks than to than to the Postbank, whereas on the asset side it is more similar to the Postbank in the sense that it has only a few own loans apart from loans to other financial institutions while savings banks have other business too. But the Postbank is also starting to enter other areas of business and the Japanese Postal Savings will rapidly increase their own fund managment starting in April 2001, when its funds will no longer have to be deposited with the then to be abolished Trust Fund Bureau of the Ministry of Finance. Only the lending to local governments by postal savings will remain subject to a decision by the Diet.

Central Giro Institutions/Landesbanks in Germany

The savings banks emerged more than 100 years ago as independent institutions, but after the proposal for a postal savings system in 1878 and the Bill of Exchange Law of 1908 they started to offer transfer services and to accept bills of exchange. Therefore in

1881 savings banks associations and in 1909 money transfer (giro) associations and central money transfer (giro) banks were established. Parallel to these pure central giro banks there were cases where the already existing state banks (*Landesbanken*) took over the functions of central giro banks. In 1918 the Deutsche Girozentrale (since 1921 Deutsche Girozentrale - Deutsche Kommunalbank) was established as the central giro institution of the central giro banks. Its main functions were to invest free funds of the central giro banks, to promote money transfers of the savings banks, and to lend to local governments. In 1999 it merged with Deka Bank to form the DGZ Deka Bank and, in addition to its original business activities, it offers investment funds which are sold by the savings banks and the state banks (from here on Landesbanks). For long-term fund raising the bank can issue bonds, mainly municipal bonds which are covered by loan claims arising from lending to municipalities and other public institutions.

Through new foundings and mergers the roles of state banks and central giro banks have come to be handeled mostly by the same institutions. Also because of mergers the number of institutions has decreased and institutions that are in charge of more than one *Land* have emerged. Among them there are large institutions such as the Westdeutsche Landesbank (WestLB, see table 4). There are slight differences from state to state, but the main functions of the central giro institutions / Landesbanks are the following: φ central giro institution (*Girozentrale*) for the savings banks, κ state and municipal bank (*Landesbank*), λ universal bank, μ building and loan association (*Bausparkasse*).

The role of φ as a central giro institution for the savings banks is mainly that of a financial intermediary for adjusting the capital surpluses and deficits of the savings banks, lending activities — especially long term loans that exceed the financial capability of a single savings bank —, securities, and others. As an important means for raising long-term funds in the capital market they are issuing bonds. They enjoy the priveledge of issuing mortgage bonds and municipal bonds. But their role as central banks of the savings banks goes further than this. They also support the savings banks in their securities activities, etc. The role of κ as state and municipal banks is their role as policy-based finance institutions. The main areas are lending and offering subsidies to small and medium-sized businesses, housing construction and environmental protection. An example of this are the Investitions-Bank Nordrhein-Westfalen and the Wohnungsbauförderungsanstalt Nordrhein-Westfalen which are both within the WestLB. In some *Länder* such tasks are performed by the Landesbank, in others there

Table 4 Central Giro Institutions/Landesbanks (End of 1998, Millions of DM)

Name of bank	State (*Land*)	Total Assets	Balance Type [1)]	Guarantors / Owners
Westdeutsche Landesbank	North Rhine-Westphalia	693,026 (540,817)	KA (EA)	43.2% *Land* of North Rhine-Westphalia 33.4% Savings banks association of the of North Rhine-Westphalia 23.4% Regional associations of North Rhine-Westphalia
Bayerische Landesbank	Bavaria	475,812 (439,754)	KA (EA)	50% *Land* of Bavaria , 50% savings banks association of Bavaria
Landesbank Baden-Württemberg	Baden-Württemberg	433,762 (388,842)	KA (EA)	39.5% *Land* of Baden-Württemberg 39.5% Savings banks associations of Baden-Württemberg 21% City of Stuttgart
Norddeutsche Landesbank	Lower Saxony Saxony-Anhalt Mecklenburg Western Pomerania	297,130 (217,475)	KA (EA)	40% *Land* of Lower Saxony 26.7% Savings banks association of Lower Saxony 16.7% *Land* of Saxony Anhalt (10%) and savings banks association of Saxony-Anhalt (6,7%) 16.7% *Land* of Mecklenburg Western Pomerania (10%) and savings banks association of Mecklenburg Western Pomerania (6,7%)
Landesbank Hessen-Thüringen	Hesse Thuringia	206,526 (186,114)	KA (EA)	100% Savings banks association of Hesse-Thuringia [2)]
Landesbank Berlin	Berlin	176,020	EA	Guarantor: 100% *Land* of Berlin Owners: 75.01% Bankgesellschaft Berlin, 24.99% state of Berlin (owners of Bankgesellschaft Berlin: 56.8% *Land* of Berlin 17.5% Norddeutsche Landesbank 10.0% Gothaer Holding AG
Landesbank Schleswig-Holstein	Schleswig-Holstein	196,159 (116,521)	KA (EA)	39.9% Westdeutsche Landesbank 25.05% *Land* of Schleswig-Holstein 25.05% Savings banks association 10% Landesbank Baden-Württemberg
DGZ DekaBank - Deutsche Kommunalbank	central bank of the central giro institutions/ Landesbanks	120,253 (110,532)	EA	50% German association of savings banks 50% Landesbanks
Hamburgische Landesbank	Hamburg	139,733 (132,409)	KA (EA)	50.5% *Land* of Hamburg 49.5% Landesbank Schleswig-Holstein
Landesbank Rheinland-Pfalz	Rhineland-Palatinate	107,048 (97,015)	KA (EA)	50% Savings banks association 37.5% Westdeutsche Landesbank 12.5% Landesbank Baden-Württemberg
Bremer Landesbank	Bremen	60,026	EA	92.5% Norddeutsche Landesbank 7.5% *Land* of Bremen
Landesbank Sachsen	Saxony	58,659	EA	50% *Land* of Saxony, 50% Savings banks association of Saxony
Landesbank Saar	Saarland	23,039	EA	Guarantors: savings banks association Saar, *Land* of Saar Owners: 57.3% Savings banks association Saar 25.1% Bayerische Landesbank 17.6% *Land* of Saar

Notes: [1)] KA stands for group balance, EA stands for single institution balance
[2)] The *Länder* of Hesse and Thuringia plan to acquire 10% and 5% respectively of the Landesbank Hessen-Thüringen in January 2001 (Handelsblatt 22.5.2000)

Source: Banken-Jahrbuch 1998

are special purpose banks responsible for them that are independent of the Landesbank. But there are also other institutional arrangements. For example, in some cases even

public law mortgage banks fulfill some of these tasks. It is difficult to get exact and detailed data, but these policy-based finance institutions of the *Länder* are not only engaged in the abovementioned financing of housing, small business and environmental protection, but they also finance technological development, regional projects and education. The role of λ as a universal bank is getting larger and larger and has become the main business of Landesbanks nowadays. Making a profit is not mentioned as a goal, but still in their role as univeral banks there is no observable difference in behavior from the private banks. Moreover, the role of the Landesbanks within German financial markets is large (see Fig. 1 and table 1), overseas business is rising, and the competition with private banks is fierce.

Therefore the private banks are criticising the full liability guarantees of the Landesbanks by their owners (state governments etc.). These guarantees are twofold: firstly the principle of guarantor liability (*Gewährträgerhaftung*), meaning that the public sector owners have unlimited liability for the obligations of the banks, and secondly the principle of institutional obligation (*Anstaltslast*), meaning that the owners are obliged to furnish the banks with the necessary funds so that these would be able to carry out their required functions. Moreover, the private banks accuse the Landesbanks of using funds given to them in their role as a state and municipal bank for their universal banking business and thus of unfair competition. In July 1999 the European Commission decided against the WestLB that the transfer of funds from the Housing Construction Promotion Agency (*Wohnungsbauförderungsanstalt*) to the WestLB, the largest of the Landesbanks, through the merger of the two institutions in 1991 was an illegal subsidy. The argument is that the WestLB has by doing so received additional own capital, 2.5 trillion of German Marks of which were used for other business too. Surveys also show that the rating of the Landesbanks by rating agencies that almost determines the interest rate at which banks can borrow funds on the capital markets, is strongly influenced by the fact that they are subject to government guarantees. This way the government guarantee is becoming a subsidy with a monetary value, and this is an issue for competion policy when the relevant institutions are also involved in normal banking business outside their role as a public policy institution. It is not easy to assess the advantage of the public sector banks through these mechanisms. The European Commision used the concept of a "reasonable private investor" for assessing the magnitude of the subsidy in connection with the capital transfer to the WestLB. Another problem is that larger private financial institutions may also enjoy government

support because they are "too big to fail". A recent example in Germany, though not a bank, is the rescue of the de facto insolvent construction company Philipp Holzmann by granting loans from the Kreditanstalt für Wiederaufbau, a central government policy-based finance institution (for more on this institution see below), and the extension of government guarantees at the end of 1999.

The role of μ as a building and loan association is the collection of savings from individuals willing to build or reconstruct a house or a flat and lending them the necessary funds when their savings have reached a certain percentage of the total costs. This system is encouraged by the government through preferential tax schemes and subsidies. But this is nothing special to the Landesbanks. As can be seen in Fig. 1, private building and loan associations also play an important role in this business (see also the part on building and loan associations below).

Mortgage Banks in Germany

The mortgage banks, which are the largest group among the specialist banks, are mainly engaged in the extension of long-term loans. These loans are refinanced by two types of bonds. The first is mortgage bonds secured by mortgages which the banks have received as a collateral for their loans. There are also two ship mortgage banks. The second is municipal bonds which are covered by loan claims arising from lending to municipalities and other public institutions. Mortgage banks can be divided into two groups based on the legal basis of their business: mortgage banks under private law and mortgage banks under public law. Traditionally mortgage banks under public law have had a substantial role in extending housing loans, but most of these institutions engaged in this business were merged with the Landesbanks and in 1993 the Bundesbank stopped publishing separate data for both groups.

In order to protect the buyers of mortgage bonds, the areas of business of mortgage banks have been limited by the Banking Act of 1899. But banks that were doing both commercial banking business and mortgage bank business before the this law came into forth in 1899 (the so-called mixed mortgage banks) have been exempted from this provision. Today there are only two mixed mortgage banks left — the Bayerische Hypo- und Vereinsbank and the DeutscheHyp Deutsche Hypothekenbank Frankfurt-Hamburg. Although there still may be failures, all in all the security of mortgage banks is relatively high and the fundraising costs for them are relatively low. Therefore the

main universal banks, which are not allowed to do this kind of business have acquired large shares of mortgage banks.

In 1995, as a preparation for the globalisation of capital markets and for European Monetary Union, the mortgage banks under private law created a standard for issuing of so-called "Jumbo mortgage bonds" (later the public law banks also adopted this standard) and have increased their lending to the public sector. In 1996 they started issuing so-called "global Jumbo mortgage bonds" in the United States and in Asia.

In 1996 there remained only one large bank among the public law mortgage banks (the Landeskreditbank Baden-Württemberg), but the business of this bank had for its most part become similar to the business of private banks and at the end of 1998 its market oriented part was merged with two other public financial institutions and is now a part of the Landesbank Baden-Württemberg. The policy-based finance part became an independent institution, which now, like the policy-based finance institutions of most other states, is classified as a special purpose bank. Its main focus is housing loans. Even though this way the largest institution of this group has disappeared, there still is the case of Westdeutsche Immobilienbank which is enjoying the advantages of an institution based on public law doing purely private business which is a severe issue not only for competition policy, but also for the allocation of resources in a mixed market economy (Sinn 1997).

Special Purpose Banks in Germany and Public Banks and Finance Corporations in Japan. Long-Term Credit Banks

In Germany the second largest bank group among the specialist banks after the mortgage banks are the special purpose banks. In the end of 1998 they accounted for nearly 8.1% of the total assets of the German banking system (see Fig. 1, please note that the figures include the Postbank). This group consists of banks which are all quite different (see table 5). It is therefore difficult to discuss them all together as we did it with the other banking groups. The most important banks in this group are the public law special purpose banks with the Kreditanstalt für Wiederaufbau (KfW) as the largest institution. Along with the policy-based finance institutions of the federal government (KfW, DtA) there are policy-based finance institutions of the *Länder* (both under public

Table 5 Special Purpose Banks (as of 31.12.1998, Millions of DM)

Legal Status	Name of Financial Institution	Total Assets	Main Tasks	Main Owners/Guarantors
Public law	Kreditanstalt für Wiederaufbau (KfW) (founded in 1948)	315,014	- Loans to the domestic economy (mainly to small and medium businesses, for environmental protection, infrastructure, housing (mainly in Eastern Germany)) - export and project finance - Subsidies for ODA loans by the federal government - Loans and consulting for Eastern Europe	80% Federal government 20% *Länder* governments
Public law	Deutsche Ausleichsbank (DtA) (founded in 1950	87,498	- Major lending institution of the ERP special fund - Main areas of lending: small and medium businesses, environmental protection	53.3% ERP special fund, 40.6% federal government 6.1% Lastenausgleichsfond
Public law	Deutsche Siedlungs- und Landesrentenbank [2)] (DSL) founded in 1966	140,258	- Loans promoting agriculture, structural change and structure conservation	51.51% Federal government
Public law	Landwirtschaftliche Rentenbank (LWR) (founded in 1949	80,062	- Main refinancing institution for agriculture, food industry, forestry and fisheries	Mainly agriculture and forestry
Public law	Landeskreditbank Baden-Württemberg [3)] (founded in 1998)	54,140	- Development bank of *Land* of Baden-Württemberg	100% *Land* of Baden-Württemberg
Public law	Bayerische Landesanstalt für Aufbaufinanzierung (operations started in 1951)	29,420	- Development bank of the *Land* of Bavaria; mainly support for structural change in the economy, small and medium businesses and tourism through (long-term and low interest loans, guarantees, subsidies, participations)	100% *Land* of Bavaria
Public law	Investitionsbank des Landes Brandenburg (founded in 1992	14,579	- Main lending instituiton of the *Land* of Brandenburg - Main areas: housing, economy (small and medium sized businesses, infrastructure, agriculture, forestry, environmental protection, social facilities	Guarantor: 100% *Land* of Brandenburg Owners: 50% Westdeutsche Landesbank, 25% state of Brandenburg, 25% Landesbank Berlin
Public law	Thüringer Aufbaubank (founded in 1992	1,679 (for 1997)	- Development bank of the *Land* of Thuringia; - Mainly promotion of the economy (small and medium sized businesses), infrastructure and housing (loans, subsidies, guarantees etc.)	100% *Land* of Thuringia
Private law	Sächsische Aufbaubank founded in 1995	31,335	- Policy-based finance institution of the *Land* of Saxony	51% *Land* of Saxony 49% Landeskreditbank Baden Württemberg
Private law	Investitions- und Strukturbank Rheinland-Pfalz (founded in 1993	1,906	- Support of the economy and economic structure of the *Land* of Rhineland-Pfalz; especially implementation of programs of the federal, the *Land* and the European Union (loans, guarantees, *Standort* marketing, participations)	100% *Land* of Rhineland-Palatinate
Private law	Saarländische Investitionskreditbank (founded in 1960	1,471	- Mid-term and long-term loans to the economy (small and medium enterprises) of the *Land* of Saar, guarantees, trust business	51% *Land* of Saar 48.8% Banks
Private law	IKB Deutsche Industriebank (IKB) (founded in 1949	54,100 (for 1998/99)	- Promotion of the economy (mainly mid-term and long-term loans to small and medium-sized businesses) - Loans by public programs for promotion of the economy	20% Allianz (largest German insurer) 11.23% Foundation for the promotion of research in trade and industry, 25% other German insurers
Private law	Liquiditäts-Konsortialbank (LIKO) (founded in 1974	439	- Help in cases of temporary liquidity problems	Bundesbank, Banks
Private law	Privatdiskont AG	n.a.	- Finance of foreign trade trough discounting bills of exchange	100% AKA Ausfuhrkredit- Gesellschaft (AKA)
Private law	AKA Ausfuhrkredit- Gesellschaft (AKA) (founded in 1952	18,410	- Mid-term and long-term export loans	52.1% Deutsche Bank, Dresdner Bank, Commerzbank, other banks

Notes: [1)] In the statistics until 1998 five other banks were in the banking group of special purpose banks. The largest of them was the Postbank, whose shares were still 100% owned by the federal government, with total assets of 108,511 million DM at the end of 1998. The others were Deutsche Bau-und Bodenbank, Deutsche Verkehrsbank, Gesellschaft für kommunale Altkredite und Sonderaufgaben der Währungsunion GmbH and Wirtschaftsförderung Hessen Investitionsbank which were privatised (and included in the banking group regional and other commercial banks), merged or dissolved.

[2)] Deutsche Siedlungs- und Landesrentenbank merged with Postbank in May 2000.

[3)] Landeskreditbank Baden-Württemberg is included in the group of special purpose banks starting from 1999.

Source: Reply to an inquiry with the Bundesbank of 26.1.2000, Banken-Jahrbuch 2000

and under private law). The Japanese equivalent of these banks are the central government banks and finance corporations (see table 6).[7]

Table 6 Central Government Banks and Finance Corporations in Japan
(as of 31.3.1999, Billions of Yen)

Name of Financial Institution	Total Assets	Main Tasks
Japan Development Bank (JDB) [1)] (founded in 1951 as the successor of the Reconstruction Finance Bank)	17,951	- Long-term loans for the domestic economy; especially for energy, sea transportation, coal mining and steel industry; but also for infrastructure, regional development and environmental protection
Export-Import Bank of Japan (EIB) [2)] (founded in 1952 as the successor of the Japanese Export Bank founded in 1950)	12,395	- Loans for Japanese exports and imports - Loans for Japanese investment abroad - Non-tied loans to foreign governments and financial institutions - Guarantees for Japanese foreign trade and Japanese investment abroad
Japan Finance Corporation for Small Business (SBF) (founded in 1953)	7,608	- Long-term loans for small business
Small Business Credit Insurance Corporation (SBCIC) [3)] (founded in 1958)	1,697	- Guarantees for loans to small businesses
People's Finance Corporation (PFC) [4)] (founded in 1949)	10,143	- Loans to very small enterprises and individuals
Agriculture, Forestry and Fisheries Finance Corporation (AFF) (founded in 1953)	4,379	- Loans to individuals and enterprises in the agricultural, forestry and fisheries sectors
Hokkaido-Tohoku Development Finance Corporation (HTDF) [1)] (founded in 1957)	1,706	- Long-term loans for the development of Hokkaido and Tohoku areas
Okinawa Development Finance (ODF) Corporation (1972)	1,842	- Loans for the development of Okinawa prefecture (combines the functions of JDB, ESFC, AFF, HLC, PFC and SBF for Okinawa prefecture)
Housing Loan Corporation (HLC) (1950)	74,246	- Housing loans
Environmental Sanitation Business Finance Corporation (ESFC) [4)] (founded in 1977)	1,132	- Modernisation loans and improvement of sanitation standards loans for restaurants, cafes, beauty salons, travel agencies etc.
Japan Finance Corporation for Municipal Enterprises (PEFC) (1954)	23,048	- Loans to local public enterprises for purposes defined by the central government

Notes: [1)] The JDB and the HTDF were merged in October 1999 to form the Development Bank of Japan (DBJ).
[2)] The EIB and the Overseas Economic Cooperation Fund, which was responsible for ODA, were merged in 1999 to form the Japan Bank for International Cooperation.
[3)] The SBCIC was merged with two other institutions supporting small business in July 1999 to form the Japan Small and Medium Enterprise Corporation (JASMEC).
[4)] The PFC and the ESFC were merged in October 1999 to form the National Life Finance Corporation.

Source: Business reports of the institutions

Although in both countries there are exceptions to the rule, in general one can state that

[7] Apart from central government banks and finance corporations in Japan there are other institutions close to the government engaged in lending activities such as the Special Account for Industrial Investment in Japan which is responsible for a part of government investments and loans, the Special Account for Lending Urban Development Funds and special status corporations such as the Social Welfare and Medical Service Corporation, the Japan Scholarship Foundation, the Fund-Securing Operations Account of the Pension Welfare Service Public Corporation, the Business Failure Prevention Account of the Japan Small Business Corporation, the Railways Account of the Corporation for Advanced Transportation and Technology, and the General Account of the Japan National Oil Corporation. In Germany there are some institutions which remain outside consideration when using the banking statistics such as the Deutsche Investitions- und Entwicklungsgesellschaft (responsible for the promotion of investments in developing countries) and some special funds of the government.

Japanese policy-based finance institutions tend to have their own monitoring and to extend the loans themselves at their own risk while in Germany policy-based finance loans to small and medium enterprises are generally made through other banks and the risk is taken by the latter. Moreover, loans are made only up to a certain upper limit, for example a share of total investment in a project or a share in total assets of an enterprise. In Japan the Development Bank of Japan (DBJ, the successor of the former JDB) has developed a fine reputation for monitoring and it has been shown that there is a cowbell effect in its lending, attracting loans from other banks (Horiuchi/Sui 1993). On the other hand, until the recent problems of the private banks there had been severe criticism accusing the JDB of competing with private banks. In Germany one does not hear such criticism because the loans are made through other banks (so-called "*durchgeleitete Kredite*"). Conversely, the system of premiums makes it a good business for the banks handing out loans for the policy-based finance institutions. The lending banks receive a margin covering their monitoring and risk costs.

There are several advantages of this system:

- First, it provides incentives for efficient monitoring because the default risk is remaining with the lending banks.
- Second, there is no default risk for the policy-based finance institutions.
- Third, errors in the design of too risky programs by the public financal institutions can be sorted out by the private ones by simply not handling these programs.
  On the background of the successful monitoring of the Japanese policy-based finance institutions, these three advantages seem not to carry much weight, but the system might be interesting for developing countries as a means of preventing corruption in the selection process.
- Fourth, it promotes competition between the banks because the borrower can choose the bank through which he obtains the loan and since due to the system even smaller banks can offer long-term loans.
- Fifth, it is cost-effective since the policy-based finance institution has no need to build up a branch network, although this advantage becomes less important with the progressive use of the internet.

But there are also some problems within the system:

- First, because of the marginally falling costs of monitoring per amount of loan it is more attractive for the lending banks to handle larger amounts of loans. In order to make smaller-scale loans more attractive for the lending banks, in recent years a system of equated margins corresponding to the amount of the loan has been introduced by the KfW.
- Second, it is impossible for the policy-based finance institutions to directly select the lendees. This can, however, be attained by changing the programmes (by abolishing old ones and introducing new ones) und thus the conditions which have to be met for receiving a policy-based loan.
- Third, a problem of this system is that leaving the risk with the lending bank makes achieving the political goal more difficult. Therefore, as an exception, in some programs it is possible to reduce the risk of the bank through which the loan is made. For example, in an environment program of the KfW for the Eastern Germany the banks can reduce their risk by 50% but the interest rate rises one half of one per cent. One should, however, be aware that a reduction of the handling bank's risk may lead to moral hazard problems in the selection process on the side of the handling bank.
- Fourth, since the default risk is with the private institutions, and since according to BIS regulations loans to enterprises have to be partly secured by their own capital, the big banks in particular, since they are trying to receive a higher return on their own capital in other areas such as in investment banking, are less willing to handle policy finance loans. As a result, the share of the big banks in handling policy loans has fallen in the 1990s, while the savings banks' and credit cooperatives' share has increased. However since these institutions also face the problem of the policy loans tying up their capital, the KfW is discussing projects for buying the policy loans from the institutions handling the loans, and plans to securitise and to resell them in the capital market. The KfW does not, however, want to do direct lending to small and medium-sized enterprises and compete with the banks and credit cooperatives. This seems to be a good way of proceeding for the loans already made by the private banks (if all loans made — or all loans made within a certain period of time — are included in the package). It is, however, dangerous to free the handling banks from all risk or to let them select which part of their loans they will sell as securities since

both options, but the freeing them from the default risk before the selection of loans to be made (or even to let them know that they will be freed from this risk at some moment in time in the future) in particular, may lead to severe moral hazard problems.

All in all, however, it is a market-enhancing system with the lending bank getting more experience in the markets stimulated by policy-based loans.

The federal policy-based finance institutions mainly offer loans for small business, export projects, housing, environmental protection etc. The funds for domestic investment are raised mainly through bonds and through funds from the ERP special fund[8] (see tables 7 and 8), which also issues bonds in the capital market. The KfW handles two types of loan programs: loan programs on behalf of the federal and *Land* governments and their 'house programs' (*Eigenprogramme*). The 'house programs' are refinanced through issuing bonds in the capital markets and thanks to the AAA rating of the KfW, it can offer low-interest loans and such a loan itself can be considered a subsidy even though there may be no explicit subsidy from the federal budget.

When discussing the size of policy-based finance in Germany one has to consider that the economic problems after unification have lead to an increase of the share of policy-based finance in total lending. One example illustrating this is the development of liabilities of the ERP special fund after 1990 (see Fig. 3). In table 7 one can see how large the share of Eastern Germany in new loans extended was in 1996. Especially for housing loans it was very high. In subsequent years the share of new loans to Eastern Germany has fallen.

As already mentioned above, the institutions of policy-based finance of the (*Länder*) also extend loans for housing, small business and environmental protection, but apart from this they also provide loans for technological development, regional development, education etc.

In addition to extending loans, some special purpose banks such as the DtA and the LfA in Bavaria also offer guarantees (mostly within 80% of the total value of loans).

[8] The funds of the ERP (European Recovery Program) Special fund and the Japanese Special Account for Industrial Investment both stem historically from proceeds of of post World War II counterpart funds of GARIOA (Government and Relief in Occupied Areas).

Table 7 New Commitments by the Kreditanstalt für Wiederaufbau in Recent Years (Millions of DM)

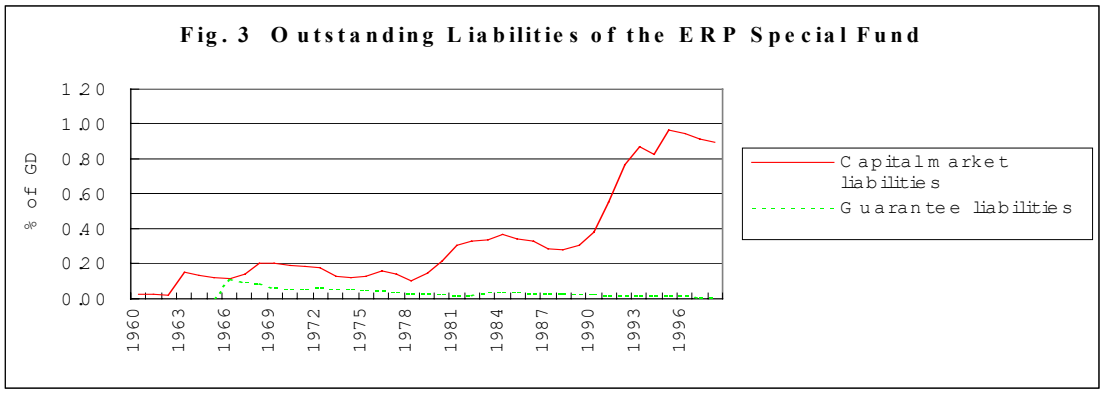
	1996	1997	1998
Total amount of new commitments	51.2	59.9	64.8
- Domestic economy	46.5	56.2	61.4
Investment loans (to East Germany)	33.0 (14.3)	41.1 (17.2)	48.0 (16.5)
Loans for Small Businesses	16.5 (4.6)	18.6	20.4
Loans for housing	10.0 (8.4)	11.6	15.2
Loans for environment protection	1.4 (0.4)	1.2	1.6
Infrastructure loans to local governments	4.2 (0.6)	6.8	6.5
Project finance (transportation, energy etc.)	0.8	2.8	4.2
Investment guarantees	0.1	0.6	0.2
Investment subsidies	0.2 (0.1)	0.1	0.1
Export and project finance	13.2	14.4	13.1
Export, project loans	12.1 (0.5)	13.9	12.4
Export, project subsidies	0.5 (0.1)	0.1	0.2
Export, project guarantees	0.8	0.4	0.4
- Promotion of developing countries	4.0	3.4	2.7
Loans for economic cooperation	2.1	1.6	1.4
Other loans	0.4	0.5	0.1
Subsidies	1.4	1.3	1.2
- Consulting, other	0.5	0.1	0.4
Loans	0.5	0.1	0.3
Subsidies	0.1	0.1	0.1
For reference:			
Sources of funds for loans for domestic investment	33.0	41.1	48.0
- Fundsof Kreditanstalt für Wiederaufbau (bonds etc.)	29.0	36.2	42.7
- ERP special fund (all for loans to small businesses)	4.0	4.8	5.0
- Federal budget	0.0	0.0	0.3

Sources: Annual Reports of the Kreditanstalt für Wiederaufbau

Table 8 New Loans by the Deutsche Ausgleichsbank in Recent Years (Millions of DM)

	1997	1998
Total amount of new loans	15.9	16.6
Promotion of small businesses (start-up loans)	9.4	9.9
Refinanced by funds from ERP special fund	5.6	5.0
Environmental protection measures	5.3	5.3
Refinanced by funds from ERP special fund	3.3	3.2
Education and training	0.6	0.5
Refinanced by funds from ERP special fund	0.2	0.2
Social infrastructure	0.7	1.0

Source: Annual Report of the Deutsche Ausgleichsbank



Source: Statistisches Bundesamt (1999)

The areas of lending of the Japanese government banks and finance corporations are very similar to those of the policy-based finance institutions in Germany: housing, small business, export, environmental protection etc. Striking is the large share of housing loans. As can be seen from table 9, this is also true for the Fiscal Investment and Loan Program, which serves as the major source of financing for the Japanese government banks and finance corporations as a whole. However, when comparing this with Germany, one has to consider that in Germany a part of this role is played by the building and loan associations.

Table 9 New Loans and Investment of the FILP (Trillions of Yen, Initial Plan Data)

	FY 1998 plan	FY 1999 plan	FY 2000 plan
Housing-related institutions	10.903	11.093	11.385
Housing Loan Corpotation	9.918	10.118	10.387
Housing and Urban Development Corporation	0.985	0.975	
Urban Development Corporation			0.998
Institutions supporting small- and medium-sized enterprises	6.271	6.471	6.443
People's Finance Corporation	3.790	3.790	
Environmental Sanitation Business Finance Corporation	0.400	0.400	
National Life Finance Corporation			0.419
Japan Finance Corporation for Small Business	2.010	2.210	2.210
Other government banks etc.	3.503	6.181	4.436
Japan Development Bank	1.355	2.555	
Hokkaido Tohoku Development Finance Corporation	0.135	0.355	
Development Bank of Japan			1.997
Export-Import Bank of Japan	1.065	1.910	
Overseas Economic Cooperation Fund	0.439	0.747	
Japan Bank for International Cooperation			1.839
Agriculture, Forestry and Fisheries Finance Corporation	0.260	0.320	0.350
Other government enterprises	6.638	6.161	5.930
Japan Highway Public Corporation	2.024	2.106	2.100
Pension Welfare Service Corporation	1.970	1.696	1.349
Social Welfare and Medical Service Service Corporation	0.365	0.365	0.411
Metropolitan Expressway Public Corporation	0.370	0.341	0.376
Hanshin Expressway Public Corporation	0.311	0.310	0.329
Subtotal	27.314	29.904	28.194
Regions	9.345	9.445	9.272
Local Governments	7.600	7.740	7.650
Japan Finance Corporation for Municipal Enterprises	1.745	1.705	1.622
Total	36.659	39.349	37.466

Portfolio Investment	13.300	13.550	6.210
Special Account for Postal Savings	8.000	8.500	2.000
Pension Welfare Corporation	2.800	3.050	2.710
Postal Life Insurance Welfare Corporation	2.500	2.000	1.500
Total	13.300	13.550	6.210
Grand Total	49.959	52.899	43.676

Source: Ministry of Finance

In Japan institutions financed by the policy-based Fiscal Investment and Loan Program are often explicitly subsidised. Therefore it has been suggested to implement policy (subsidy) cost analysis of the Fiscal Investment and Loan Program. Policy cost analysis is a way of estimating the total costs of a project that have to be born until its completion. The cost for each year is derived by adding explicit subsidies from the national treasury and implicit subsidies (such as the the opportunity costs of a loan, i.e. the amount of benefit that could have been obtained if these funds had been invested elsewhere) and subtracting payments and dividends that are expected to be received by the national treasury. In order to be able to compare different projects, these annual cost (or revenue) amounts for each year are converted to a current discounted value. Such an analysis has been conducted for four institutions receiving funds from the Fiscal Investment and Loan Program (see table 10). This kind of analysis strongly depends on the assumptions made for interest rates and subsidies, etc. that have to be granted each year. However, the assumptions about future interest rates and on the discount rates used are the same for all institutions, while the estimations on future subsidies etc. were made based on the situation of each institution. The estimates were made for all outstanding loan commitments made by fiscal year 1999 including those budgeted for FY 1999.

Table 10 Estimate of Policy Costs for Institutions Financed by the FILP for FY 1999

name of institution	Policy cost (Trillions of Yen, analysis period) (A)	Subsidy in the initial budget for FY 1999 (B)	(A)/(B) (times)
Housing Loan Corporation	1,238.3 (31 years)	435.0	2.85
People's Finance Corporation	84.6 (21 years)	42.6	1.99
Japan Highway Public Corporation	3,351.3 (43 years)	288.4	11.62
Chubu International Airport Public Corporation	-11.0 (35 years) when excluding revevenues nues form enterprise tax: 34.1 (35 years)	5.1 5.1	- 6.69

Source: Naoyuki Yoshino (1999)

The knowledge of these future costs is important for decision making, since it is possible to compare the cost of different policies or institutions, and then compare that with their expected benefits. Since the figures in table 10 include only the costs of

subsidies provided from the general account of the central government, it would be desirable to extend this analysis to include the costs of subsidies from local governments and other sources within the public sector.

Last but not least, the group of special purpose banks in Germany also contains some institutions which cannot be considered policy-based finance institutions, although historically they have played such a role in part. Examples are the Deutsche Bau- und Bodenbank (DBB) and the Deutsche Verkehrsbank (DVK), which consequently have been included in the group of regional and other commercial banks starting from January 1999. Nor is the IKB Deutsche Industriebank a policy-based finance institution. In its objectives it is similar to the Japanese long-term credit banks, which historically have also in part played a role as policy-based finance institutions, with a long tradition of publicly owned banks in the prewar period. In the last few decades these banks have been private. It was shown for the Industrial Bank of Japan that particularly in the 1950s the government still influenced the long-term credit banks considerably through regulation and purchase of their bonds (Calder 1993). However, because of deregulation this influence has decreased dramatically. The Japanese long-term credit banks have the privelege of issuing bonds up to 20 times their own capital worth, but having lost large businesses as their traditional main customers due to the internationalisation and liberalisation of capital markets and the subsequent possibility for large businesses to issue bonds in global capital markets, nowadays their role is much less important than in the prewar and immediate postwar years.

Building and Loan Associations in Germany (*Bausparkassen*)

When comparing the shares of loans provided through special purpose banks in Germany and central government banks and finance corporations in Japan, the large share of housing loans in Japan is striking. One reason for the lower share in Germany is the existence of the building and loan associations. The first building and loan association in Germany was established in the late 19th century inspired by the British building and loan associations that had existed there already since the late 18th century, but the German association had to be closed soon because at the time the market for housing finance was worked well. The first successes of building and loan associations in Germany date from the period after World War I, a time of extremely high interest rates and difficulties for housing finance.

Building and loan associations in Germany accept deposits from customers so that the customers can later use those funds for building and renovation of housing. At this second stage the customers also usually take out a relatively low-interest loan from the building and loan associations.

While the first building and loan associations emerged spontaneously on the market (though often through savings Banks associations and Landesbanks), nowadays they are supported by the government mainly through so-called housing construction subsidies (*Wohnungsbauprämien*) and savings promotion subsidies for low-income families. The building and loan associations play an important role in providing fixed low-rate housing loans to a large public.

Financing the Public Sector: Strong Positions of Public Sector Banks

At the end of 1998 the total outstanding liabilities of the different levels of the public sector in Germany amounted to 2356.1 billion DM and half of these liabilities were raised from the German banking system. Data by banking groups are are available for 901.5 billion DM of direct lending and 235.4 billion DM of bonds bought by the banks. The total outstanding liabilities of the public sector to the banking system comprise federal government bonds (more than 50%), bonds issued by *Land* governments (about 5%), while local government bonds are nearly non-existent (0%). Federal borrowing from the banks accounts for 8%, state borrowing for 20% and municipal borrowing for 10% of these outstanding liabilities (see table 11). When looking at the holders of bonds issued by the different levels of government, one can see that more than a third of them is held by the Landesbanks and the savings banks (see table 12).

A glance at the institutions extending bank loans to the different levels of government shows that at the federal and at the *Länder* level the mortgage banks (68% and 67%) and the Landesbanks (21% and 21%) dominate (see table 13). The most interesting situation, however, occurs at the level of municipalities; 43% of the total bank loans to municipalities are extended by the savings banks which also have institutionally the closest links to the local governments. Another 17% is held by the Landesbanks and 11% by special purpose banks. When taking into account the almost inexistence of municipal bonds, this means that more than two thirds of the liabilities of local governments are held by public financial institutions. Mortgage banks have increased their lending to all levels of government, but for municipalities their market share was

still only 18% at the end of 1998. Regional and other commercial banks held 8% of municipal liabilities (table 13).

In Japan too, a large proportion of government debt is held by public sector financial institutions. More than one third of all outstanding central government liabilities (both bonds and loans) is held by the Trust Fund Bureau. Moreover, there are other government financial institutions that hold other portions of central government debt, such as the Postal Life Insurance, the Postal Savings Liberalisation Fund and the Bank of Japan. Altogether public financial institutions held more than half of the central Table 11 Outstanding Public Sector Bonds and Borrowings in Germany

(as of 31.12.1998)

	Bonds and Borrowings (billions of DM1998)	Percent
Federal bonds	1215.6	51.6
Railway and Postal bonds	93.1	4.0
Bonds from *Länder*	120.6	5.1
Local government bonds	2.3	0.1
Federal borrowing	190.1	8.1
Borrowing by social insurance etc.	23.0	1.0
State borrowing	472.7	20.1
Local government borrowing	238.8	10.1
Total	2356.1	100.0

Source: Deutsche Bundesbank, Bankenstatistik, Kapitalmarktstatistik

Table 12 Holding of Public Sector Bonds by Banking Group in Germany

(as of 31.12.1998)

	Holding of bonds (billions of DM)	Percent
Big banks	22.7	9.6
Regional banks etc.	47.7	20.3
Foreign banks	8.8	3.8
Private bankers	0.9	0.4
Landesbanks	32.7	13.9
Savings banks	47.0	19.9
Central cooperative banks	8.1	3.4
Credit associations	29.2	12.4
Mortgage banks	32.1	13.7
Special purpose banks	6.1	2.6
	235.4	100.0

Source: Deutsche Bundesbank, Bankenstatistik

Table 13 Lending to the Different Levels of German Government by Banking Group

(Figures as of 31.12.1998, Billions of DM)

	Lending to federal government outstanding	Percent	Lending to state governments outstanding	Percent	Lending to municipalities outstanding	Percent

Big banks	2.484	1.3	5.557	1.2	4.286	1.8
Regional banks etc.	4.605	2.4	11.578	2.4	19.72	8.3
Foreign banks	0.1	0.1	0.397	0.1	0.068	0.0
Private bankers	0.41	0.2	1.974	0.4	0.939	0.4
Landesbanks	37.823	19.9	97.899	20.7	99.811	41.8
Savings banks	2.236	1.2	14.699	3.1	41.612	17.4
Central cooperative banks	2.388	1.3	5.785	1.2	0.067	0.0
Credit associations	0.474	0.2	3.885	0.8	3.293	1.4
Mortgage banks	127.915	67.3	310.36	65.7	42.753	17.9
Special purpose banks	11.627	6.1	20.577	4.4	26.212	11.0
	190.062	100.0	472.711	100.0	238.761	100.0

Source: Deutsche Bundesbank, Bankenstatistik

government's outstanding debt as of March 1998. It is interesting to see that at the level of prefectures the government dominance is not as strong as in the case of the central government and that there is more reliance on commercial banks and public subscription bonds. Altogether the public financial institutions still account for more than 40% of outstanding prefectural debt. As in Germany, the share is larger a the level of municipalities. There it amounts to as much as 65.7%, which is quite similar to the 60-70% in Germany (see table 14).

It is also interesting that holdings of local government bonds by domestically licenced banks concentrate more on regional banks than on on city banks or on members of the Second Association of Regional Banks. This indicates a close relationship between the local governments, especially the prefectures, and the regional banks, in a way similar to the relationship between the German savings banks and local governments.

While in Japan strong positions of public sector financial institutions can be seen at all levels of public borrowing, in Germany they concentrate on public sector bonds and on lending to municipalities, while loans to the federal and the state governments are dominated by the mortgage banks.

Table 14 Outstanding Liabilities of the Different Levels of Japanese Government by Holder (Figures as of 31.3.1998, Trillions of Yen)

	Outstanding central government borrowing	percent	Outstanding prefectural borrowing	percent	Outstanding borrowing of cities, towns and villages	percent
Trust Fund Bureau	164.649	42.4	16.774	29.2	21.941	40.6
Other gov. funds and fin. institutions	46.500	12.0	6.459	11.3	13.555	25.1
Bank of Japan	50.806	13.1				
Commercial banks	58.764	15.1	24.955	43.5	11.130	20.6
Other financial institutions			2.066	3.6	2.191	4.1

Public subscription bonds			6.537	11.4	2.530	4.7
Other	67.428	17.4	0.616	1.1	2.741	5.1
	388.146	100.0	57.407	100.0	54.089	100.0

Source: Local Finance Statistics, Government Bonds Yearbook

Term Structures of Loans by Banking Group: Long-term Engagements of the Public Sector Banks

When excluding lending by the banking group of regional banks etc., the German private commercial banks mainly lend to enterprises on a short-term basis while the mortgage banks, the special purpose banks, Landesbanks and savings banks mainly extend long-term loans. Lending to personal enterprises is long-term for all banking groups, but the large shares of the two banking groups having strong local links, the savings banks, whose lending activities are restricted the region of their activity and who are in most cases owned by local governments, and the credit associations, who lend to their own members, is striking. Long-term lending to banks is especially large with the Landesbanks and with special purpose banks. While the first play the role of a central giro institution of the savings banks, the latter comprise the abovementioned loans (*durchgeleitete Kredite*) from the policy-based finance banks (see table 15 for the figures).

Interestingly, the short-term orientation of the private banks which was so evident for Germany is not that clearly observable for Japan, where all groups of domestically licensed banks have loan engagements for more than one year or with no agreed maturity, accounting for about 70% of their total loans. However, in Japan too, government banks and finance corporations, especially the Development Bank of Japan and the Housing Loan Corporation, engage in long-term lending.

Table 15 The Structure of Outstanding Loans by Banking Groups at the End of 1998 (Excluding Loans for Housing and to the Government), Billions of DM, percent

	Enterprises			Personal enterprises			Domestic banks			
	short-term	mid-term	long-term	short-term	mid-term	long-term	short-term	mid-term	long-term	Total
Total for all banks (billions of DM)	454.8	95.4	995.7	106.6	36.8	677.9	691.8	111.3	1011.6	4181.8
Big banks	2.63	0.29	2.16	0.37	0.10	1.58	1.50	0.07	0.34	9.04
Regional banks etc.	2.08	0.49	2.94	0.32	0.16	2.30	2.58	0.09	0.34	11.30
Branches of foreign banks	0.54	0.05	0.11	0.00	0.02	0.01	0.39	0.03	0.05	1.20
Private bankers	0.22	0.02	0.04	0.06	0.01	0.05	0.29	0.00	0.01	0.72
Landesbanks	1.33	0.48	5.77	0.11	0.03	0.94	3.36	0.52	9.15	21.69

Savings banks	1.86	0.38	3.75	0.85	0.20	5.24	2.91	0.11	0.30	15.60
Central cooperative banks	0.50	0.09	0.62	0.01	0.00	0.03	1.01	0.19	2.04	4.51
Credit associations	1.17	0.27	1.41	0.77	0.34	3.28	2.38	0.36	0.30	10.28
Mortgage banks	0.27	0.12	4.95	0.04	0.02	2.21	0.85	0.83	5.60	14.89
Special purpose banks	0.28	0.08	2.07	0.01	0.00	0.57	1.27	0.44	6.06	10.78
Total for all banks (percent)	10.65	2.26	23.77	2.49	0.87	16.16	16.54	2.66	24.19	100.00

Note: Short-term loans are loans with an agreed maturity up to one year, mid-term loans are loans with an agreed maturity of over one but under four years and long-term loans are loans with an agreed maturity of more than four years.

Source: Deutsche Bundesbank, Bankenstatistik

The Size of Policy-Based Finance in Germany and in Japan

In Germany at the end of 1998 public sector banks (savings banks group, mortgage banks based on public law, building and loan associations on public law and the special purpose banks of the federal and of the state governments) comprised about 40% of the total assets of non-insurance financial institutions (see Fig. 1). Since the financial behaviour of the Postbank, the savings banks and of the Landesbanks is to a large extent similar to private banks, as pure institutions of policy-based finance there remain only the KfW, the DtA and the special purpose banks of the state governments. Adding up their total assets and allowing for banks which have to be considered as institutions partly engaged in policy-based finance (parts of the Landesbanks, of the mortgage banks based on public law and other special purpose banks) the share of policy-based finance in total assets of the German banking system is more than 5% (see also table 16). Because of the practice of lending through other financial institutions, however, this figure understates the importance of policy-based finance in Germany.

Table 16 Institutions of Policy-Based Finance in the German Financial System

	Policy-based finance		Institutions with private behaviour	
	Pure policy-based finance	Partly policy-based finance	Private institutions and institutions with private behaviour	
On public law	- Kreditanstalt für Wiederaufbau - Deutsche Ausleichsbank - Bayerische Landesanstalt für Aufbaufinanzierung - Thüringer Aufbaubank - Investitionsbank des Landes Brandenburg	- Landesbanks - Mortgage banks on public law - Deutsche Siedlungs- und Landesrentenbank - Landwirtschaftliche Rentenbank (LWR)	- Savings banks [1)] - Building and loan associations on public law [2)]	a b o u t 40 %

On private law	- Sächsische Aufbaubank - Saarländische Investitionskreditbank - Investitions- und Strukturbank Rheinland-Pfalz - Wirtschaftsförderung Hessen Investitionsbank	- AKA Ausfuhrkredit-Gesellschaft	- Private commercial banks - Cooperative banks - Mortgage banks on private law - Building and loan associations on private law [2)] - Investment companies - Postbank [3)] - Deutsche Verkehrsbank [3)] - Deutsche Bau- und Bodenbank [3)] - IKB Deutsche Industriebank	about 60%
	more than 4% of total assets of non-insurance financial institutions	about 20%	more than 75%	

Note: [1)] The savings banks could also be considered as partly policy-based finance institutions because of the loans to municipalities, because of the legal limitation of their investment to the locality of their activity and because of the possible influence of local governments on their business through ownership. All in all they behave, however, largely like private banks and have therefore been included in the column 'banks with private behaviour'.

[2)] The building and loan associations are indirectly supported by the government through subsidies to persons who wish to engage in housing construction through housing construction subsidies, etc.

[3)] From 1999 these banks are included in the group of private commercial banks

[4)] The Landeskreditbank Baden-Württemberg is still contained in the data for mortgage banks on public law

Source: Deutsche Bundesbank, Bankenstatistik, Banken-Jahrbuch 2000, replies to inquiries with the Bundesbank of 23.12.1997 and 26.1.2000; estimate by the authors on the basis of data for 31.12.1998

For Japan the figure is easier to obtain. The share of public financial institutions in total assets of all Japanese non-insurance financial institutions is 38.8%, but this figure totally overstates the role of the public sector banks. There is huge double counting of assets among the public financial institutions. Of course, to some extent there is also double counting of assets among the private financial institutions, but for the public financial institutions, most of the postal savings assets are deposited with the Trust Fund Bureau and most of the funds of banks and finance corporations are loans from the Trust Fund Bureau. Therefore the share of public financial institutions in total assets of Japanese non-insurance financial institutions adjusted for this double counting should be about 25%. Since a large proportion of these funds is used for housing loans to individuals or is invested in lending to central and local governments, the share in financing private enterprises is even lower.

Guarantees Provided by the Government

The governments not only make loans, but also actively extend guarantees. In Germany this is mainly done by the federal government, state governments and by municipalities, but the federal government's share is especially large (at the end of 1998 the federal government accounted for 71.9% of all guarantees outstanding of the total of all levels of government, see table 17).

Table 17 Outstanding guarantee liabilities by level of government

(Billions of DM, per cent)

	End of 1996		End of 1997		End of 1998	
Federal government	344.374	75.0	354.138	73.2	366.985	71.9
Länder governments	77.415	16.9	92.909	19.2	101.992	20.0
Municipalities	34.553	7.5	35.063	7.2	39.576	7.8
Others	2.747	0.6	1.969	0.4	1.917	0.4
Total	459.089	100.0	484.079	100.0	510.470	100.0

Source: Statistisches Bundesamt (1999)

A closer look at the guarantee activities of the federal government shows that the main area with more than 50% of the outstanding guarantee liabilities is export guarantees (see table 18). The export guarantee business for the federal government has been entrusted to the private firms Hermes and C&L Deutsche Revision. Export guarantees usually cover up to 85-95% of the risk. In 1998 3.2% of total German exports have been covered by guarantees from the federal government. When looking at the geographical distribution of these guarantees, 68.1% have been used to cover exports to developing countries. This equals 15.9% of the exports to these countries. 0.1 % of the exports to developed countries have been covered by guarantees from the federal government. In the case of Eastern European countries the figure is 6.5%, but in 1991 and 1992 it was as high as about 30%. This was caused by the wish to support the exports of Eastern Germany after unification and can therefore be seen as a special kind of labor market policy since Eastern Europe was the major export destination of East German enterprises before the unification of Germany. But since this led to huge deficits of the federal export guarantee system, in 1994 there was a change in the fees system away from the same fees for all countries to a division by country group. This led to a gradual improvement of the financial performance of federal export insurance (see Table 19). When looking at the federal export guarantees by industry, one can see that in the 1990s guarantees were mainly provided for equipment and machines, but also for construction projects, ships, ship equipment and airplanes.

Table 18 Guarantees by the Federal Government (Billions of DM, Percent)

	Initial budget 1999 (A)	Losses (B)	Disposable (C)=(B)-(A)	Used by the end of June 1999 (D)	Share (D')
Exports	220.000	1.308	218.692	196.823	52.7
International financial institutions	65.000		65.000	50.181	13.4
Other guarantees extended abroad	57.650	0.934	54.006	40.374	10.8
For untied loans				19.168	5.1
For investment abroad				19.015	5.1
Domestic Economy	112.500	5.966	96.534	83.155	22.3
Trade and industry				27.511	7.4
Housing				22.944	6.1
Taken over from East Germany and Treuhandanstalt [1)]				8.090	2.2

Agriculture/food storage				11.865	3.2
Transportation				4.898	1.3
Successors of Treuhandanstalt [1]	3.500		3.500	2.894	0.8
Total	458.650	8.208	450.442	373.427	100.0

Note: [1)] The Treuhandanstalt was an institution created for the managment and the privatisation of East German properties and enterprises.

Source: Finanzbericht 2000, pp. 342 - 351

Table 19 Average Yearly Financial Result of the German Federal Export Insurance

Year	Average yearly financial result (millions of DM)	Year	Average yearly financial result (millions of DM)
1950-54	5.28	1985-90	-1298.12
1955-59	-3.88	1990-94	-3252.54
1960-64	-38.52	1995	-1517.6
1965-69	7.04	1996	-866.8
1970-74	-30.48	1997	-583.2
1975-79	274.94	1998	-55.7
1980-84	-346.56		

Source: Bundesministerium für Wirtschaft (1997), p. 26 and (1999), p. 41

Apart from export guarantees there are other guarantees to foreign countries. In Germany these are mainly guarantees for non-tied loans and guarantees for investments abroad. Non-tied loans are mainly loans to ensure resource deliveries to Germany and loans for the stabilisation of the financial and economic situation of other countries as well as loans for the promotion of investment of small and medium-sized industrial enterprises in Eastern Europe. Guarantees to international financial institutions are obligations resulting from the German participation in the European Investment Bank, the World Bank, the European Bank for Recovery and Reconstruction, etc. where Germany in case of need has to provide capital on demand. The same is true for Japan's participation in international financial institutions.

The Japanese system of public export guarantees managed by the Export, Import and Investment Insurance Department of the Ministry of International Trade and Industry (MITI) also groups countries according to their level of risk. However, its coverage when compared to total exports, is much larger than in Germany and amounted to more than 25% in the fiscal year 1998. This large coverage means that the Japanese government is entering business areas which could also be done by the private sector. Japan also has a developed system of public guarantees for investments of Japanese enterprises abroad.

Most of the federal guarantees to the domestic economy in Germany are guarantees for the promotion of trade and industry and for the promotion of housing construction. Guarantees for the promotion of trade and industry, among others, include guarantees

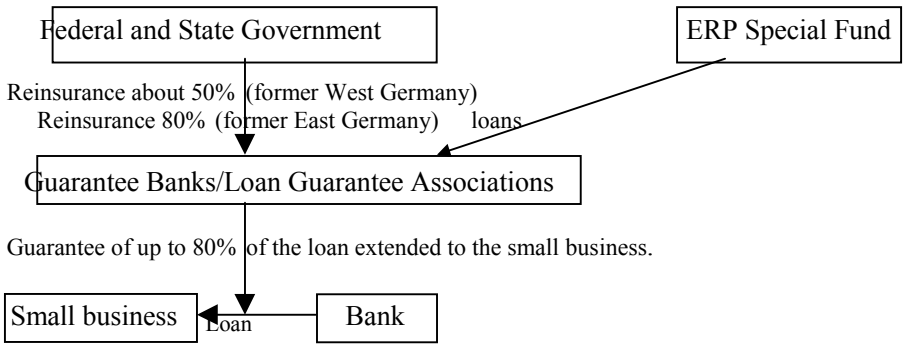
for founders of enterprises by the DtA within the ERP-Program, large-scale guarantees and guarantees for the guarantee banks. Guarantee banks and guarantee companies are enterprises founded and owned by the chambers of industry and commerce, banks, insurance companies, etc. They aim at promoting small and medium-sized enterprises. Historically they have been divided by industry, but through mergers they are gradually developing into one institution per *Land*. Their business is the extension of guarantees for loans up to 15 million DM. In order to prevent moral hazard, the guarantees cover up to 80% of the amounts of the loans. The guarantees are re-guaranteed by the state and by the federal government. Through the KfW the guarantee banks also receive loans from the ERP special fund. There are also cases where the guarantee banks hold shares in small and medium-sized businesses.

The very large guarantees are handled by the state and federal governments, but there are other important institutions offering guarantees which have to be mentioned. The most important are the DtA, which is offers guarantees between 10 and 200 million DM to enterprises in Eastern Germany, and the Bayerische Landesanstalt für Aufbaufinanzierung (for more details see SBCIC 1994).

The most striking difference between the German guarantee banks and the Japanese credit guarantee corporations is that the latter offer guarantees of 100% of the loans of the banks to small business, while in Germany the upper limit is 80% of the loans (see Fig. 4). A system guaranteeing 100% of the value of the loans produces moral hazard on the side of the banks since it does not provide incentives for the banks to monitor the borrowing company well. This may lead to severe losses for the credit guarantee corporations.

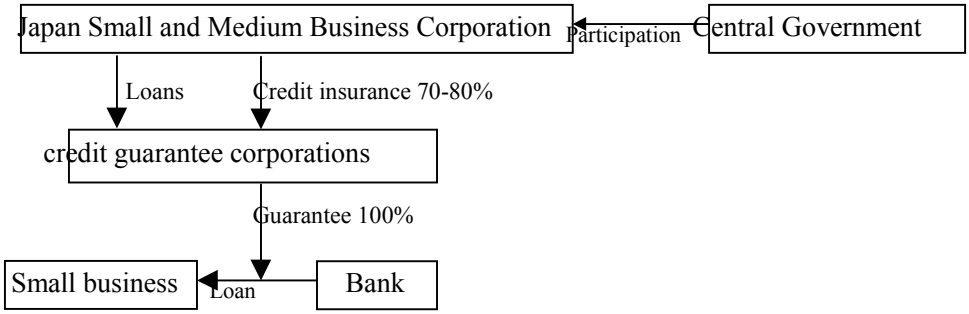
Fig. 4 The Credit Guarantee Systems for Small Businesses in Germany and in Japan

Germany:



Source: Verband der Bürgschaftsbanken (1998), p. 9

Japan:



Note: the coverage is 50% in the case of insurance contracts of the JASMEC with authorised support organisations who offer guarantees for corporate bonds issued by venture businesses.

Source: SBCIC (1997), p. 5-6

Summary: Public Banking in Germany — a Comparison with the FILP in Japan

Although Germany has no explicit Fiscal Investment and Loan Program as in Japan (see figure 5 for a chart of this system), there are similar institutions that play the same role de facto (see figure 6). On the fund raising side the most similar German institutions to postal savings in Japan are the savings banks. Both collect large portions of the savings of the population through large numbers of branches and are backed by government guarantees (in Japan by the central government and in Germany by local governments).

The use of funds, however, is different. While under the present system in Japan the funds are deposited with the Trust Fund Bureau and are mainly used for policy-based finance and for the purchase of government bonds, the German savings banks behave largely like private banks. They are only limited by the provison that their activity has to remain in the region where they were established, and by some influence of the local governments as their owners and guarantors. These are reasons why they have relatively high shares of lending to personal enterprises and to local governments. When the reform of the FILP in Japan, which plans to abolish the compulsory deposit of postal savings and government pension funds to the Trust Fund Bureau and to invest them in the capital market, will be put into effect starting in April 2001, the systems will become even more similar. Of course, on the capital market they can, among others, invest in FILP bonds and in bonds of government financial institutions and enterprises (see figure 7 for the new Japanese system).

When excluding their role as institutions of policy-based finance, which is small when compared to their total business, the German Landesbanks mainly behave like private banks. In Germany the functions of the Japanese policy-based finance institutions are mainly performed by the special purpose banks on the federal and on the *Länder* level (as mentioned above this role is in some *Länder* performed by the Landesbanks or other institutions). But apart from the use of the ERP special fund, these activities are not subject to decisions by the parliament as in the case of Japan, where the FILP and the budgets of government banks and finance corporations are subject to decisions of the Diet. Moreover, in Germany, because of the existence of policy-based finance institutions on the federal and on the state level, policy-based finance is different from *Land* to *Land*.

As a whole the areas of lending of policy-based finance institutions in Japan and in

Fig. 5 The Current Japanese FILP (until March 2001)

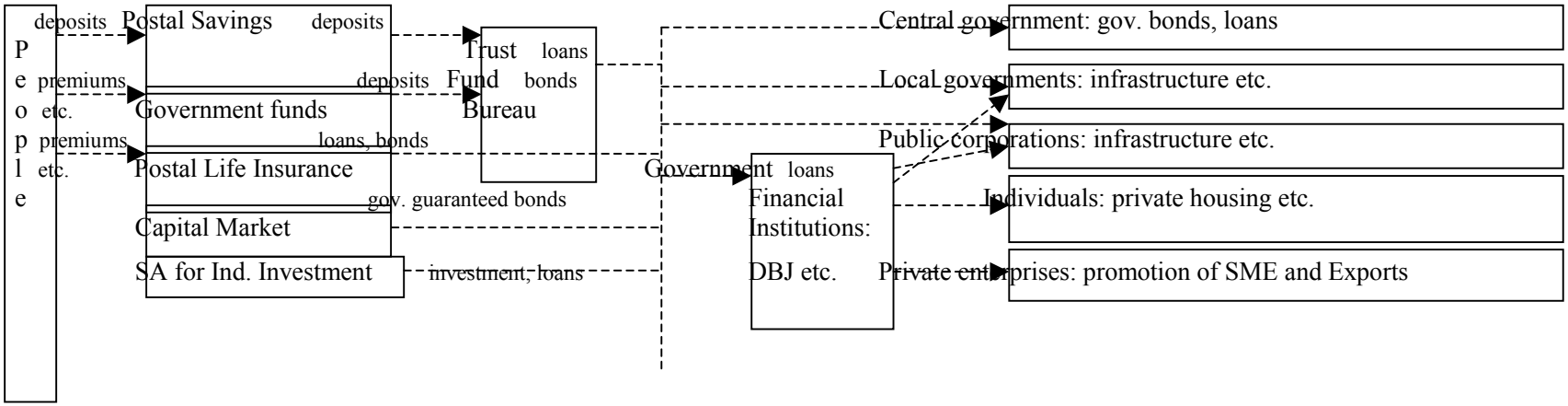


Fig. 6 The German System of Policy-Based Finance

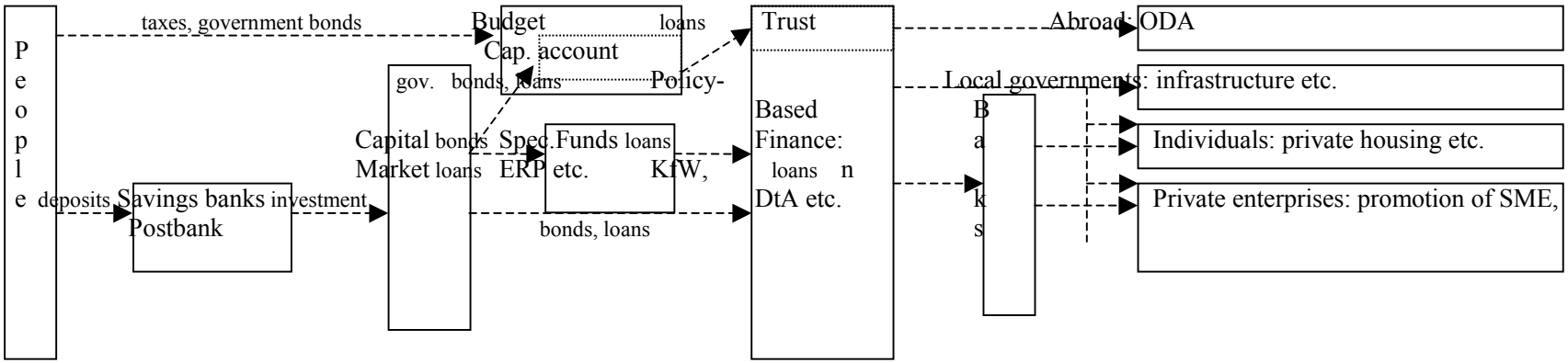
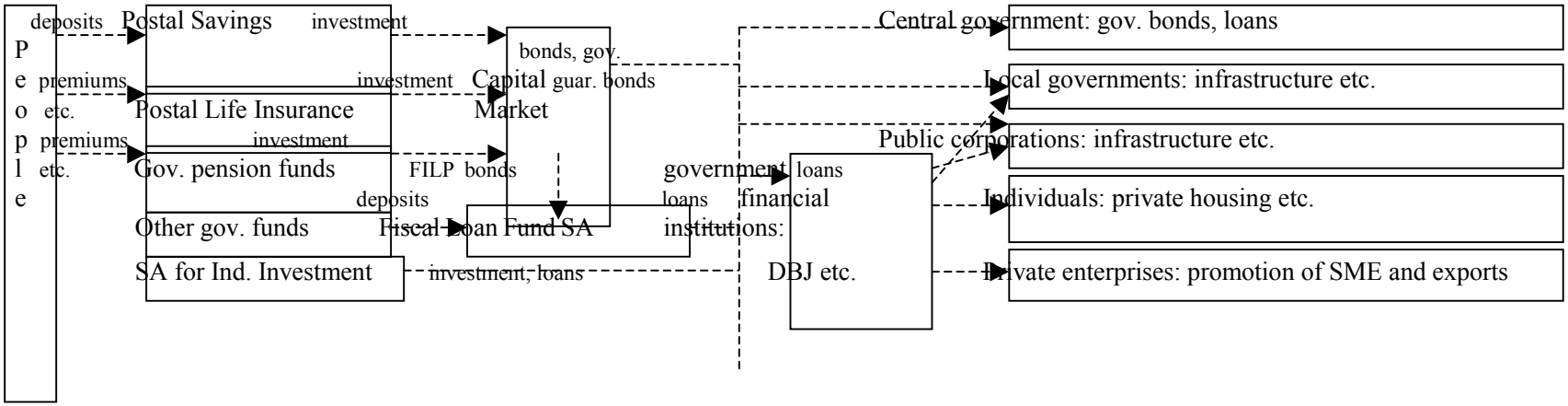


Fig. 7 The New Japanese System of Fiscal Investment and Loans (from April 2001)



Germany are similar. The emphasis in both countries is on loans to small and medium-sized businesses and on housing loans, although the share of the latter is much larger in Japan. Both Japan and Germany have no tradition of policy cost analysis for policy-based finance. However, in Japan first estimates for some institutions were made in 1999. The estimates of policy cost are important for decision making since they allow to compare the cost of different policies and to compare them with their expected benefits.

An important difference between the two countries, and this difference will also persist after the reform of the Fiscal Investment and Loan Program in 2001, is that in Japan the loans are mostly extended directly through the institutions of policy-based finance, which do the monitoring and take on the risk, while in Germany the loans of institutions of policy-based finance are mostly handed out through other financial institutions which receive a premium for handling the loans, but who typically also take on the risk of the loans. Thus the German policy-based finance institutions usually do not take the risk of the loans on themselves, as would be normal with their Japanese counterparts. This system is seen to be market enhancing and increases the monitoring efforts of the banks through which the loans are handed out.

In addition to their lending activities, the governments extend guarantees. This policy tool is actively used for exports in particular, both in Japan (Export, Import and Investment Insurance Department of the MITI) and in Germany (Hermes). The share of total exports covered by the system is much larger in Japan, indicating that it also offers some marketable services. The small business insurance systems are similar in Germany and in Japan, but the design of the Japanese system can lead to serious problems of moral hazard because of the provision of 100% guarantees through the credit guarantee corporations.

All in all, despite differences in names and institutional design, we can state that the systems of public financial institutions in Japan and in Germany perform similar tasks. In both countries, however, there are areas where it is questionable whether it is necessary for these tasks to be performed by public financial institutions. This is particularly the case for the market part of the German Landesbanks, the German savings banks and postal savings in Japan. Their backing by the government leads to considerable advantages over their private competitors in acquiring relatively cheap funding. This is hardly fair competition if they are involved in the same activities as the private banks on the asset side of their balance sheets. Therefore it would only be fair to

privatise the Postbank in Germany; for postal savings in Japan, the Landesbanks and for the savings banks it has to be discussed whether a privatisation or a regulation of their activities that clearly defines their tasks would be a better solution. Another possibility is to limit their investment activities, e.g. to government bonds, and at the same time to open their branch networks to sell financial products of private financial institutions as suggested for postal savings in Japan by Yoshino (1998a).

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