

**Economic Effects of “THE REEVISED MONEY LENDING BUSINESS CONTROL AND
REGULATION LAW” and The Underground Finance¹**

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ABSTRACT

This paper analyzes three cases concerning the influence of national policies on economic conditions, with a focus on economic effects and employment effects in the national economy and regional economies (Hokkaido and Osaka). Specifically, it deals with the following:

- (1) The economic effects of Maximum Interest-rate Regulation under the revised Money-lending Control Act as a system design change.
- (2) The economic effects of regulations on Loan Amounts (Total Value) under the revised Money-lending Control Acts.
- (3) The economic effects of Fixed-Amount Cash Handouts as a public policy requiring an injection of taxpayers' money.
- (4) The economic effects of Underground Finance under the revised Money-lending Control Act.

The results can be summarized as follows:

- (1) Maximum Interest-rate Regulation produced negative effects, including nominal GDP growth rate shrinkage and an increase in the new unemployed rate.
- (2) Regulations on Total Values produced negative effects, including nominal GDP growth rate shrinkage of 0.51% and an increase in the new unemployed rate to 0.5% under the not pass the credit inquiry 42.1% on 2008.
- (3) Fixed-Amount Cash Handouts resulted in an economic expansion of up to 0.31% in the GDP growth rate and the creation of jobs for about 188,000 people. However, this was a once-only measure to boost final consumption, and its cost-effectiveness must be examined thoroughly.
- (4) Underground Finance resulted negative effects, including nominal GDP growth rate shrinkage of -0.3% and lose jobs for about 341,138 people.

Key words: ripple effects, input-output, the consumer credit service

Category & Number: 3. 5. 9.12.

JEL Classification Code: E44, E47, G18, R15.

1. Introduction

The revision of the Money Lending Business Control and Regulation Law (Article 1) came into force in four stages. The first implementation was in December 2006, and the last part of the revision

¹ Research results of the Research Grants-in-Aid for Sapporo University 2008.

became effective on June 18, 2010. The followings five points summarize the revision.

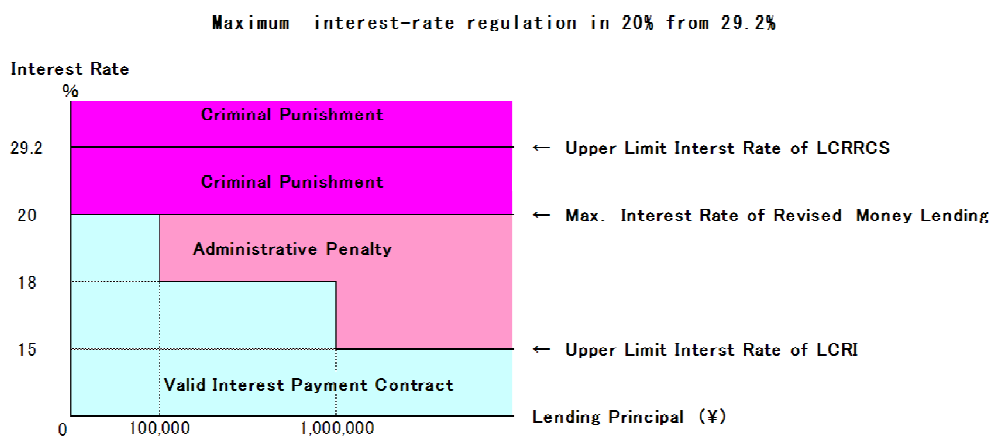
- 1) The maximum allowable interest rate was brought down from 29.2% to 20% (Maximum Allowable Interest Rate Restriction).
- 2) When a borrower receives a loan from a moneylender of 500,000 yen or more, or from several moneylenders of one million yen or more, he/she must submit a certificate of income and withholding tax, etc. (Total Value Restriction). This is to avoid the granting of a loan of more than a third of the borrower's annual income, which is a part of "the introduction of preventive measures against over-borrowing and over-lending."
- 3) Consumer data organizations designated by the government consolidate the debt situations of borrowers.
- 4) Stricter requirements were applied to people wishing to become moneylenders. A moneylender must have more than 50 million yen in net assets and has to follow strict rules regarding the content and frequency of TV commercials. Life insurance contracts were forbidden; this is one of the "various regulations for a fair moneylender industry."
- 5) Repeal of the Money Lending Business Control and Regulation Law Article 43 (deemed payment).²

Of these five points, the first (the maximum allowable interest rate restriction) and second (the value restriction) greatly affect borrowers.

After the first implementation in December 2006, the moneylender industry shrank considerably. The balance of unsecured loans for consumers decreased from 11.7 trillion yen in March 2006 to 7.2 trillion yen in March 2009, which indicates that the market shrank approximately 4.5 trillion yen over three years. Moneylenders brought down the maximum allowable interest rates to 18% before the final implementation in June 2010. The major consumer finance company, ACOM, lowered the floor rate from 12.0% to 7.7%. The average loan rate of the four major consumer finance companies (including ACOM) decreased from 22.2% at the end of March 2006 to 17.2% at the end of March 2009. This indicates that the profitability of the companies went down significantly. The rate of decrease in outstanding loans has become significantly larger (Fig.1). In particular, outstanding loans with an interest rate of more than 20% decreased by 7.5% in FY 2006 and by 20.9% in FY 2008. The rates of decrease in the total outstanding loans were 7.1% in FY 2006 and 19.4% in FY 2008 (Fig.2).

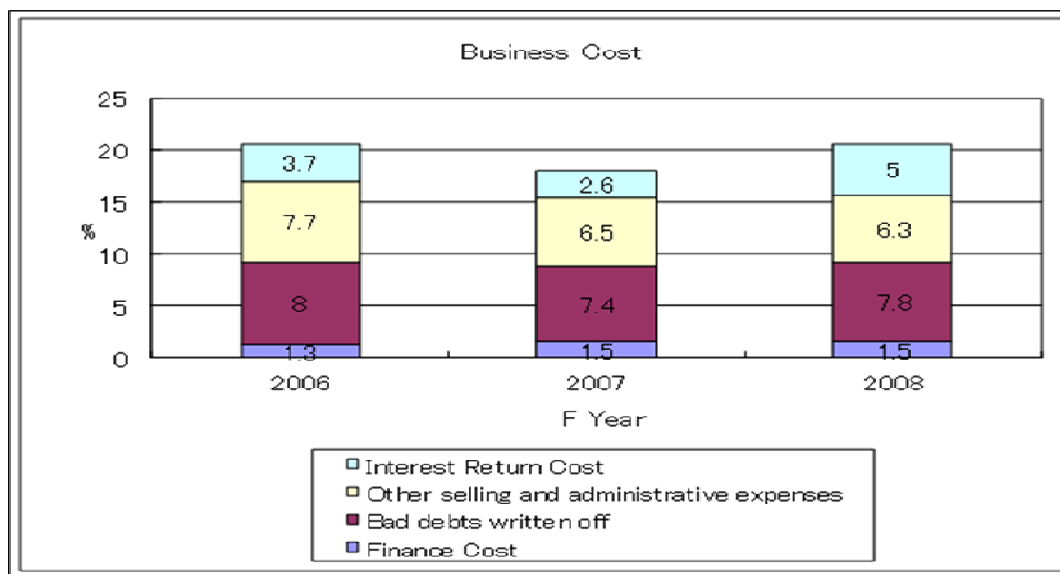
Fig. 1 .

² Regarding the Money Lending Business Control and Regulation Law Article 43 (deemed payment), in the case of borrowers being forced to pay interest at more than the maximum interest rate decided in the law, such interest is not considered to be paid arbitrarily and it is not a valid payment of interest. The Supreme Court made a judgment in January 2006 that "a payment with a special agreement (if a borrower does not pay interest at a decided rate, which is more than the maximum interest rate, he/she loses benefit of time) does not have arbitrary property." Since the judgment was made in January 2006, the number of cases "to request the return of overpaid interest" went up significantly.



※ LCRRC : Law Concerning the Regulation of Receiving of Capital Subscription
 LCRI : Law Concerning the Regulation of Interest

Fig. 2.



Many people were initially optimistic about the effects of the law revision. However, business confidence has totally changed since the revision came into effect. In particular, in rural areas, which tend to suffer more serious economic stagnation than urban areas, the effects of the law revision on regional economies in Japan have become a cause of great concern. In fact, the effect on these economies became a matter of concern especially after the final implementation. This is because there was insufficient debate about economic policies in the Diet. There should have been a clear distinction between, and full discussion of, the arguments from both sides: a discussion about social policies that help heavy debtors, and a separate discussion about economic policies or positive economics, such as the effects on macro stability and the effects on micro resource distribution. However, not enough attention was paid to the economic policies or positive economics aspect. As a

result, the entire economy, including individual consumption, is being adversely affected at present. In addition, there was insufficient debate on economic policies and social policies from the point of view of normative economics, such as poverty and gap issues.

In this report, the “economic effects of a central government’s policy on regions with different industrial structures” are discussed. The economic effects and employment effects of the following two cases are analyzed, with a focus on the Japanese economy, the economy of Hokkaido, whose main industries are primary and tertiary, and the economy of Osaka, whose main industries are secondary and tertiary.

- (1) Economic effects of the maximum allowable interest rate and the total value restrictions of the revised Money Lending Business Control and Regulation Law.
- (2) Economic effects of fixed-amount cash handouts as a public policy to pump tax money into the economy.

Problems with the law revision after the final implementation are revealed in this report by comparing the economic effects of the law revision with the economic effects of fixed-amount cash handouts paid to stimulate consumption.

2. Analytical Method

The “Inter-Industry Relations Table (authentic information) 2005” issued by the Statistics Bureau of the Ministry of Internal Affairs and Communications, and the “Hokkaido Inter-Industry Relations Table 2000 – Hokkaido Inter-Industry Relations and Coefficient Tables in 33 Sections” issued by the Hokkaido Regional Development Bureau in 2004 were used for this analysis.

For the analysis,

- 1) The amount of associated consumption was estimated by referring to user questionnaires and distributed proportionally to each section with an adjusted coefficient value.
- 2) An imputed interest (net income = interest income – interest expenses) of 2,106,661 million yen (Japan, 2005) was used as the production value of moneylenders (with unsecured consumer loans). This is the “imputed interest” estimated by the Financial Services Agency in “Moneylenders for Consumers (secured and unsecured loans).”

The data pertaining to Osaka and Japan presented in this report is from section “5-I Reanalysis of the Survey on Existing Fixed-Amount (Comparative analysis of data between Osaka and Japan) as of March 31, 2010 (The main survey was conducted from May 18 [Mon.] to 31 [Sun.], 2009)” in the “Report of the Survey on Moneylenders³” issued by the Moneylender Measure Section, Finance Room, Commerce, Industry and Labor Department, Osaka Prefectural Government. Then, the coefficients were distributed proportionally to the Inter-Industry Relations Tables in 33 Sections.

³ The Report of the Survey on Moneylenders, March 31, 2010, Moneylender Measure Section, Finance Room, Commerce, Industry and Labor Department, Osaka Prefectural Government (2010)

<http://www.pref.osaka.jp/attach/1917/00034733/doukoutoyousakekka.pdf>

The data on Osaka have been updated with data collected in a survey conducted from February 12 (Fri.) to 15 (Mon.), 2010.

The Survey on Users of Moneylenders and the Results of the Questionnaire on Moneylenders (Questionnaire surveys of the Japan Financial Services Association), April 30, 2010, Financial Services Agency (2010)

<http://www.fsa.go.jp/news/21/kinyu/20100430-3.html>

The data for Hokkaido is assumed to be the same as the data for Japan (Fig.3 and 4).

To include various values regarding the profits of financial suppliers of the consumer finance service industry, 2,106,661 million yen (Japan, FY 2005) was used as the “imputed interest” of “moneylenders for consumers (secured and unsecured loans).” The imputed interest was estimated by the Financial Services Agency in the section “Changes of the production value of moneylenders for consumers in Japan.” The imputed interest was inserted in parallel with the loan balance of moneylenders for consumers (unsecured loans; based on business reports) and the rate of decrease in the loan balance of moneylenders for consumers (unsecured loans; based on business reports) until FY 2008. Imputed interest figures are set to 1,947,503 million yen for FY 2006, 1,612,678 million yen for FY 2007, and 1,299,438 million yen for FY 2008, although they include secured loan balances.

Fig.3.

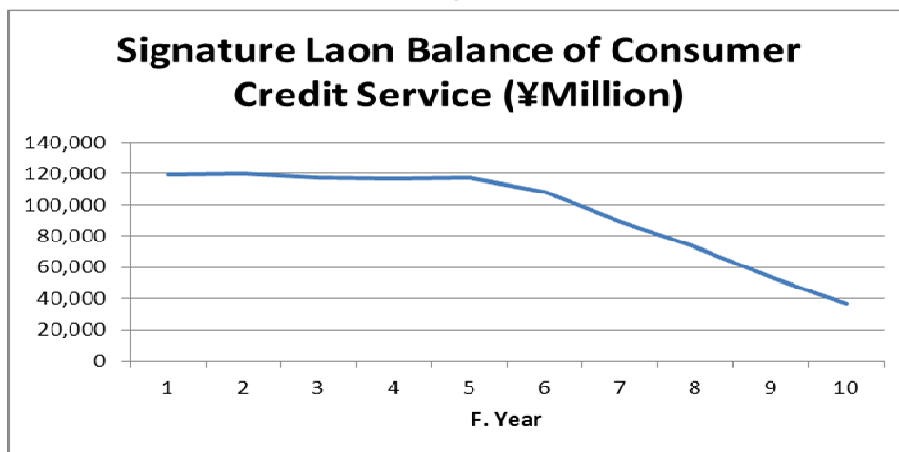
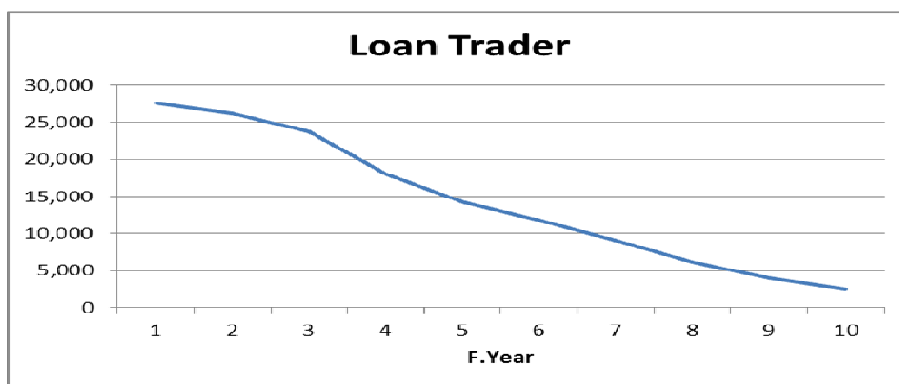


Fig.4.



3) Values regarding the loan balance (unsecured loans; based on business reports) of moneylenders in FY 2008 were also referred to for the calculations relating to the total value restriction. In the

Report of the Survey on Moneylenders (March 31, 2010) issued by the Moneylender Measure Section, Finance Room, Commerce, Industry and Labor Department, Osaka Prefectural Government, which was used for the analysis of the maximum allowable interest restriction, the results of a questionnaire show that 52.8% (Japan: n=3136) and 54.8% (Osaka: n=250) of current users violated the total value restriction in FY 2009. The Survey on Users of Moneylenders and the Result of the Questionnaire on Moneylenders were published by the Financial Services Agency on April 30, 2010. In the Report of Survey Results⁴ in the Survey on Users of Moneylenders (March 24 to 26, 2010), the percentage of users who have taken loans in the last three years, have a loan balance with a consumer finance company, and have violated the “total volume restriction,” is 42.1%. In this report, the results of questionnaires conducted by the Osaka Prefectural Government were used. The base of coefficients for the total volume restriction was calculated by multiplying the loan balance of moneylenders for consumers (unsecured loans) in FY 2008 by the percentage of users who violated the total volume restriction.

The values for Hokkaido were calculated under the assumption that Hokkaido’s share of the national GDP was 3.82% in FY 2005 and 3.65% in FY2006 and 2007. Then, the economic effects of the decrease in the loan balance were estimated. Osaka’s share of national GDP is considered to be 7.56% (FY 2005), 7.52% (FY 2006) and 7.55% (FY2007).

- 4) The Aso Cabinet adopted the second supplementary budget for FY 2008 that included the distribution of a fixed-amount cash handout amounting to two trillion yen as one of its additional economic measures. The purpose of the measure was “to respond to the anxieties of citizens suffering from the economic stagnation, to help their lives, and to stimulate regional economies by distributing cash handouts widely to citizens.” On February 1, 2009, (1) Japanese residents registered in a municipality, or (2) Non-Japanese residents registered in a municipality were entitled to receive the benefit (non-Japanese residents without a proper visa or people holding a tourist visa were not eligible). The head of each household which had eligible family members applied for and received the benefit. (In the case of non-Japanese residents, each eligible resident applied for and received the benefit.) The value of the benefit was 12,000 yen per person. (However, people aged 65 and older and people aged 18 and younger received 20,000 yen per person.) Data for Hokkaido on the reference date was collected by referring to estimated data for 2010 in the section “Results of the estimation: Populations for each prefecture sorted by gender and by five-year groups, and lists of the estimation results for each prefecture” in “Estimated Future Populations of Each Prefecture in Japan (estimated in May 2007)”⁵ edited by the National Institute of Population and Social Security Research in 2009.

The number of people in “Estimated Future Populations of Each Prefecture in Japan” was for those aged between 15 and 19 years old. To give an even division for each age group, this

⁴ The Survey on Users of Moneylenders and the Result of the Questionnaire on Moneylenders were published by the Financial Services Agency on April 30, 2010. In the Report of Survey Results of the Survey on Users of Moneylender (March 24 to 26, 2010) [Table 10] the rate of borrowers who violated the total value restriction: <http://www.fsa.go.jp/news/21/kinyu/20100430-3/01.pdf>

⁵ Website of the National Institute of Population and Social Security Research: <http://www.ipss.go.jp/pp-fuken/j/fuken2007/t-page.asp>

number was divided by five, with 80% of that number then being allotted to the 15 to 18 age group, with the other 20% taken as being the number of 19-year-olds.

The fixed-amount cash handout can be considered as a temporary income and an increment of income. In order to determine the increment of consumption, consumption propensity was calculated as below. The average consumption propensity (after-tax income of consumer expenditure) of households that received the fixed-amount cash handouts was calculated three times, at the end of every quarter from March to December 2009, which was when the cash handouts were distributed. The results of household budget surveys (household income and expenditure) were published; these were categorized into two groups—those who filled in the values of the fixed-amount cash handouts and those who did not. A consumption propensity of 0.63 is used here. This is the average of the average percentages of consumption propensity (64.9% from April to June, 72.2% from July to September, and 52.0% from October to December, 2009) which were calculated in “The percentage against after-tax income and the average consumption propensity (%) (previously presented)” in “All Households” in the Statistical Data⁶ (2009), published on the website of the Ministry of Internal Affairs and Communications.

Secondly, the total value of cash handouts in Hokkaido was calculated. The amount of 20,000 yen was paid to each of 2,204,886 people for a total of 44,097,720,000 yen. The amount of 12,000 yen was paid to each of 3,338,670 people for a total of 66,773.39 million yen. Therefore, the total value of cash handouts paid in Hokkaido was 84,161.760 million yen.

The amount of money used 0.63 by recipients for consumption can be calculated by multiplying consumption propensity by the total value of the cash handouts. The cash handout was transient this time, so the money used by recipients for consumption is the increase in final consumption value, which is 5,302,190.88 million yen.

Consumption converters were created according to enumerated data in the Inter-Industry Relations Tables regarding the final consumption commodities, and the increase in final consumption value was distributed proportionally to each commodity using these converters.

Table 5

Cost	Proportion	Proportion (when the sum is 100%)	Note
Cost of living (food, etc)	38.9	0.180594243	A third of this portion is for 03. Food A third of this portion is for 22. Estate A third of this portion is for 18. Electricity, Gas, Heating 19. Water, Waste Disposal 24. Communication,

⁶ The Director-General for Policy Planning (Statistical Standards) and the Statistical Research and Training Institute of the Ministry of Internal Affairs and Communications [13](2009) “Monthly income and expenditure for a household sorted by household attributes and divided into two groups: those who filled in the amounts of cash handouts and those who did not”

			Broadcasting
Purchase of goods	31.5	0.146239554	This portion is for 20. Commerce
Payment of debts	19.1	0.088672238	This portion is for 32. Unsorted
Entertainment	17.5	0.081244197	This portion is for 30. Personal Services
Travel and leisure	16.8	0.077994429	Half of this portion is for 23. Transportation and the other half is for 30. Personal Services.
Eating- and drinking-out	16.4	0.076137419	The portion is for 30. Personal Services
Gambling such as Japanese pinball and horse racing	14.1	0.06545961	This portion is for 30. Personal Services
Pocket money	13.3	0.06174559	This portion is for 32. Unsorted
Business fund	10	0.046425255	This portion is for 32. Unsorted
Housing and car loans	7.4	0.034354689	This portion is for 32. Unsorted
Medical care	7.4	0.034354689	This portion is for 27. Medical care, Insurance, Social Security, Nursing
Education for children	5.9	0.027390901	This portion is for 26. Education, Research
Moving (including deposit and key money)	5.6	0.025998143	Half of this portion is for 22. Estate and the other half is for 23. Transportation.
Ceremonies	5	0.023212628	This portion is for 30. Personal Services
Other	5.8	0.026926648	This portion is for 32. Unsorted
No answer	0.7	0.003249768	This portion is for 32. Unsorted
Total	215.4	1	

3. Analysis Results

3.1 Economic Effects of the Maximum Allowable Interest Restriction

The effects of the maximum allowable interest restriction can be seen in nominal GDP growth rates: minus 0.22% in FY2006, minus 0.49% in FY 2007 and minus 0.45% in FY 2008. Due to the economic slump, the numbers of resulting unemployed were approximately 150,000 in FY 2006, 340,000 in FY 2007 and 320,000 in FY 2008.

The effects of the maximum allowable interest restriction in Hokkaido cooled the economy. Nominal GDP growth rates were minus 0.14% in FY 2006, minus 0.30% in FY 2007 and minus 0.28% in FY 2008, which indicates that the effect of the restrictions was to bring down the economy at an annual average rate of 0.24%. There was also a negative effect on the total number of unemployed, which reached approximately 290,000.

The effects of the maximum allowable interest restriction in Osaka also cooled the economy. Nominal GDP growth rates were minus 0.16% in FY 2006, minus 0.33% in FY 2007 and minus 0.31% in FY 2008, which indicates that the restriction brought down the economy at an annual average rate of 0.27%. There was also a negative effect on the total number of unemployed, which reached approximately 380,000.

3.2 Effects of the Total Value Restriction

According to a questionnaire survey conducted by the Osaka Prefectural Government, if 50% of the users who violated the total value restriction went bankrupt, the effect of the total loan value restriction started from June 2010 would be to bring down the nominal GDP growth rate (2008) of Japan by 0.38% and create 230,000 unemployed. The effect of the restriction would be to bring down the nominal GDP growth rate of Hokkaido by 0.25% and create 10,000 unemployed. The restriction would bring down the nominal GDP growth rate of Osaka by 0.64% and create 30,000 resulting unemployed. The nominal GDP of Osaka is twice as big as that of Hokkaido. The fact that refunding became more difficult due to the total volume restriction seems to have had a much greater effect in Osaka. Therefore, additional measures are necessary to protect users and employees. In this respect, the Osaka Prefectural Government has recently established a special zone and announced measures to prevent users from defaulting.

3.3 Effects of the Fixed-Amount Cash Handouts

When the consumption propensity with cash handouts was 63%, the effect of the cash handouts was to raise the nominal GDP of Japan by 0.31% and create approximately 190,000 unemployed. They raised the nominal GDP by 0.3% and created 7,695 employed in Hokkaido, and in Osaka they raised the nominal GDP by only 0.2% and created 8,440 unemployed. The nominal GDP of Osaka in FY 2008 was approximately 38 trillion yen, which was about twice as big as that of Hokkaido (18 trillion yen). However, the economic effect in creating new employment was small. The cash handout was paid only once to enlarge final consumption. Its cost effectiveness should be examined thoroughly (Fig. 6, 7 and 8).

3.4 Effects of the Underground Finance

Underground Finance resulted negative effects, including nominal GDP growth rate shrinkage of -0.3% and lose jobs for about 341,138 people.

Fig. 6

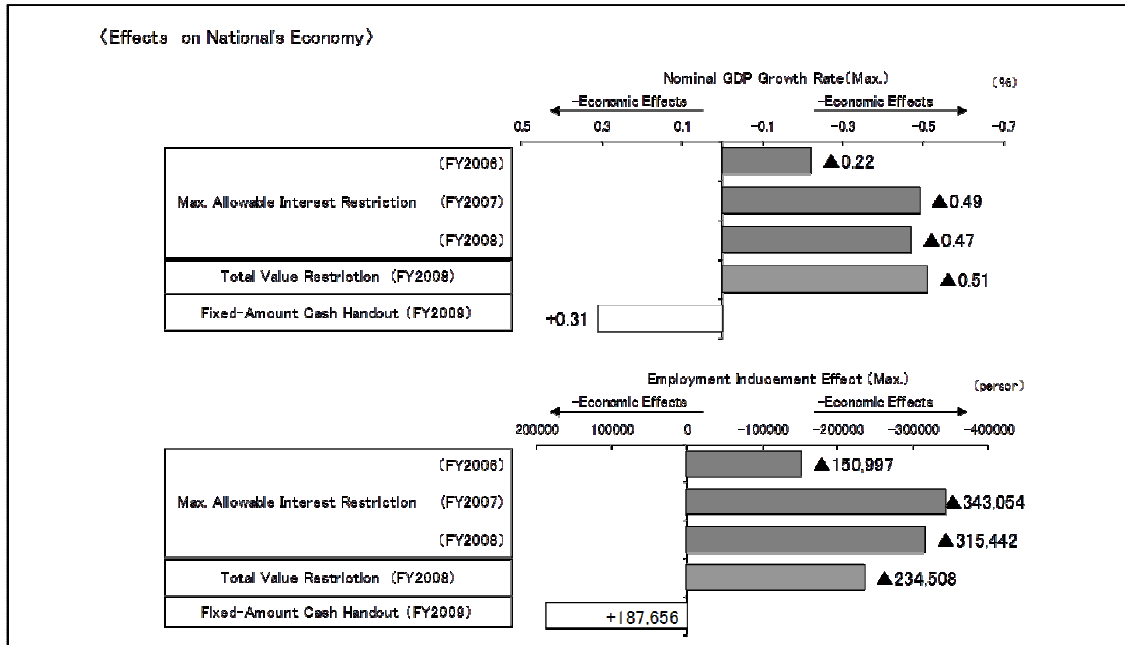


Fig. 7

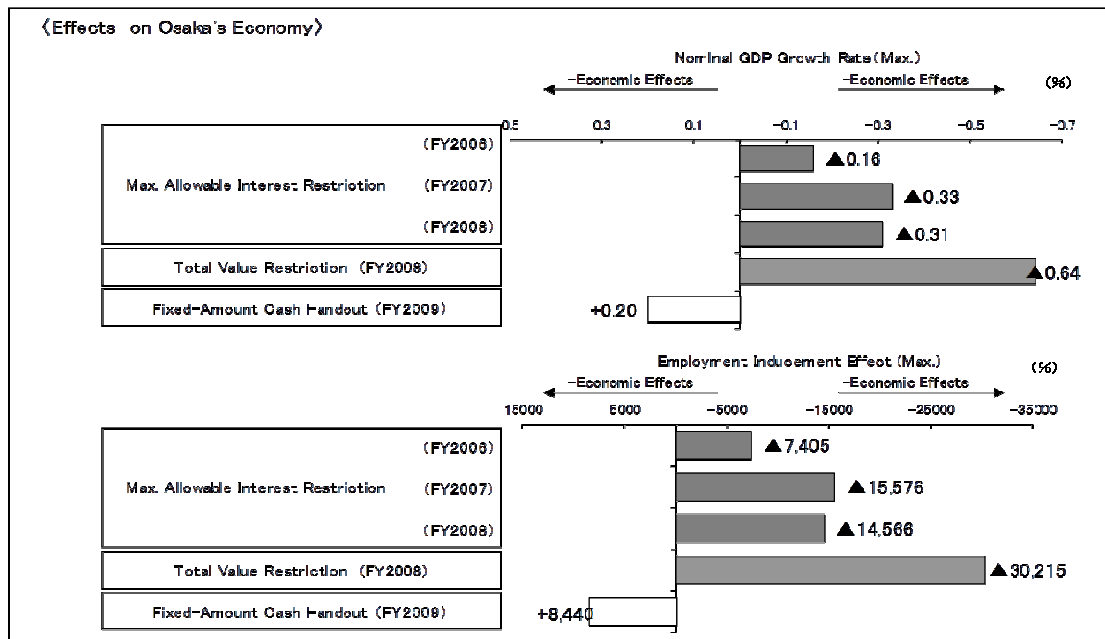
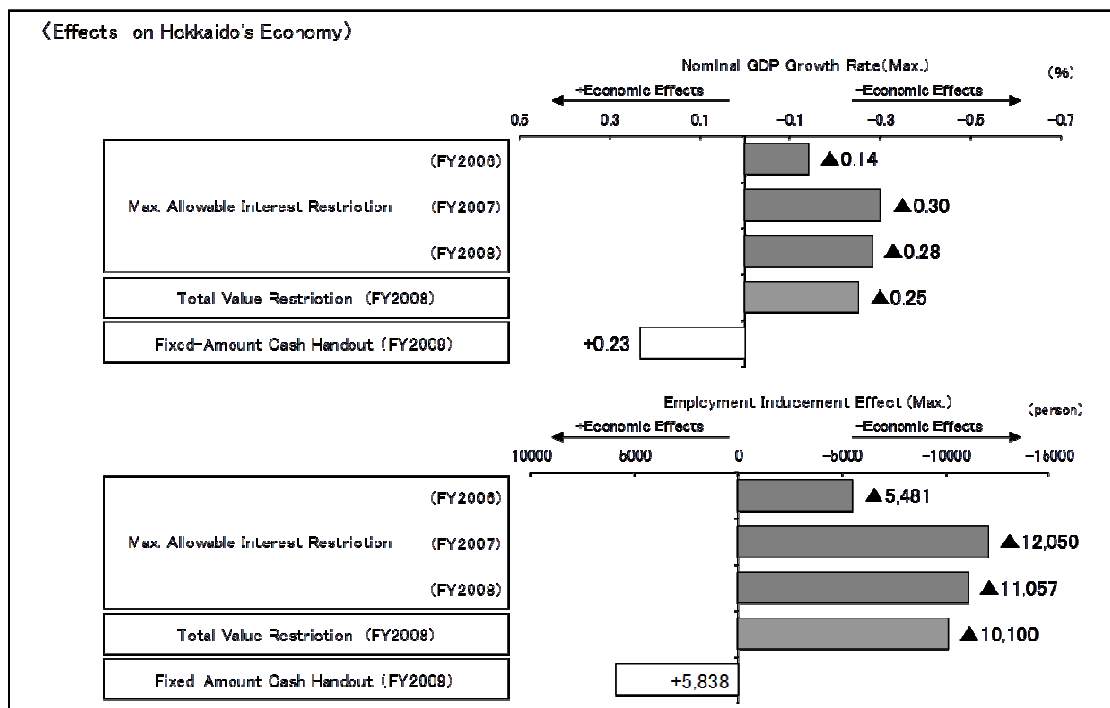


Fig. 8



4. Conclusion

The maximum allowable interest rate and the total value restrictions force the economy into a slowdown and create more unemployed.

The results can be summarized in the following five points.

- I. The maximum allowable interest rate and the total value restrictions go against the tide of monetary easing and would cause an extreme liquidity constraint. As a result, they worsen the economy and increase the number of unemployed.
- II. The total value restriction disturbs the free economic activities of borrowers with salaries above a certain level and
- III. Certain borrowers should be exempted from the Money Lending Business Control and Regulation Law. This should not apply to pathological heavy debtors
- IV. Special exceptions for refunding and exemptions from the total value restriction, etc. should be considered, since there are situations that cannot respond to big transformations and easing.
- V. Examination of a drastic revision should be started as soon as possible.

These results can be justified with the following reasons.

- (1) There should be a clear distinction in the discussions about aspects of social policies and aspects of economic policies; unfortunately, these are often confused.
- (2) What are the right measures for the government to take?
 - (2-1) The raison d'être of moneylenders is to make extremely short-term loans and small-amount

loans so that the development of professional environments like the call market, in which anybody can collect funds, can raise the competitiveness of individuals and entrepreneurs. As a substitute for direct financing, it is better to raise funds from moneylenders than discounting a promissory note with high interest.

- (2-2) The Supreme Court decision that made it possible to request the return of overpaid money ignores completely the “responsibility of borrowers.” Business behavior that followed the laws and directions of government and lent money with interest calculated based on time and opportunity costs, was not considered. Moneylenders simply demanded “returns of past time” and they “respected laws.”
- (2-3) The maximum allowable interest rate and the total value restrictions were decided without any discussion of the economic aspect, such as the “relationship between borrowing periods and interests” and “the critical point of going bankrupt which is decided by paying capacities and interests.” As a matter of fact, this caused credit rationings and liquidity constraints and users were forced to depend on loan sharks. The deficiencies of the system are revealed. The establishment of a refunding system is necessary. With such a system, borrowers, who originally wanted to make short-term loans but are unable to pay back their debts, can smoothly shift a short-term refunding plan to a long-term refunding plan. Borrowers at the critical point of going bankrupt, whose interest cost is less than their monthly income, should be exempted from the restrictions. The restrictions are necessary only for pathological heavy debtors. A drastic revision of the law to solve problems should be examined as soon as possible.

(3) Estimation Results

According to the estimate, after the final implementation of the revision of the Money Lending Business Control and Regulation Law in June 2010, the economic effects of the maximum allowable interest rate and the total value restrictions would bring down the nominal GDP growth rate by minus 0.83% based on the total loan balance in FY 2008, and the number of resulting unemployed would be 549,945.

This is the result of analyzing only “the unsecured loan balance of moneylenders for consumers (unsecured loans),” which is approximately 17% (6,586.5 billion yen) of the total loan balance (37,846.7 billion yen in FY 2008) of moneylenders. If the data for cash advances and loans by credit card companies were added to the analysis, the economic effects would be even greater.

(4) Negative effects predicted to happen according to the estimation results

- (4-1) Finance suppliers are forced to scale down or close down their businesses.
- (4-2) Due to dwindling funds, unincorporated enterprises are forced to scale down or close down their businesses and the liquidity in the hands of housewives, etc. is lowered. This causes more civil rehabilitations, personal bankruptcies and cases of people disappearing to avoid loan sharks. Therefore, final consumption regarding living necessities goes down drastically.
- (4-3) Problematic borrowers shift from being tax payers to being recipients of unemployment insurance and welfare benefits.
- (4-4) Tax revenue goes down and government expenditure goes up. Public security deteriorates and government revenues decrease.

In fact, the loan balance of the seven major consumer finance companies was approximately 3.7 trillion yen as of August 2010. It had always been around 8.5 trillion yen until 2005. Therefore, it is about 44% of what it used to be. The initial contract rate went down from 56% to 30%.

The number of moneylenders in Japan went down from 47,504 in 1986 (1,147 companies registered to the finance bureaus and 46,357 companies registered to municipalities) to 2,701 by the end of November 2010 (360 companies registered to the finance bureaus and 2,341 companies registered to municipalities), which is 5.7% of its peak figure⁷. In particular, many local small companies were closed down. The consumer finance service industry and its market were damaged severely.

It is becoming more obvious that there are many people who have become “unhappy because they could not borrow money.” Many of them are housewives, who cannot show their incomes, and sole business proprietors whose family members became debtors because they took personal loans for business funds. According to an estimate by Hiroshi Domoto (2011), the number of loan shark users is increasing: 460,000 as of May 2008, 420,000 as of May 2009, and 580,000 as of May 2010. The number of users went up greatly in the last year, so it is possible that fund demanders are using loan sharks as a means of short-term funding.

The reality indicates that the use of loan sharks is increasing against the intention of the revision.

4.2 Points arising in the analysis results

- (1) The calculation of economic ripple effects is the calculation of multiplier effects. It is used often for the numerical simulation of project results. Numbers cannot fully be trusted.
- (2) The program used this time calculates multiplier effects by infinitely looping. Therefore, results such as economic ripple effects are the final results after infinite years.
- (3) Since the average propensity to consume is used in the analysis, result values tend to be bigger. If a marginal propensity to consume were used, result values would become smaller and closer to reality.
- (4) To estimate the amount of associated consumption, employer incomes are used, but incomes after tax and social security costs should be used. The national burden rate⁸ was 39.0% in 2010, so employer incomes are reduced by approximately 40%.

⁷ “Statistic Data on Moneylenders,” December 28, 2010, Website (2010) of the Financial Services Agency: <http://www.fsa.go.jp/status/kasikin/20101228/01.pdf>

⁸ The national burden rate calculated by the Ministry of Finance: <http://www.mof.go.jp/jouhou/syukei/futan.htm>

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