Five Public Sector Financial Institutions to Merge

By Aoki Masaru

THE Koizumi cabinet continues with the privatization of the postal service, a source of public funds, and is reforming policy financing, a drain on those funds.

In May 2006 the Diet passed the Administrative Reform Promotion Law, which establishes fundamental policies for policy financing reform and the reduction of total civil servant personnel expenses. At the beginning of June, the institutional design was approved at a meeting of the government's Policy Financing Reform Promotion Headquarters. As a result, five of the eight public-sector financial institutions entirely or partially funded by the government will merge by October 2008 to form a new type of policy finance institution, and two institutions will be converted into private-sector corporations. The goals of policy financing reform are to put the brakes on the runaway expansion of public-sector financial institutions, and to stimulate the efficient application of capital in the private sector. The Koizumi cabinet, which has pushed the movement "from public to private" as the fundamental philosophy of its structural reform efforts, followed the proposal for legislation to privatize the postal service in October 2005, a reform targeting a source of public funds, with a proposal for radical reform of policy financing, a drain on public funds. The government will submit proposed legislation to the Diet by 2007 at the latest.

Using postal savings and other monies, public sector financial institutions have traditionally provided funding in accordance with national policy. Taking "supplementing the private sector" as their fundamental policy, they provided funding in areas shunned by private-sector financial institutions due to high risks or for other reasons. However, there was persistent criticism from the financial community that this allowed the government to exercise undue pressure on private companies. As a step toward the reform of special public corporations, the Development Bank of Japan (DBJ), the Export-Import Bank of Japan (EXIM Bank) and four other institutions were merged into three corporations in 1999. The Koizumi cabinet, which took office in 2001, decided to abolish the Government Housing Loan Corporation in FY 2007 and continue its functions through an independent administrative institution. That left eight institutions to reform. With private-sector financial institutions wrestling with the bad debt problem, financial conditions at that time were strongly colored by banks' reluctance to lend, and calls from government and the ruling party for policy financing grew stronger. At the December 2002 meeting of the Council on Fiscal and Economic Policy it was decided to (1) implement a new structure in FY 2008 and (2) to adopt a policy restricting total future financing to half of GDP, and the debate on reform was shelved.

Then in 2005, the Koizumi cabinet introduced proposals for legislation privatizing the postal service, which it designated the lynchpin of reform efforts. This proposed legislation was rejected in August by a plenary session of the House of Councillors, but was reintroduced following the resounding victory of the Liberal Democratic Party (LDP) in the September House of Representatives election. A majority composed of both the LDP and the New Komeito passed it into law in a special session of the Diet in October. With the way paved for the privatization of the postal service, a long-cherished wish of Prime Minister Koizumi Junichiro, the next priority was the reform of the policy-financing field, which is a drain on public funds. Following the House of Representatives election, the outspoken opposition within the LDP to the merger and privatization of the eight remaining public-sector financial institutions dissipated, and a fundamental approach to policy financing reform was hammered out at a November meeting of the government's Council on Fiscal and Economic Policy.

Two Institutions to Become Private Corporations in October 2008

The underlying principle of this fundamental approach is to limit the functions of public-sector financial institutions to: (1) supporting the procurement of funds by small and medium-sized businesses and individuals; (2) securing resources important to national policy from overseas and providing financing indispensable to international competitiveness; and (3) providing yen-loan financing. It was decided that public-sector financial institutions would withdraw from all other operations. Further, to realize a "small and efficient government," total policy financing will be reduced to half of GDP before the end of FY 2008, the enterprises in question will be completely privatized, and the practice of hiring former government officials will be abolished.

It was decided that: (1) the National Life Finance Corporation, the Japan Finance Corporation for Small Business, the Agriculture Forestry and Fisheries Finance Corporation, the Okinawa Development Finance Corporation, and the Japan Bank for International Cooperation (JBIC) will merge to become a new institution, based on the special company or the independent administrative agency format; (2) the DBJ, which primarily provides financing to large corporations, and the Shoko Chukin Bank, which receives investment from the private sector, will be completely privatized; and (3) the Japan Finance Corporation for Municipal Enterprises, which underwrites joint bond issues by local governments and public corporations, will be abolished. Of these, the Okinawa Development Finance Corporation will remain in existence until the completion of the Okinawa Promotion and Development Plan in FY 2011, in consideration of the realignment of the US Forces in Japan. It will then merge with the new institution.

JICA will Operate Soft Loans

However, the government and the ruling parties have postponed any announcement of a successor to the JBIC overseas economic cooperation functions, and have established the Council for Overseas Economic Cooperation (Harada Akio, Chairman) under Chief Cabinet Secretary Abe Shinzo. In March 2006, the council submitted a proposal for ODA reform to Abe, the major provisions of which were (1) moving toward the unification of aid agencies by dissolving the JBIC and consolidating soft loans under the Japan International Cooperation Agency (JICA), and converting the JBIC into a new policy finance institution that provides international financing for resource development, and (2) establishing an organization tentatively named the Overseas Economic Cooperation Committee to develop ODA strategy proposals for the cabinet.

The government submitted proposed legislation to the Diet, incorporating policy finance reform and other issues, and this proposed legislation was enacted by a plenary session of the House of Councillors on June 26. Then, at a meeting on June 27, the Policy Financing Reform Promotion Headquarters decided on a system design for public-sector financial institutions that specifies the shape of organizations and operations in greater detail. This design specifies that the new type of policy finance institution to be formed from the five institutions will take the form of a special company.

A special company is established by a special law but deemed a corporation under the Company Law. Its operation is fundamentally in accordance with the Company Law, and it strives for highly transparent and efficient management through the same accounting procedures and corporate organization as private-sector companies. The stock of the new type of policy finance institution will be wholly owned by the government, and fund procurement will be via government-guaranteed bonds. Accounts will be audited in accordance with corporate accounting principles by an independent auditor whose duties will be as specified in the Company Law. In addition, representatives of the company will “give due consideration to restraint in the permanent appointment of persons with a background in certain areas of public service,” incorporating the current restriction on executives who are former government officials to approximately half the total number.

The internal organization of the new type of policy finance institution will be broadly divided into a domestic business division, an international business division, and the accounting for these will be managed separately. In the interest of maintaining relationships of trust built over the years, the international business division will adopt and use the name of the present JBIC, and the use of this name for the entire institution is under consideration. The new type of policy finance institution will build a structure that will allow it to supply funds in times of financial instability, disaster, or other emergencies.

The DBJ and Shoko Chukin Bank will each commence operations as special companies in October 2008, the DBJ being wholly owned by the government, and the stock of the Shoko Chukin Bank in the hands of both government and existing investors. The government will reduce funding to both these institutions as the market allows, and will cease all funding from five to seven years after their conversion to the new structure in fiscal 2008. In the interval until complete privatization, the DBJ will be allowed to issue government-guaranteed bonds. Following privatization, both institutions will be subject to the Bank Law and all other laws and regulations pertaining to financial institutions.

With the abolition of the Japan Finance Corporation for Municipal Enterprise in FY 2008, local governments will jointly establish new organizations and issue bonds as needed to procure needed funds. The government will not, therefore, be involved in any facet of funding, guarantees, people, and money.

Total loans outstanding at the eight financial institutions as of March 31, 2005 were ¥90.9 trillion. Total loans outstanding of the five institutions that will merge to become the new type of policy finance institution will be approximately ¥30 trillion, but even this is more than the combined ¥26 trillion (as of March 31) of the four banks under the Resona Holdings, Inc. umbrella. When this new type of policy finance institution is formed, a total of approximately 1,100 people doing the same jobs in administrative divisions will have to be unified and the consolidation of 80 of 233 branches will have to be undertaken to reduce redundancy. These steps will reduce personnel and operating expenses. However, because no specific policy regarding reductions in the workforce has been announced, the degree to which the effects of rationalization will be seen following the merger remains unknown.

The institutional design of the new type of policy finance institution mandates the establishment of evaluation and oversight systems, including an Assessment Committee composed of persons with appropriate knowledge and experience from outside the institution, with a mission of “ceaselessly re-evaluating the necessity of operations while steadfastly supplementing the private sector.” Because the possibility exists that the institutions that merge to form the new type of policy finance institution will seek to preserve existing operations, it will be necessary to observe operations with an austere eye. JS

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