

Emergency Economic Package for Drastic Disposal of Bad Loans

By Tani Sadafumi

In early April, the government and ruling parties worked out the Emergency Economic Package to accelerate the disposal of bad loans and limit stock holding by banks. While the economic countermeasures, mainly the addition of new public works projects, that have been taken since the bursting of the bubble economy were expected to stimulate total demand, this Emergency Economic Package emphasizes the promotion of structural reform. However, the disposal of bad loans may very probably cause liquidations of unprofitable companies and an increase in the unemployment rate. Regarding the establishment of the Bank Equity Purchasing Corporation (BEPC; provisional name), the Ministry of Finance and younger members of the Houses who belong to the Liberal Democratic Party (LDP) have come out against its foundation, saying, "It will be an inappropriate intervention in the market." (Watanabe Yoshimi). Furthermore, it is not clear whether the organization will work practically.

The Nikkei Stock Average (closing price) on the Tokyo Stock Exchange was ¥13,691 at the beginning of this year, ¥12,883 on February 28, below ¥13,000, and down to ¥12,681 on March 1, which was below its lowest level since the bubble burst (¥12,879 on Oct. 9, 1998). The average dropped down further to ¥11,819 on March 11. Although the Nikkei Stock Average lost its continuity as an index because of the drastic replacement of issues last year, this collapse of the stock market scared not only traders and investors but also the policy-affairs members of the government and ruling parties.

Facing the harsh reality, the LDP planned a measure to bolster stock prices in February and put economic measures into shape together with the other two ruling parties, the New Komeito and the New Conservative

Party, in early March. On March 15, the government and ruling parties organized the Emergency Economic Measures Headquarters, lead by then Prime Minister Mori Yoshiro and announced the emergency economic measures on April 6. Then, on April 20, the LDP's tax commission began discussing tax reforms.

The key phrases for the Emergency Economic Package were "structural reform" and especially the "disposal of bad loans." It is said that the bad loans have prevented the more than ¥100,000 billion in financial investments that have been made in the last 10 years from reviving the economy. This view indicates that economic buoyancy cannot be triggered simply by injections of "hemostatic agents" and "camphor" unless the "diseased part" is removed.

The State Minister in Charge of Financial Affairs Yanagisawa Hakuo suggested the need for financial institutions to directly redeem (off-balance or write off) bad loans. Financial institutions have not always neglected to deal with bad loans; however, they have chiefly dealt with them by indirect redemption or by adding reserve funds to cover expected bad debts. When the value of mortgaged real estate fell, they had to increase their reserve funds. Thus, they could not be relieved of the burden of bad loans. Most direct redemptions of bad loans they conducted occurred under backward-looking conditions in which financially assisted companies went bankrupt.

Conversely, Yanagisawa's opinion was forward-looking. He suggested removing bad loans from banking facilities' balance sheets by abandoning or selling credit. In the Japan-U.S. summit meeting held in Washington D.C. on March 19, U.S. President George W. Bush strongly requested Mori to promote the disposal of bad loans. Mori recognized that the disposal of bad

loans was the most urgent issue and answered that the Emergency Economic Measures Headquarters was focusing on the problem, indicating the government's policy to directly deal with the bad-loan issue. At the conference of G-7 Finance Ministers and Central Bank Governors held on April 28 in Washington D.C., newly appointed Finance Minister Shiokawa Masajuro presented the contents of the Emergency Economic Package and internationally committed himself to its steady implementation.

Japanese banks (excluding credit associations and agricultural cooperatives) have a total of ¥24,000 billion (as of the end of September 2000) in loans to bankrupt or nearly bankrupt debtors and debtors believed to be bankrupt. The government's policy for disposing of bad loans is to make major banks off-balance bad loans amounting to ¥12,700 billion (as of the end of September 2000) within two years in fiscal years of 2001 or 2002. Furthermore, the government's policy requires the major banks to dispose of new bad loans within three years.

In response to this policy, Nishikawa Yoshifumi, the president of Sumitomo Mitsui Banking Corporation and a former president of the Japanese Bankers Association, expressed a cooperative attitude, saying, "It is right for us to be in a hurry to dispose of bad loans." The United Financial of Japan (UFJ) group, consisting of Sanwa Bank, Tokai Bank, Toyo Trust & Banking and many other major banks have added reserve funds before the end of the fiscal year 2000, although they might show deficits in their settlements of accounts. They have aimed to minimize adverse influences in their business of the off-balancing to be started in fiscal 2001. This measure, however, requires the approval of the financially assisted companies in the final stage of

the bad loan disposal, because, "The disposal cannot be implemented only through the banks' decisions," Nishikawa said.

For example, even if a bank plans to abandon a part of a loan to a stagnant company on condition that the company sheds its unprofitable divisions to help the company recover its business, the bank can carry out the plan only with the company's approval. It is not easy for the company to transfer employees from unprofitable divisions to others, and the traditional Japanese relations between labor and management may cause opposition to layoffs. In a macroeconomic view, the shedding of a large number of unprofitable divisions is a deflationary factor. Selling bad loans can be another way to dispose of them. However, Japanese loan markets are not well-ordered and investors' ability to take risks is low when compared with those in Europe and the United States. A major bank executive said, "We cannot place our hope very much on selling bad loans." Furthermore, the loans to bad credit risks, which are not the targets of disposal promoted by the Emergency Economic Package, seem to include many loans to stagnant general constructors, distribution companies and the public-private sector. According to the expected economic trend, it is also indicated that these loans may deteriorate into loans to debtors suspected of bankruptcy.

As mentioned above, there are many problems in achieving the objective of off-balancing bad loans, but economists agree that bad-loan disposal is essential for the reactivation of the Japanese economy. Claiming to stand for structural reform, Prime Minister Koizumi Jun'ichiro has ordered Yanagisawa to remain in office and clearly set forth his stance for implementing bad-loan disposal, which has been an international commitment.

Another big issue in the Emergency Economic Package is a limitation on the stocks held by banks. Major banks hold a total of ¥37,000 billion in stocks (at the end of September 2000) and seem to have a total of ¥5,000 billion to ¥7,000 billion in latent losses. Because

accounting at market values is applied to settlements from the fiscal year 2001 and it is undesirable that bank operations are affected by changes in stock prices, the Emergency Economic Package includes a policy to limit the amount of stocks held by a bank to a level within the bank's risk management capacity, for example, to at most a percentage of the bank's owned capital.

For instance, if stock holding is limited to Tier 1 (including funds and surpluses), which are fundamental capital resources of major banks, they will have to sell over ¥13,000 billion in stocks. If such a large amount of stocks is released in the sluggish stock market, stock prices will undoubtedly fall. In anticipation of this, the government has established BEPC in the Emergency Economic Package to temporarily retain the stocks held by banks.

Many functions of this organization still remain unclear. It has already been decided that the main investors for the organization will be banks and that the government will provide a degree of protection against secondary losses which may occur if the stocks bought by the organization fall in price. However, some important details regarding the operation are undecided; namely, whether banks will be allowed to decide the issues of stocks to be sold to the organization and how far the government will participate in the organization's operation. The government's participation, in particular, has caused controversies during the making of the Emergency Economic Package.

Former Finance Minister Miyazawa Kiichi and Kamei Shizuka, former Chairman of the Policy Research Council of the LDP, proposed an aggressive participation by the government; while younger House members of the LDP were opposed to the proposition. Hiranuma Takeo, Minister of Economy, Trade and Industry, urged for a cautious attitude, saying, "In principle, we should promote economic structural reform and deregulation while respecting the independence of the stock market to let the market function smoothly." Counter to the push for aggressive government participa-

tion, noting that Nippon Shoken Hoyu Kumiai (Japan securities holding association) made a profit from stocks bought during the depression in the securities market in the 1960s, Yanagisawa stated, "We should remember that the Japanese economy is not in a growth period. Good luck does not always repeat itself. We must not think about this in an easygoing way."

The most recent tax reform aims to direct private property said to amount to ¥1,300,000 billion into the stock market. The new tax system does not impose a tax on personal profits from transfers of stock that is worth up to ¥1 million a year and has been held for one year or longer. The new tax system will be enforced in October 2001. Regarding the taxation on stock transfer profits, the LDP's tax commission discussed but shelved a reform plan to integrate the withholding separation system, which has a low tax rate, into the declaration separation system at the end of 2000. Under these circumstances, there were many concerns regarding the impartiality of the taxation system. For example, Hitotsubashi University President Ishi Hiromitsu, who is also the Chairman of the Tax System Research Council, said, "The withholding separation system is one of the best tax privileges in the world. It is improper to add another tax privilege with the withholding separation system left in place."

At the Tokyo Stock Exchange, the average stock price rallied as soon as the Emergency Economic Package was announced, and it has moved higher due to the forming of the Koizumi Cabinet on the platform of structural reform. On the other side, most economists take the view that the future trend in the stock market depends on whether the Cabinet can actually carry through the disposal of bad loans. JTI

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