How Taxpayers Feel Toward Gov't Support of Banks

By Hamano Takayoshi

Major financial institutions collapsed one after another in Japan in 1997, as the currency crisis swept Asia, fueling concern among the public over the nation's economic fate. To cope with the unprecedented credit crisis, the Japanese Government and the ruling Liberal Democratic Party (LDP) decided in December to funnel ¥30 trillion in taxpayers' money into the banking system in an effort to enhance a safety-net mechanism in preparation for further bank failures. More specifically, the government will give the Deposit Insurance Corp. (DIC) ¥10 trillion in the form of national bonds that can be issued at the DIC's request. The DIC is a public entity designed to protect depositors. At the same time, the government will secure ¥20 trillion in debt guarantees. The bond scheme is one of several measures which the government has pledged to take to help boost flagging confidence in Japan's financial system.

The action followed a call for public support made in early December by Michel Camdessus, managing director of the International Monetary Fund (IMF), when he conferred with Prime Minister Hashimoto Ryutaro during his visit to Tokyo. The IMF appeal came at a time when the Japanese government was under pressure to take action to bolster the financial system with public money so as to prevent Japan's credit unrest from triggering a global economic crisis.

In addition to the ¥30 trillion bond program, Prime Minister Hashimoto unveiled a special income tax cut of ¥2 trillion at the national and local levels. Given depressed economic activity and continued reluctance among banks to extend fresh lending, however, business and financial circles saw the tax cut as insufficient, sending stock market prices reeling. Alarmed at the negative response, the government took further action, making it clear that it will exercise flexibility in implementing a belt-tightening fiscal reform law passed by parliament in November. The law requires the government to stop issuing deficit-covering bonds by the early 21st century in a bid to rebuild the debt-ridden national coffers.

The series of measures, though taken belatedly, meant the government's policy had changed to one giving top priority to stabilizing the financial system and boosting economic activity rather than promoting fiscal overhaul, one of six reform plans initiated by the Hashimoto administration. But public sentiment remains harsh against such a government stance, particularly the use of taxpayers' money in keeping the financial system afloat. It may be safely said that the issue of using tax money has split public opinion in two. Why is this so? The reason can be seen from the following review of recent developments.

Collapses rock banking

In the fall of 1997, three well-established financial institutions became insolvent in three months—Sanyo Securities Co., Hokkaido Takushoku Bank and Yamaichi Securities Co. In particular, Yamaichi's failure, which left ¥3.5 trillion in debts, marked both the largest bankruptcy in half a century in Japan and the collapse of one of the nation's Big Four brokerages, sending shock waves across the country. The Bank of Japan swiftly stepped in, providing huge special loans to Yamaichi and thus ensuring the protection of all deals conducted through the brokerage. But the Yamaichi case has left anxiety deep in the psychology of the investing public. It has also created serious employment problems for all 7,500 Yamaichi employees, who are left uncertain as to whether they can find new jobs, and some 500 new recruits who were to enter the company in April, but who now must seek jobs elsewhere.

Moreover, the revelation that Yamaichi had concealed ¥260 billion in off-the-book debts has aroused suspicion at home and abroad about the creditworthiness of Japanese securities companies and banks. The loss of confidence in the Japanese financial system has also led to the emergence of a "Japan Premium"—a surcharge Japanese financial institutions must pay in additional interest on borrowings from overseas lenders. Most Japanese financial institutions are saddled with huge amounts of problem loans left uncollected following the collapse of the asset-inflated economic bubble in the late 1980s. Yamaichi's off-the-book debts, coupled with such swollen irrecoverable loans, have apparently left Euromoney lenders suspicious of Japanese borrowers, sending the interest premium climbing past 1% to reach an abnormal level in the London market in December.

Ahead of the measures taken by the government in December to help stabilize the financial system, action was taken to beef up the deposit insurance system. In mid-December, the government won parliamentary approval, without the presence of the opposition, which boycotted a Diet session, of a bill to revise the Deposit Insurance Law. Under the revised law, the DIC is empowered to offer monetary help to a merger of financial institutions which have become insolvent. Previously, the DIC was allowed to finance a merger only when a sound financial institution absorbed a troubled one.

The LDP-led ruling coalition and the government have also finalized a legislative package featuring financial relief for the recapitalization of troubled banks. In addition to grant bonds, the package calls for the purchase of subordinated bonds and preferred stock with taxpayers' money channeled through the DIC. Subordinated bonds are close to net worth on the part of financial institutions issuing them, because they may not be redeemed in the event of a collapse. Preferred shares make it easier for financial institutions facing the need for improved capital adequacy to raise funds by issuing them, because such shares give their holders priority in dividend payout and asset distribution among creditors in case of an issuing bank's failure. But some LDP members have taken issue with the inclusion of subordinated bond and preferred stock purchases in the public support program based on tax money. They insist that the program should be limited to the protection of depositors and that the proposed securities purchase system could result in the rescue of failed financial institutions which normally should be forced out of business. The governing camp is discussing details such as under what conditions financial institutions can be allowed to use public funds in strengthening their capital base.

Criticism of gov't persists

Some people actively support the use of tax money for the assistance of financial institutions, while others flatly reject it. Behind the rejection are the following arguments:

—In no way must the government be allowed to go easy on a failed bank by passing the bank's bill to taxpayers;

—It could be morally hazardous—some operators of financial institutions could permit risky lending, counting to an unjustifiable extent on the DIC which will protect depositors;

—Financial institutions must make as much self-sacrificing effort as possible before the use of public money can be justified; and

—None has taken responsibility for having caused the financial system crisis and thus a means of punishing irresponsible people, such as by class action suits on the part of shareholders, should be established.

私たちの税金を使うな!!

Photo: SHINFUJIN SHINBUN

Taxpayers protest: citizens' distrust of government deepens

Regarding the ¥30 trillion relief scheme, the government has stated that it does not mean to disburse tax money immediately, because bonds are issued only after the DIC has exhausted all of its funds. Critics, however, accuse the government of seeking to issue extra deficit- covering bonds for the proposed ¥2 trillion tax cut at the cost of fiscal reform.

One key factor behind the persistent criticism of government support for financial institutions is the abrupt announcement two years ago of a plan to pump ¥685 billion in taxpayers' money into the controversial disposal of failed housing loan companies or "jusen." The announcement, which took the public by surprise, came without any advance information, and the plan was intended in effect to rescue agricultural financial institutions that had heavy outstanding loans to *jusen*. There was a barrage of criticism then, but the government did not change the plan, though it did have difficulty justifying it.

Rather than encouraging competition, Japan maintained a policy of safeguarding financial institutions for a long time, thus trailing behind other countries in liberalizing interest rates. In the fall of 1994, Japan completely liberalized interest rates. Many pointed out that had they been liberalized earlier, Japanese depositors would not have been subject to low interest rates for so long.

Interest rates have since been kept at historically low levels due to slack economic recovery from a slump caused by the collapse of the bubble economy. Pensioners who depend largely on interest earnings for their daily life are increasingly dissatisfied with low rates. Some economists say that a hike in the official discount rate, now at a historic low of 0.5%, might rather serve to boost consumer spending.

It is probably not too much to say that Japan's past financial policy put the interests of financial institutions above those of individual depositors (consumers) in the name of ensuring stability of the financial system. Presumably for that reason, taxpayers have given a negative response to the use of public money. Given Japan's financial system crisis, there is every reason for the government not to leave it neglected. But what is essential is to ensure thorough disclosure of information persuasive enough to taxpayers, and not to resort to such an easy-going means as imposing a relatively light but widespread financial burden on them.

If the government continues implementing policies which lack nationwide public support, it could render Japan a community lacking global confidence and not a comfortable one to live in. JJTI

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