Scepticism over Japanese 'bridge bank'

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The Japanese government has announced its plan for the restructure of the banking system but there is mounting scepticism in financial circles that it will do anything either to halt pressure on the yen in the short-term or restore financial health in the long-term.

The plan was brought forward in the aftermath of the joint intervention by the US and Japanese central banks to halt the free fall of the yen on currency markets at the end of last month. After enjoying a slight recovery, the yen has started to come under pressure once again.

Under the bank restructure plan, the government is to set up a so-called 'bridge bank' to liquidate failed banks and financial institutions. The liquidation is to take place in two stages. First the failed bank will be placed under administration while a merger partner is sought. Corporate customers of the failed bank deemed to be creditworthy will be provided with access to loans. If no buyers emerge within a period of five years, the collapsed bank will be acquired by the government and the asset-backing of the bad loans liquidated.

One of the reasons for financial-market scepticism is that the plan contains no provisions for dealing with the bad loans held by the supposedly healthy banks. The Tokyo Mitsubishi bank, for example, the largest bank in the world, has billions of dollars of bad loans on its books but nothing in the plan compels it to take any action.

Financial analysts are insisting that the plan will only be considered to be working when real mergers and real banking failures take place, or, in the words of one commentator 'blood has to start to flow'.

Comments from the US administration on the plan have echoed these sentiments. US Treasury Secretary Robert Rubin said the plan contained 'potentially significant steps' but added that 'what is important is for the Japanese authorities to move quickly to translate this approach into concrete actions.'

Speaking in Hong Kong at the end of his nine-day visit to China, US president Clinton said the markets were now 'waiting for some action and a sense that if the implementation is not enough then more will be done.'

He warned that the measures to be undertaken 'will be particularly unpopular and will take courage.'

The measures being demanded by the international money markets involve one of the largest asset and financial write-downs in world financial history.

The total bad debts in the Japanese banking system are estimated to range between 77 trillion yen ($US600 billion) and 100 trillion yen. This means that the restructuring operation involves the elimination of a sum of capital equivalent to at least twice the gross domestic product of Australia.

Elimination of bad debt on this scale will see the closure of banks, financial institutions and heavily indebted corporations as well as a rapid rise in bankruptcies and unemployment. When the country's 10th largest bank, the Hokkaido Bank, collapsed last November it set off a financial panic as depositors rushed to withdraw their savings.

It is now a standing joke that while the Japanese economy continues to stagnate, sales of home safes are booming.

The basic demand of the international financial markets is that the Japanese government ends the so-called 'convoy' principle in the banking system under which the larger financial institutions, working under the supervision of the Ministry of Finance, have supplied credit to the smaller banks to ensure their solvency.

There is nothing peculiarly 'Japanese' about the operation of this mechanism - it is a classical example of the way in which national-based cartels have always worked to manage and protect their collective interests. It has only now started to unravel because of the stagnation in the economy.

Since the collapse of the share and asset bubble in 1991, Japan has experienced growth rates of between 1 and 2 per cent. This has meant that bank profits have been so low that they have barely been able to cover new bad loans, let alone tackle the mountain of debts from the collapse of the bubble.

Under these conditions, the continuation of the convoy system threatens to strangle economic growth as vast amounts of credit are used to prop up insolvent institutions. It is one of the chief reasons why the government's various expenditure packages have failed to stimulate the economy. Businesses find that when they seek loans from the banks there are no funds available, even though interest rates are at a record low.

Whatever the immediate effect of the Japanese restructure plan on the money markets, the activity of international financial authorities is starting to resemble the fabled boy with his finger in the dyke as their attention turns from one trouble spot to another.

The past two weeks have seen a rapid fall in the value of the Indian currency, a sharp drop in the Pakistani rupee and a fall in the value of the South African rand to record low levels.

And the financial situation of Russia goes from bad to worse. The government has now called for the establishment of an international fund to stabilise the rouble. Since the Asian crisis began, authorities have already used up $14 billion of their foreign exchange reserves to try to maintain the link with the dollar. As of mid-June reserves were down to $15 billion, most of it borrowed.

At the same time domestic interest rates are still around 80 percent after hitting 150 percent several weeks ago. In order to stabilise the situation the Russian government urgently needs an injection of cash - possibly as much as $20 billion.

But the problem for international financial authorities is that no such funds are available. In an interview with the *Sueddeutsche Zeitung* newspaper last weekend, the managing director of the International Monetary Fund, Michel Camdessus, pointed to the dangerously low levels of the fund's reserves.

He warned that without a boost from member states, the usable reserves would be between $10 and $15 billion, barely enough to deal with Russia let alone respond to other crises. 'If we run out of money, this would worsen a very unstable global situation and mean a serious danger for the world economy,' Camdessus said.

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