

Doubts grow over Japanese bank bailout

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The uplift in global financial markets that followed news of an agreement between the Japanese government and opposition parties over legislation to bail out Japan's crippled banks seems to have lasted about 24 hours. Questions have emerged about how the plan will actually operate.

After rising sharply on Monday, the Nikkei index of Tokyo stocks fell by 2.3 percent on Tuesday. Japanese Finance Minister Kiichi Miyazawa admitted he had no idea how public funds would be injected into the insolvent banking system. Asked whether the government had a plan to force banks to take funds to cover their problem loans he replied: 'I cannot tell you how we will address this issue.'

Under the plan the Japanese government will make available as much as 60 trillion yen, around \$500 billion, to recapitalise major banks with problem loans. Legislation to enact the bank rescue--the biggest in world financial history--is expected to go through the Japanese parliament on Friday. But whether it goes into operation is another question.

There are considerable doubts over whether any of the country's 19 top banks will apply for the government funds. To do so would be a public declaration that they are carrying bad loans on their books. Such an admission could bring an immediate downgrade from credit rating agencies, a loss of share values and even a run on funds by depositors.

To force banks to accept funds the government would have to open their books to reveal the problem loans and devise procedures for the liquidation of the assets on which they were based. But this too could set in motion a collapse of the banking system.

The financial crisis is rapidly assuming the form of a vicious circle. The bad loans on the books of the banks have resulted in the restriction of credit and a consequent contraction in the economy. The shrinking economy means in turn that bad loans are increasing

faster than the banks can write them off. And the longer the crisis continues, the greater the threat of an international credit crunch and global recession.

Thus the increasingly strident calls from Europe and the United States for the Japanese government to 'restructure' the banking system. In a recent editorial the British magazine the *Economist* demanded an economic revolution on the scale of the Meiji period of the 1860s which saw the overthrow of feudalism and the establishment of capitalism in Japan.

Tough measures, it said, would bring large debt write-offs, as well as soaring unemployment and bankruptcies. But if handled with 'sufficient ruthlessness,' they would enable the benefits of a bailout to flow into the economy as a whole. While the editorial claimed this would lay the ground for eventual recovery, it did acknowledge that 'no one can know in advance whether the good effect will outweigh the bad'.

However Japanese authorities have warned that such measures cannot be undertaken because the bad loan problem does not just affect one or two banks, but is a crisis of the entire banking system which would rapidly spread throughout the global market.

Further warnings of the implications of the Japanese financial crisis were issued at the World Economic Forum conference on East Asia held in Singapore this week. The chief Asian economist for Deutsche Bank, Kenneth Courtis, told the 700 conference participants, all business and government leaders, that the world economy faced the greatest risks since the 1930s.

The Japanese economy, he warned, was 'inches away from an implosion of the type that rocked America in the thirties. If that happens, everything we have seen now will seem like a Sunday picnic.'

Courtis said discussion at the International Monetary Fund about the design of a new international financial architecture was pointless unless the present crisis was addressed.

'The immediate priority is to get control of the monster of deflation that's now released in the world. And if it's not brought under control it could lead to a vicious global cycle of debt deflation. If we don't, we'll all regret it tomorrow more than we could imagine today.'

Ford Motor Company vice-chairman Wayne Booker said he did not expect any recovery in the Asian region for 'about five years' and that the Japanese government had not 'even begun to come to terms with' what was needed.

Clyde Prestowitz, president of the Washington-based Economic Strategy Unit, told the conference the United States was experiencing the beginnings of a 'credit crunch' sparked by the flight of American banks from risks. Calling for action to stimulate the world economy, he said there was already overcapacity in the auto industry, steel, chemical and electronics.

Asian economies could not rely on exporting to the US because the American economy was moving towards a recession. Prestowitz said his institute had completed a study which predicted a 'strong recession in the US beginning in 1999 and deepening into 2000'.

With the Japanese economy showing no signs of recovery--machinery orders, for example, recorded a 28 percent decline in the year to August--such an eventuality would almost certainly bring on the deepest global slump in the post-war period.



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