

Financial Restructuring in Japan

- a Korean Perspective -

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May 30, 2003

I. Current Japanese Economy: an Overview

1. Number 2 in the world (2002)

- ◇ Second largest: GDP = \$3,992 billion
- ◇ Second richest: Per capita GDP = \$31,200
- ◇ Population: 128 million

2. Current Situation

- ◇ Not growing fast enough

*Growth rates in the good old days:

1960s: 10%

1970s: 4.4%

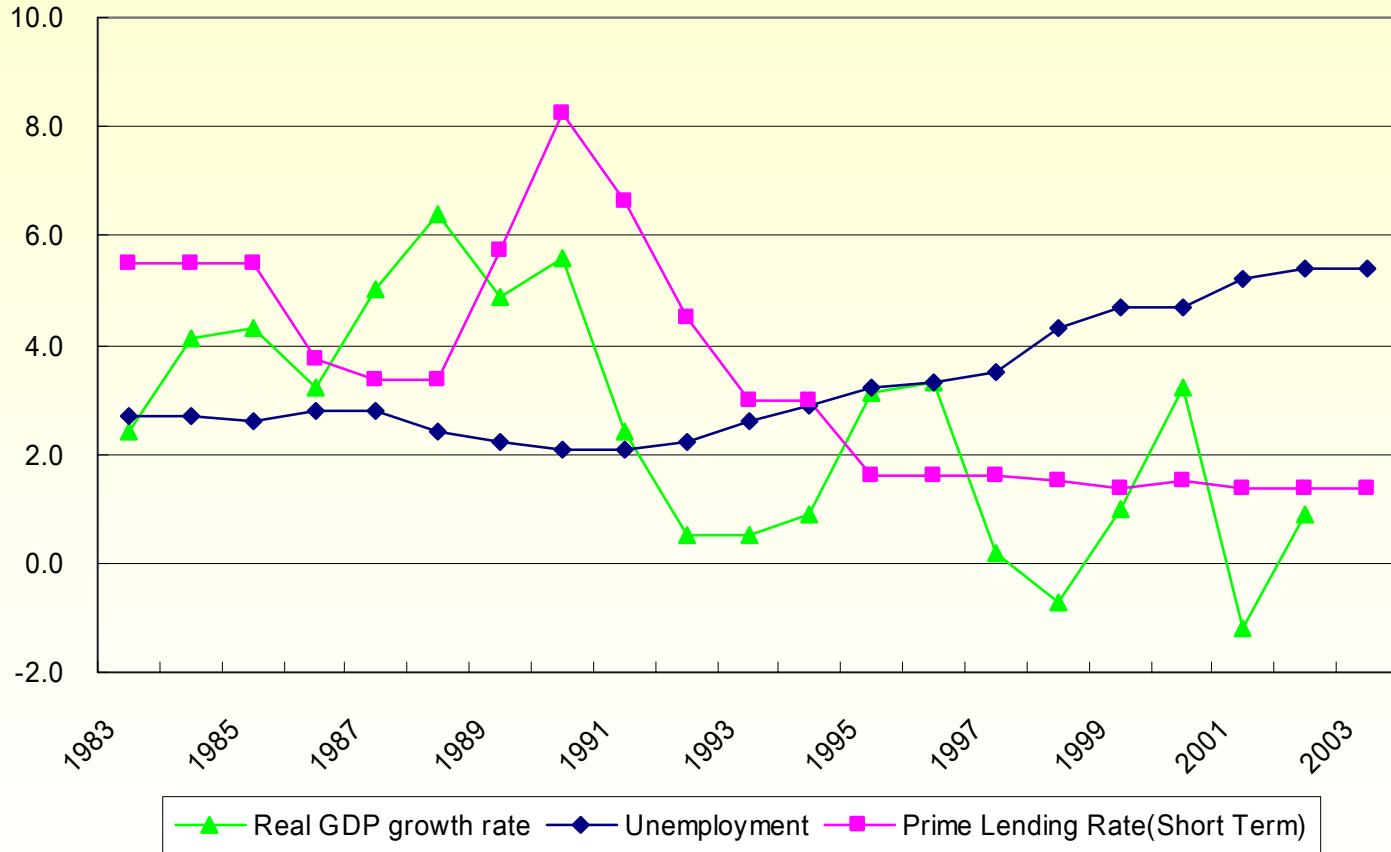
1980s: 4.1%

1993-2002: 1.1%

- ◇ Unemployment rate: 2.2% (1992) → 5.4% (2002), and rising.
- ◇ Deflation in goods and asset prices

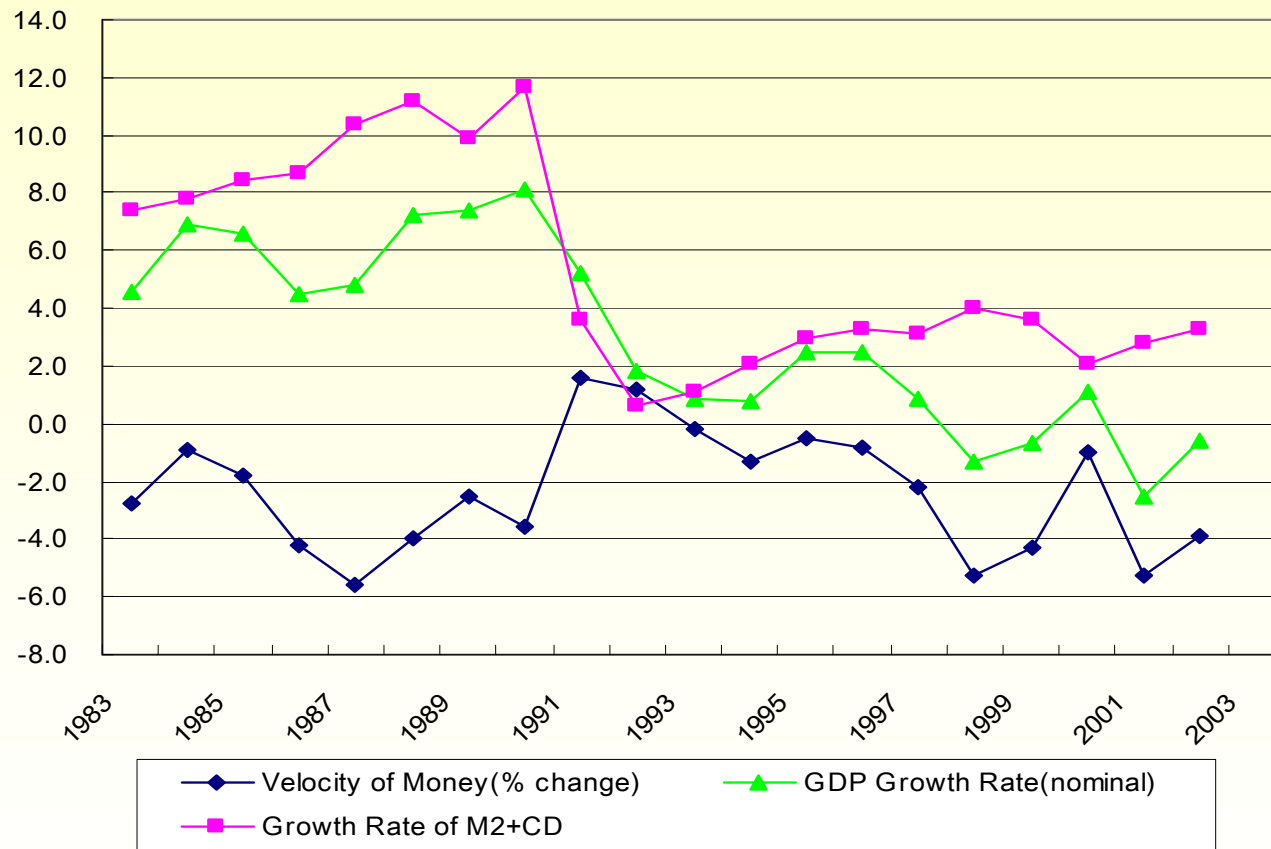
☞ The financial system is believed to be at the center of the problem

Figure 1. Economic Growth, Unemployment, and Interest Rate (%)



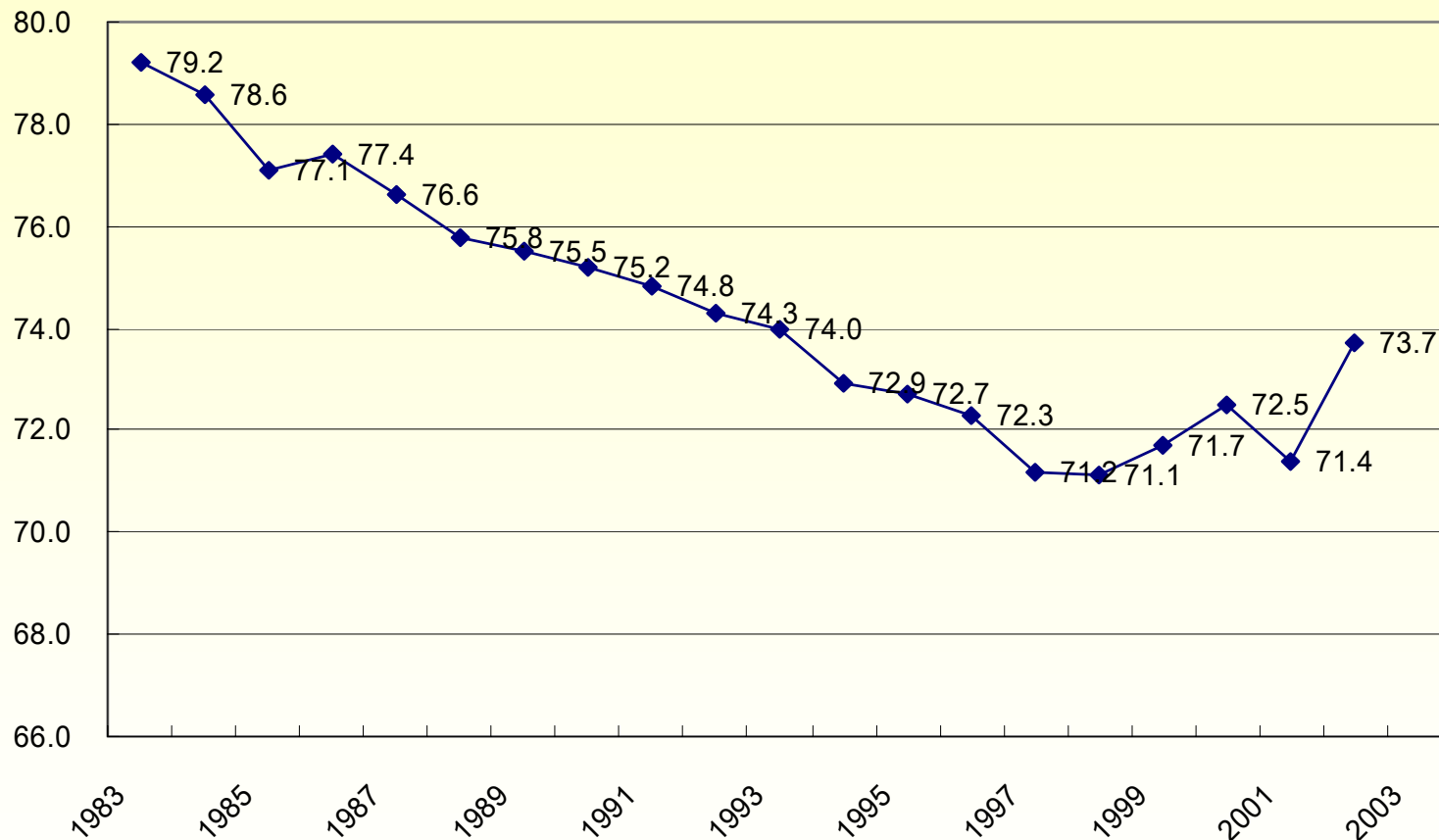
Source: Bank of Japan, "Bank of Japan Statistics and Other Key Statistics," May, 2003

Figure A1. Velocity of Money: % Change in GDP/(M2+CD)



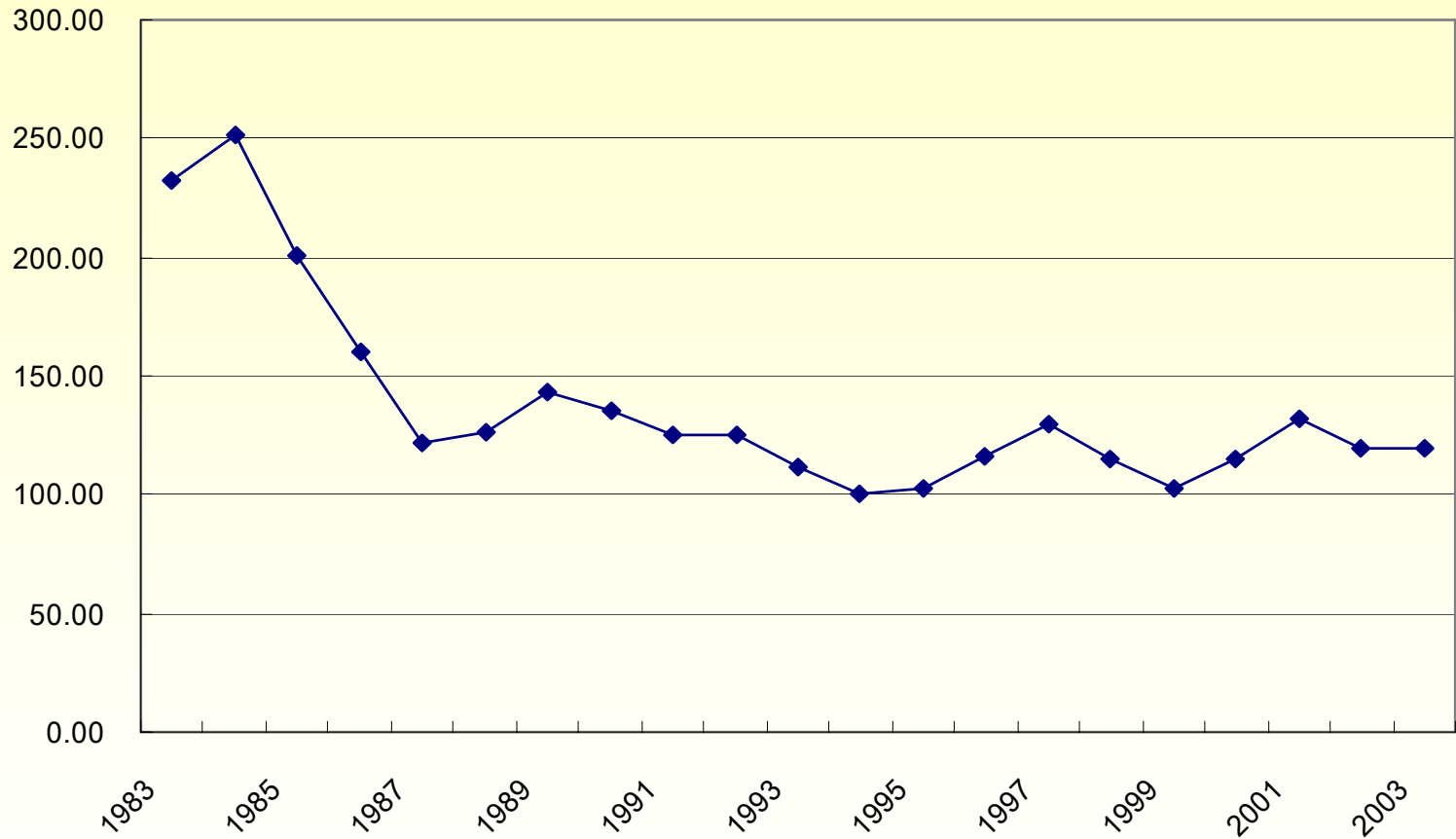
Source: Bank of Japan, "Bank of Japan Statistics and Other Key Statistics," May, 2003

Figure A2. Propensity to Consume (%)



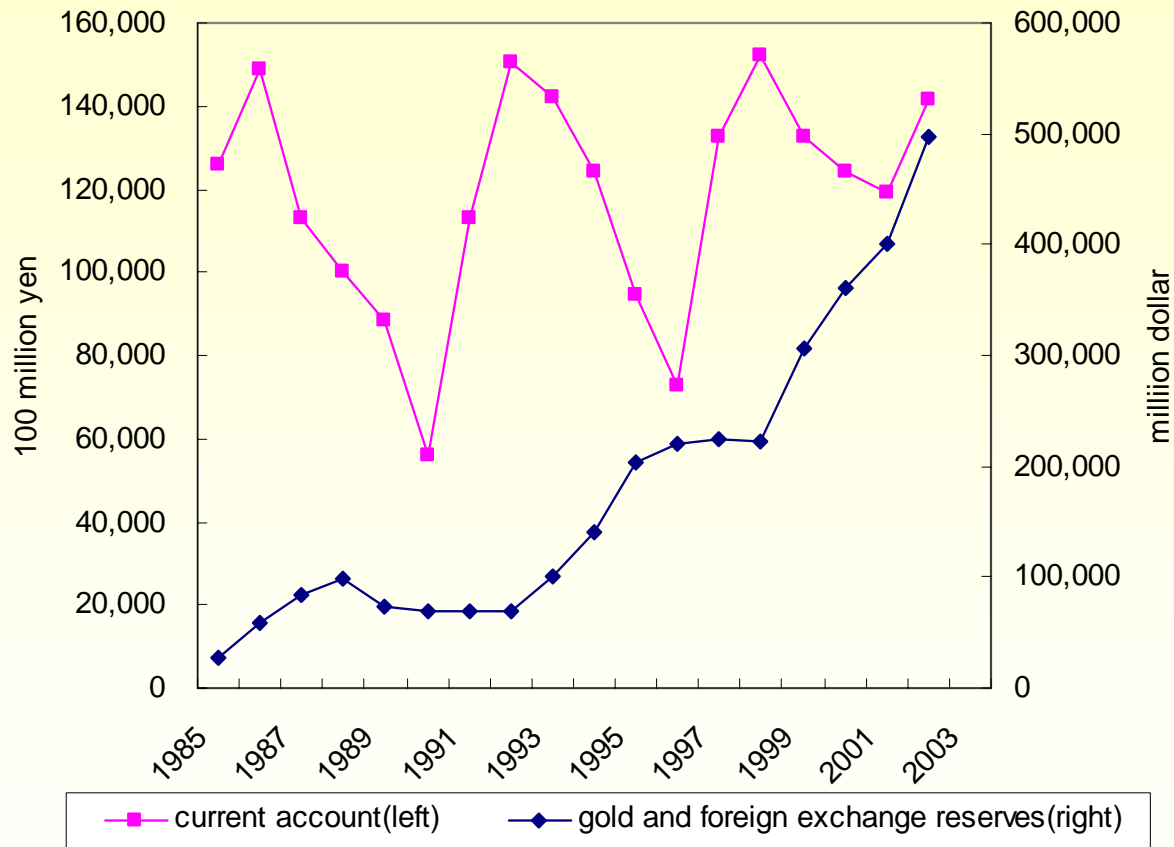
Source: Bank of Japan, "Bank of Japan Statistics and Other Key Statistics," May, 2003

Figure A3. Exchange Rate (Yen/US dollar)



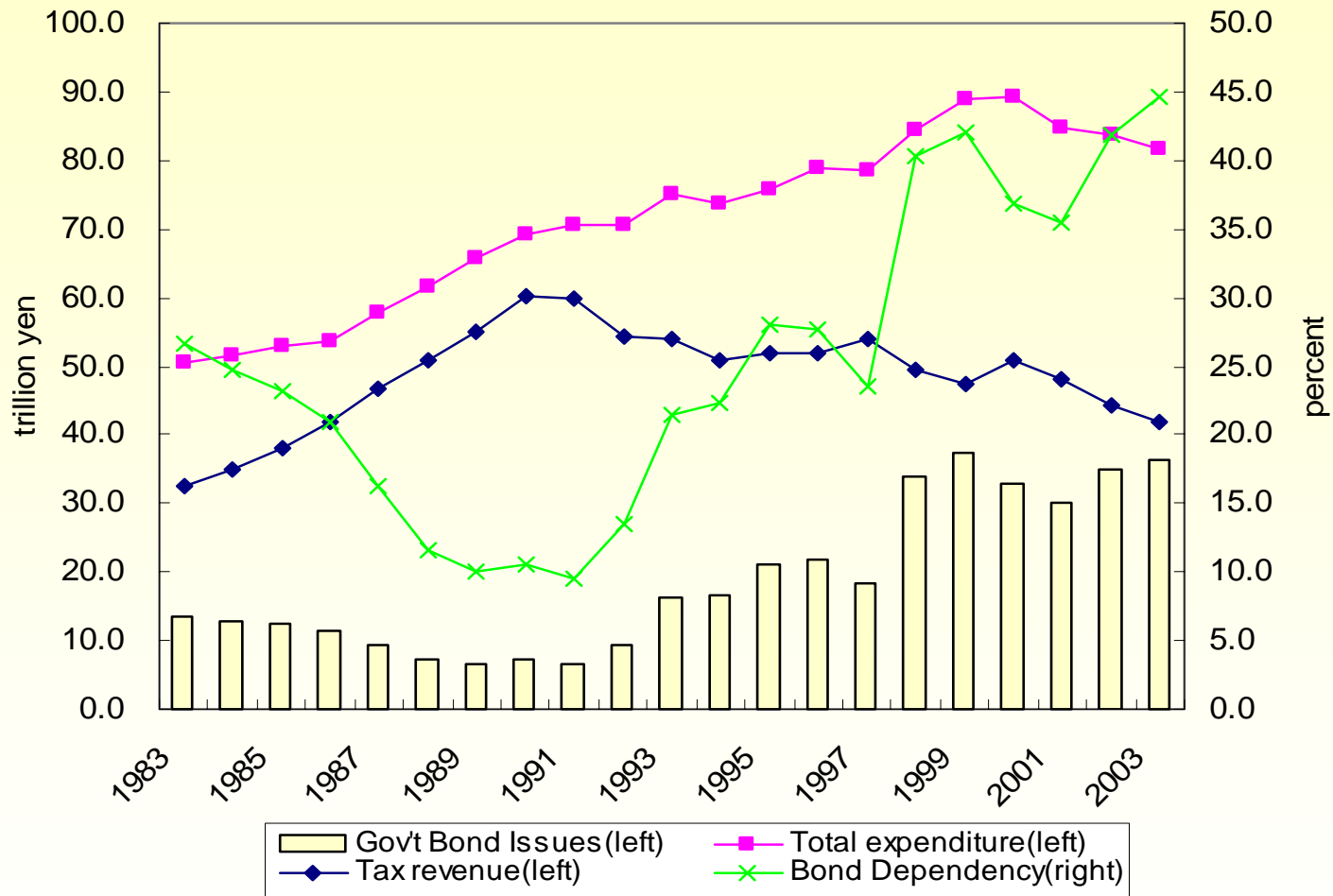
Source: Bank of Japan, "Bank of Japan Statistics and Other Key Statistics," May, 2003

Figure A4. Balance of Payment and Foreign Exchange Reserves



Source: Bank of Japan, "Bank of Japan Statistics and Other Key Statistics," May, 2003

Figure A5. Balance of Government Budget

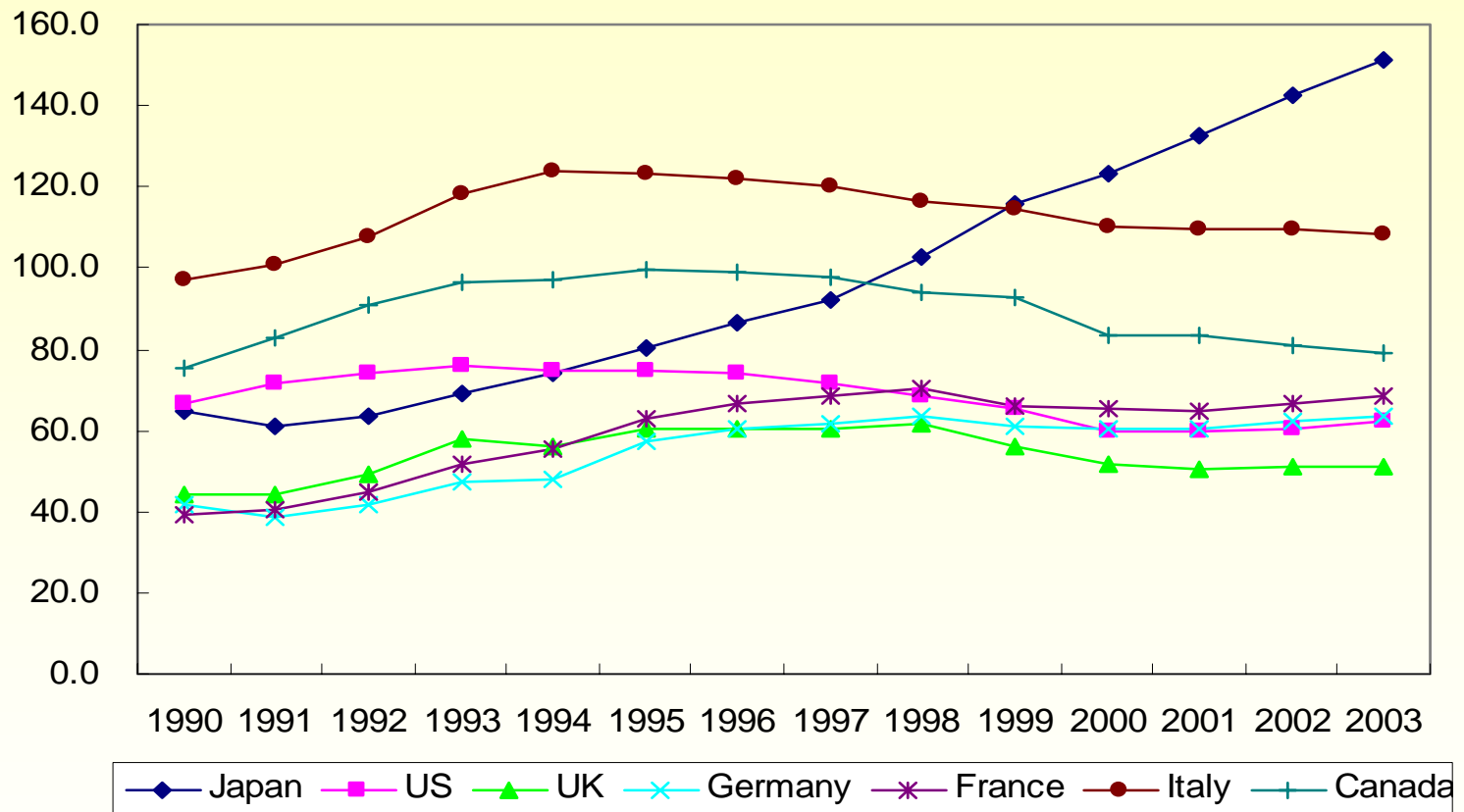


*Note: Bond dependency = Govt Bond Issues / Total expenditure

FY 1983-2001: settlement; FY 2002: revised; FY 2003: Budget

Source: Ministry of Finance, "Highlights of the Budget for FY 2003," Dec., 2002.

Figure A6. General Government Debt / GDP (%)



Source: Ministry of Finance, "Highlights of the Budget for FY 2003," Dec., 2002.

II. Current Issues on the Japanese Financial System

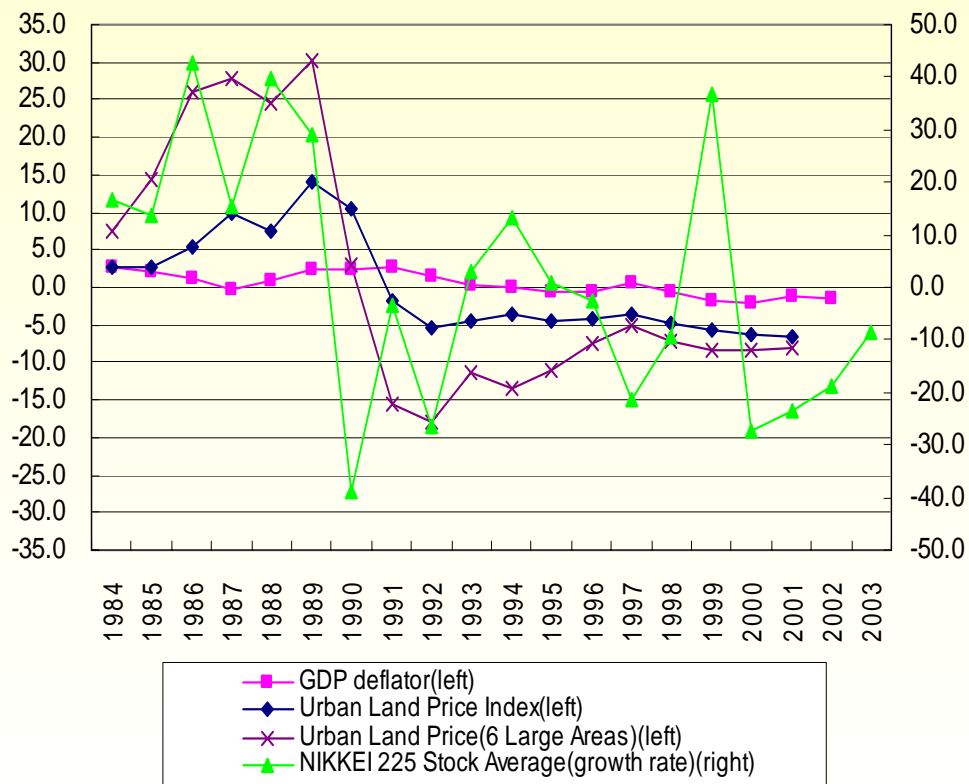
1. Bubbles in the Asset Markets

- ◇ Nikkei 225
 - 9,894 (1983)
 - 38,916 (1989)
 - 7,831 (April 2003)

- ◇ Land in 6 large urban areas
 - 1.00 (1982)
 - 3.47 (1990)
 - 1.02 (2001)

- ◇ Δ in GDP Deflator
 - 1993-2002: -0.7%
 - less than 0 in 8 out of the last 10 years

Figure 2. Deflation in Japan (%)



Source: Bank of Japan, "Bank of Japan Statistics and Other Key Statistics," May, 2003

2. Impacts of the Collapse on the Financial System

Table 1. Non Performing Loans of Japanese Deposit-taking Financial Institutions (End of March)
(trillion yen)

	1998	1999	2000	2001	2002	Sept, 2002
1. Banks						
Total Loans (A)	553.1	506.6	496.2	494.1	473.2	453.6
NPLs (B)	19.5	29.6	30.4	32.5	42	39.2
NPLs-FRL ¹⁾	-	33.9	31.8	33.6	43.2	40.1
Losses from Disposal of NPLs (C)	13.3	13.6	6.9	6.1	9.7	-
Cumulative Losses since 1992 ²⁾	45.1	58.8	65.7	71.8	81.5	83.4
B/A (%)	3.5	5.8	6.1	6.6	8.9	8.6
C/A (%)	2.4	2.7	1.4	1.2	2.0	-
2. Banks + Cooperative Type Financial Institutions						
Total Loans (D)	688.5	642.2	629.2	626.4	606.4	-
NPLs (E)	25.0	38.7	41.4	43.4	53.0	-
NPLs-FRL	-	42.6	40.9	43.0	52.4	-
E/D (%)	3.6	6.0	6.6	6.9	8.7	-

Note: 1) NPL-FRL: Non-performing loans based on Financial reconstruction Law.

2) Cumulative losses from disposal of NPLs.

Source: Financial Services Agency, Japan.

☞ Banks are burdened by NPLs and pressured to meet capital adequacy requirements.

→ Bank lending and business investment are shrinking.

3. Government Policy for Economic Revival

Emergency Countermeasures to Deflation, Feb 27, 2002.

*Comprehensive Measures to Accelerate Reform, Oct 30, 2002, and
Program for Financial Revival, Oct 30, 2002*

☞ Why is the problem so persistent?

The answer may be: Systemic nature of the problem requires a comprehensive, decisive, and bold policy.

☞ Any lessons to be drawn from the Korean experience?

III. Financial Restructuring in Korea

1. The Korean Economic Crisis: 1997-1998

- ◇ GDP growth rate in 1998: -6.7% (the lowest in post-Korean war period)
- ◇ Unemployment rate surged to 8.8% in Feb 1999.

2. Resolution of Bad Institutions and Bad Loans

Table 2. Financial Restructuring in Korea

	Number of Companies (year-end 1997) (A)	Restructuring Status					Newly Opened	Current Total
		License Revocation	Merger	Liquidation, Transfer to Bridge Bank, Suspension of Operations	Total (B)	Change (B/A)		
Banks	33	5	9	0	14	42.4	1	20
Merchant Banks	30	18	6	4	28	93.3	1	3
Securities Companies	36	5	1	1	7	19.4	16	45
Insurance Companies	50	7	6	2	15	30.0	9	44
Investment Trust Companies	30	6	1	0	7	23.3	6	29
Mutual Savings Banks	231	71	26	25	122	52.8	12	121
Credit Unions	1666	2	102	303	407	24.4	9	1268
Lease Companies	25	9	1	0	10	40.0	3	18
Total	2101	123	152	335	610	29.0	57	1548

Source: Annual Report-2001, Korean Deposit Insurance Corporation, 2002, Table 1-3.

3. Public Funds and Public Burdens

Table 3. Sources and Uses of Financial Restructuring Funds(Nov, 1997-March, 2003)

(trillion won)

	Equity Participation	Contributions	Deposit Insurance Claim	Asset Purchases	Purchases of NPLs	Total
Bond Issues	42.2	15.2	20.0	4.2	20.5	102.1
Recycled Funds	3.9	1.6	6.2	4.4	17.0	33.1
Public Funds ¹⁾	14.1	-	-	6.3	0.5	20.9
Others ²⁾	-	0.1	2.9	0.1	1.1	4.2
Total	60.2	16.9	29.1	15.0	39.1	160.3

1) Include government budget, government fund, and foreign loans.

2) Include loans from financial institutions, KAMCO's and KDIC's own funds.

Source: Public Fund Oversight Committee, 2003

Table 4. Uses of Financial Restructuring Funds(Nov, 1997-March, 2003)

(trillion won)

	Equity Participation	Contributions	Deposit Insurance Claim	Asset Purchases	Purchases of NPLs	Total
Banks	33.9	13.7	-	14.0	24.6	86.2
Merchant Banks	2.7	0.2	17.2	-	1.6	21.7
Securities Companies and Investment Trust Companies	7.7	-	0.01	-	8.5	16.2
Insurance Companies	15.9	2.9	-	0.4	1.8	21.0
Credit Unions	-	-	4.6	-	-	4.6
Mutual Savings Banks	-	0.1	7.3	0.6	0.2	8.2
Overseas Financial Companies	-	-	-	-	2.4	2.4
Total	60.2	16.9	29.1	15.0	39.1	160.3

Source: Public Fund Oversight Committee, 2003

4. Fixing the Stable after the Cow Is Stolen

- ☞ Financial Supervisory Commission (FSC) investigated 464 institutions:
 - ◇ 4,879 people involved in inappropriate activities.
 - ◇ 2,404 people contributed to the losses of financial institutions
 - 1,377 people were reported to the prosecutors' office.

- ☞ Korea Deposit Insurance Corporation (KDIC) investigated 418 institutions:
 - ◇ 4,716 people have contributed to the losses of financial institutions.
 - Sued 5,166 people for 1,534 billion won and confiscated 1,373 billion won.

IV. Restructuring Japan's Financial System: a Korean Perspective

1. Comprehensive Measures and Financial Revival

- ◇ Four strategic areas of structural reform:
 - Financial system
 - tax policy
 - regulation, and
 - government expenditures.

- ◇ Financial Restructuring:
 - Accelerate disposal of NPLs => resolution of the NPLs problem by 2004 (reduction of NPLs/Loans ratio of major banks by half)

- ◇ Improve Financial Administration:
 - tightening asset assessment
 - enhancing capital adequacy, and
 - strengthening governance of major banks

- ◇ And revive corporate borrowers
 - + ensure smooth flow of loans to SMEs.

- ☞ Lessons from Korea
 - A well functioning financial system is essential for stability and growth.
 - Stem the deterioration of financial system at the earliest possible date.

2. Would it work this time? Some Remarks.

- ◇ If the excessive NPLs in the financial institutions are the prime cause of deflation and economic slowdown, the cost of NPLs disposal and bank recapitalization is a small price to pay.
 - Since the government purchases (through RCC) NPLs and new claims on the banks at market value, the expected net burden to taxpayers is zero.
 - Injection of public funds for disposal of NPLs and bank recapitalization causes temporary, not permanent, increase in government debt.
 - Disposal of NPLs, *per se*, does not “create” losses. Financial institutions merely realize the capital losses that accrued in the past.
- ◇ Temporary reduction of NPLs may not be sufficient to restore stability to the financial system.
 - The large flow of loans that are downgraded from performing to non-performing must be dealt with.
- ◇ Improve profitability of the borrower corporations!
 - Financial restructuring itself helps move resources from inefficient to efficient firms.
 - Other factors affecting profitability of firms include tax policy, regulation, competition in the markets, R&D, education, etc.
- ◇ Provide adequate safety nets for the unemployed, and ensure stable flow of funds to SMEs !
- ◇ Act decisively, boldly, and quickly to clean-up NPLs and recapitalize the weakened banks.

V. Concluding Remark

- ◇ Overhauling the financial system may be the most urgent problem to be resolved.
 - Must treat the fundamental sources of the problem.
 - No More Stop-gap!!
 - No More Piecemeal Approach !!
 - Decisive and bold approach is recommended.
 - Commit sufficient public funds for quick resolution of NPLs and recapitalization of the financial institutions.
 - Otherwise, the economy may have to continue on the suboptimal path for a long time, and the restructuring process may be overtaken by other events demanding urgent government attention.