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EYE ON JAPAN
By Brian Bremner

Is the IMF Ready to Lean on Japan?

An ex-IMF economist predicts that the institution will crank up the pressure big-time on Tokyo and its amazing banking mess in 2003

Argentina, Brazil, Indonesia, Thailand -- all these developing economies have been subjected to controversial bailout packages courtesy of the International Monetary Fund over the last decade or so. Sometimes the bailouts go swimmingly, as with South Korea during the 1990s. Sometimes, the results are mixed -- Russia in the 1990s, for example. And in still other cases, such as Indonesia, IMF-enforced remedies have been hamfisted, failing to produce the desired results.

So what if the IMF suddenly felt it necessary to pressure a big, rich economy to get its act together? Say, Japan and its world-class banking mess? That might strike some as absurd. Sure, Japan has its share of economic woes, but isn't this a $4.5 trillion economy with a brimming current-account surplus and foreign-exchange reserves of well north of $400 billion. This isn't the portrait of a crisis-stricken, middling economy, the sort the IMF is used to swooping in on.

And yet the notion isn't unprecedented. IMF intervened with Britain in the 1970s, when runaway inflation, deep labor unrest, and fiscal deficits placed its economy in quite a jam. And let's not forget how the IMF hectored the U.S. during the Reagan Administration, demanding that Washington restore some fiscal discipline.

CARRY THE WEIGHT. Now, it may be Japan's turn, according to a new book by Sayuri Shirai, an associate professor at Keio University and visiting scholar with the Asian Development Bank Institute. Shirai has just a published a book in Japanese called *Megabank Crises and IMF Economic Policy* (Kadokawa Shoten Publishing). Shirai takes a hard look at the IMF's handling of the crises in Korea and Russia during the 1990s. But what has tongues clucking in Tokyo is her prediction that the IMF is readying a very tough new report on Japan's banks set for publication about half-way through 2003 that will basically say the banking sector is dangerously undercapitalized.

Of course, most folks who have read the financial reports of Japanese banks closely already know things are fairly grim. It's not just the total burden of dud loans weighing down on the system -- though that could total $600 billion or more systemwide, say some private analysts. Worse, if you stripped away the deferred tax credits and public money big banks received back in 1998, most capital-adequacy ratios would fall below 8%, the level considered safe by international bank regulators.

Yet this inspection by the IMF's Financial Sector Assessment Program will carry far more weight in the eyes of the international community and the Japanese government, figures Shirai, an ex-IMF economist herself. "The IMF will approve a tough report with strong recommendations," she predicts.

"STRESS TESTS." I bet she's right. But the real question is whether it will matter. I have my doubts. First, the IMF and a chorus from Washington -- from ex-Treasury Secretaries Robert Rubin and Paul O'Neill to Federal Reserve Chairman Alan Greenspan -- have been spent years trying to jawbone the Japanese into more effective action on their banking mess. This kind of *gaiatsu* -- or pressure from abroad -- hasn't added up to much so far.

Shirai thinks this time might be different, for two reasons. First, this study will be comprehensive: full of specific financial metrics like return on assets, capital-adequacy ratios, liquidity measures, and so on. It will also be benchmarked against other banking systems in Asia.

On top of that, there will be "stress tests" to forecast what the points of vulnerability are for Japan's rickety banking system. Though the IMF team of financial sleuths and Japan's financial bureaucrats are banging heads on what sort of measures might be used here, one possible scenario might look at a 20% plunge in the stock market and the impact on the banks' massive stock holdings.

FACE FACTS. Once this study comes out in next year's annual IMF country review, it will be harder and harder for the antireform crowd in Prime Minister Junichiro Koizumi's coalition government to argue that all is well and good, Shirai thinks. It could also give Japan's top bank regulator, Heizo Takenaka, more ammo to push through his tough-love action plan to purge the banking sector of nonperforming loans once and for all.

A toughly worded IMF report with some damning facts and figures will surely help. The Japanese government is going to have to face facts now -- or face them later. The country must achieve a tough and credible banking program that will be expensive for taxpayers, mean more bankruptcies and higher unemployment, and other forms of economic pain in the short-term. But it has to be done.

That will call for some gutsy domestic political leadership. The IMF, despite the best of intentions, can't change that.

Bremner, Tokyo bureau chief for *BusinessWeek*, offers his views every week in Eye on Japan, only for BusinessWeek Online
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