

International Conference on “Asian Market Integration and Financial Innovation”

Ryutaro Hatanaka

Commissioner, Financial Services Agency (FSA)

Good morning ladies and gentlemen.

I would like to give my warm welcome to all of you for coming to this international conference.

In my remarks this morning, I would like to touch upon some experiences and lessons we learned in developing and maintaining the stability of our financial markets, together with some suggestions which might be useful for Asian countries in developing their own markets.

Witnessing the recent debt crisis in Europe, governments should take appropriate policy measures to reduce their fiscal deficits. In addition, it is also important to ensure the stability of the financial markets that finance those fiscal deficits, and to maintain and reinforce the functioning of the financial system so as to facilitate the supply of necessary funds for achieving economic growth.

To this end, I think it is vital to pay careful attention to interactions between the economy, public finance, and financial markets and the financial system, and implement comprehensive policy measures in the correct sequence. Since I myself was involved in handling more than half of the nearly 200 financial institutions that went bankrupt in Japan in the 1990s, I learned some lessons on how to maintain the stability of the financial system in difficult times. Taking this opportunity, I would like to share with you what we have learned from such an experience.

First, no matter how much regulations are tightened, the possibility of the occurrence of a bubble economy and its inevitable collapse, accompanied by failures of financial institutions will never be ruled out in the future. In order to minimize any disruptions to the financial system, what is essentially important is to improve the self-discipline of financial institutions and enhance the forward-looking supervisory capacity of authorities. Setting up a regulatory framework is an important task, but regulation is not a panacea, in terms of securing the stability of the financial system. In this regard, we should bear in mind that regulation only complements self-discipline and supervision, or provides incentives for their improvement.

Second, in times of crises, necessary and adequate measures, that is, bold measures to dispel uncertainties in markets, must be taken promptly and in the proper sequence. For example, we should first conduct rigorous evaluation of banks' assets, and if it is found as a result of such evaluation that banks hold liabilities in excess of their assets, then we should quickly take resolution procedures, if banks are suffering a capital shortage,

we should take actions to increase their capital base, without hesitating to inject public funds into banks when needed.

When considering injections of public funds, there is some difference between the case of resolution and capital increase. However, if we decide to inject public funds into banks, we need to gain the understanding of taxpayers by setting up a rule that banks would not be granted public funds unless their management assumes responsibility. In the financial crisis triggered by the collapse of Lehman Brothers, measures taken in this regard were not always adequate, and sometimes provoked strong reactions from the public. I would add that in Japan's case, we have gained a good amount of returns from capital investment using public funds.

Third, the sequencing of policy measures is also an important factor. For example, when one conducts evaluations of bank assets and stress testing of banking system, one should also have in place measures to prevent a credit crunch and excessive deleveraging as a backstop. If the authorities or financial institutions are unable to take policy measures at one time, the authorities will need to make clear the overall picture of the objectives and measures, by presenting roadmaps for immediate, medium-term, and long-term period.

As I mentioned, Japan has paid a high price for solving its non-performing loan problems, but I can say that Japan has never provoked any global-scale financial turmoil originating from Japan. To date, a consensus has been built among the Japanese people in support of the basic approach, as I mentioned, in taking the necessary measures to cope with the financial crisis. We will continue our efforts to actively contribute to reinforcing the stability of financial systems at home and abroad, and will also provide advice and support to any countries facing difficulties.

Let us now look at the recent developments in Asia. Since the collapse of Lehman Brothers and up until now, Asia's financial system has been relatively stable compared to those in the United States and Europe.

However, Asia faces many challenges of its own. In Asia, there are an abundant savings in excess of investment opportunities, but such savings have not been effectively invested within the region.

In addition, large capital flows from the United States and Europe into Asia gave rise to volatile movements in Asian financial markets, such as sudden rises or falls in stock prices and large fluctuations in the volumes of capital flows in and out of the region. These movements could have adverse impacts on sustainable growth and development of Asian economies.

Against such a backdrop, we should strive to make efficient use of the high savings in Asia, instead of depending on volatile short-term capital flows, or so-called "hot money," and ensure stable financing necessary for achieving economic growth and industrial development within the region. To this end, we need to discuss two challenges in particular.

First, in Asian countries, economic growth is largely driven by SMEs—small and medium-sized enterprises—and individuals. So, we must consider how we should respond to their financing needs; in other words, consider a well-functioning scheme for SME and retail financing.

Second, at the same time, we should also pay attention to ensuring the appropriate means of financing for larger companies and public-sector entities. It is therefore necessary also to consider how to develop and deepen capital markets in Asia, such as stock markets and bond markets, so that these entities could raise funds in a stable manner directly from the markets, in addition to bank lending.

With regard to these two challenges, the initiatives that Japan has taken so far may provide helpful suggestions for Asian countries.

I will start with our initiatives to improve SME financing.

In Japan, according to the data as of fiscal year 2009, there are approximately 4.2 million SMEs, accounting for 99.7% of all domestic companies, and over 28 million people work at SMEs, which accounts for about 70% of all employees in Japan. SMEs also have a high share in Japan's GDP, and therefore play a significant role in the Japanese economy. As I see it, other Asian countries have similar structures as Japan.

Given their importance in the economy, measures to secure stable financing for SMEs are indispensable. In growing sectors in particular, initiatives should be taken to combine effectively the elements, namely, the excellent technologies that SMEs hold, the seeds of innovation developed at R&D institutions, and new marketing channels. This will support the growth of resilient SMEs and help them develop into larger enterprises. At the same time, it is also necessary to support the recovery of firms that are suffering a deterioration of their business conditions, or to advise them to launch new businesses, so as to minimize the damages and enable them to take on new business challenges. Such measures cannot be taken by the SMEs' own efforts alone. The government and the private sector must work together to this end.

In the process of supporting SMEs, which lay the foundation of the Japanese economy, there are three important approaches. One approach will be for financial institutions to not only provide those firms with loans but also to propose the optimal financial solutions that suit their respective business conditions. Financial institutions should strengthen their consulting functions and support the SMEs by, for example, assisting their search for new customers and markets.

The second approach focuses on borrower firms and measures to support them directly, by finding investors and business partners for them, through the use of advice and expertise from institutions other than financial institutions.

As a useful tool for taking the second approach, Japan has two institutions which have excellent expertise in corporate revitalization: the Enterprise Turnaround Initiative Corporation of Japan, and the Small and Medium-Sized Enterprise Revitalization Support Councils. The Enterprise Turnaround Initiative Corporation has a wide range of functions necessary for the revitalization of SMEs, including investment of capital, lending, and debt purchase. The Small and Medium-size Enterprise Revitalization Support Councils established at the level of the prefectures can provide SMEs with consultation services and business advice closer to their areas of business.

It is important to provide the best solution for each firm gathering the expertise and experiences of these relevant organizations, such as accounting, tax, and corporate revitalization.

As the third approach, it is important to provide necessary funds and human resources to such firms that are developing and carrying out innovative business strategies beyond the bounds of the conventional business models. In Japan, this task is undertaken by the Innovation Network Corporation of Japan, an investment firm funded by the public and private sectors.

We have been promoting the approaches mentioned earlier, and I believe that these approaches will be quite useful in other Asian countries as well.

Now, let me move on to Japan's initiatives related to the second challenge, which was to develop the bond markets in Asia.

During the period of high economic growth in Japan after the end of the Second World War, a rapid increase of the population and a large improvement in labor productivity contributed to Japan's high growth. In the course of investing Japan's affluent savings into growth sectors with priority, adequate financing from capital markets through bonds, as well as an intensive allocation of financial resources through postal savings and the government's Fiscal Investments and Loans Program, played a significant role, in addition to the expansion of lending from private financial institutions.

When bond markets were created in the post-war period, Japan strived to promote the issuance and trading of bonds of public entities and quasi-public large enterprises, for example, government-guaranteed bonds, telephone subscription bonds, and electric utility bonds, as well as bonds of specialized banks engaged in supplying long-term industrial funds. By doing so, we were able to increase the thickness and liquidity of the bond markets as a whole, and developed the general corporate bond markets.

An important factor in this process is to maintain a strong discipline on the part of bond issuers. In this respect, Japan made various arrangements depending on the stage of development, such as requiring the issuance of secured corporate bonds and the involvement of financial institutions in the issuance of corporate bonds.

To foster bond markets, measures must also be taken to develop secondary markets. Accordingly, the protection of bond holders and appropriate disclosures of information, as well as the promotion of a stable bond investor base are needed in Asia, as it was the case in Japan.

Concerted efforts within the ASEAN +3 countries have already been launched under the Asian Bond Markets Initiative (ABMI). In order to promote a further development of Asian bond markets, it is necessary to take measures that suit the different financial conditions in individual countries, taking into account the diversity of their current economic conditions and financial systems. In this course, I strongly believe that the experience and expertise that Japan has acquired over the years will be helpful for other Asian countries.

Let me conclude my remarks by thanking you for this opportunity. I hope this conference will be fruitful for everyone present today.

Thank you for listening.