

# The Loan Sale Market and the Financial Deregulation

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## abstract

The loan sale markets are classified into two types. The one is the “positive” market, which improves the efficiency or economizes the transaction cost accompanied with all financial intermediation and the other is “negative” one. The introduction of the loan sale market is an important step from the regulation-oriented financial system to the market-oriented one and we believe no doubt that accelerates the speed of financial liberalizations and replaces the regulatory factors to the market based ones. Logically discussing, the loan market is closely related to the free issuing system. In this sense, we can derive some lessons from the free banking era.

## I Introduction

Japanese economy is currently locked in a vicious deflationary circle, with chronic financial instability at its center. In spite of the gigantic stimulus package of 14 trillion yen, the unemployment rate has been historically high, the growth rate of national income has been low and the stock price has been depressed. The situation has not been restored even in 1995. The financial system has also been facing severe turbulence due to the adverse macroeconomics shocks. Falling land and stock price have more weakened such a situation.

Japanese financial authorities (Bank of Japan, Ministry of Finance) do not intend to remove the “too big to fail” principle, which symbolizes the regulation-oriented banking policy, at least through 2000. As the results, a large discussion on the rescue program for failing banks raised from the all angles. Unfortunately, under such a confusing situation, the public confidences to the whole banking system and financial authorities was further harmed. As the public has been recognizing the inability of the traditional fiscal and monetary policy, the regulation-oriented system has been challenging and changing drastically without the explicit authorized guidance.

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The introduction of the loan sale market is the example in the financial field. This market was originally emerged in U.S.A. to liquidate the long term housing loan mainly and then exported to many other countries. In recent Japan, the growth of this market is spontaneous one which is aimed to react the BIS regulation or some governmental regulation on bank's balance sheet or the business district.

However, unfortunately after 1991 in Japan, the loan sale is regarded as the emergency evacuation for *quasi*-failed financial institutions which include the commercial banks and some specialized financial institutions (the housing loan companies, *Jutaku senmon kin'yu kasiya*, *Jusen* in short). In our view, this kind of loan sale must be classified to "negative" market and the one which improves the efficiency or economizes the transaction cost accompanied with all financial intermediation is "positive". In principle, however, we can evaluate these movement positively as an important step from the regulation-oriented financial system to the market-oriented one and we believe no doubt that accelerates the speed of financial liberalizations (deregulation) and replaces the regulatory factors to the market based ones. In this paper, by focusing the implications of the loan sale market, we consider the future shape of the banking system<sup>1)</sup>.

## II The informational aspect of the loan sale market

### II - 1 The classification of the loan market

Before discussing the titled issue, we must consider the fundamental features of the loan sale market. In our view, the loan sale market has two basic functions as follows,

- a . to improve an efficiency by reducing the transaction cost any financial intermediaries must suffer.
- b . to improve an efficiency by removing the bad performed financial activities.

The former corresponds to "positive" market and the other to "negative". We will discuss these in turn.

#### (1) the positive market

In general, the financial intermediation is formed from two activities, one is to raise funds and the other is to use funds. Needless to say, they require the different financial skill, although they are closely related. From the view points of the economics, the term of "different

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1) The rapid development of the information processing and telecommunication technique must be necessary. On this point we can be optimistic. For example, by the introduction of the digital communication technique, the channel of the communications satellites are drastically increased which brings the opportunities for entry to the communication business. The financial technology development is also very brilliant.

skill” means the room for the division of labour and “closely related” for scope economy. Which shape the financial industry should be take depends critically on which aspect we must emphasis. In the case when we think the scope economy is important, then a concentration of finical activities into few entities will be desirable, that is , if “closely related” is emphasized, the traditional shape of the banking system will be imaged, where the fund raising and using are conducted within the one entity called bank. It leads the mixed bank, or in extreme case,the universal bank. We can expect to enjoy the benefit of the scope economy in this case.

It is natural to say that the introduction of the loan sale market into current system is related to the former concept, “different skill” in the sense that the loan sale market is typically the place where the fund raiser ,ex., the mutual fund , the institutional investor like insurance company, buys the asset which embodies the claims to the future cash flow from the fund users, for example, the venture capital. This means the division of labour between the fund raiser and the fund user and enables to realize the benefit from the specialization. As the reader may notice, the concept of “different skill” is located near the market-oriented system and the other near the regulation-oriented system. In what follows, we call this type of loan sale market “the positive market”.

## (2) The negative market

As noted above, unfortunately in Japan in 1990's, the loan sale market is expected to be a rescue scheme for the bad loan problem. Nowadays, it is proposed the selling of the bad loan at the market to be off balance, and to boot up the asset value and stock prise. It means to detach the unhealthy assets from the hearth body or to detach the unhealthy banks from the whole system, partly to protect the business itself and mainly, more importantly, to protect the payment system/credit creation cycle. Broadly speaking, this contributes to improve the efficiency so we can also call this type “the negative market” or the loan market in the weak sense<sup>2)</sup>.

In Japan, Co-operative Credit Purchasing Company (CCPC) was built in 1993. It aims to purchase the bad loans from the unhealthy banks and sell them off. But there are few buyers currently. On September 1995, the governmental task force proposed the establishment of the real asset backed security market. The principal purpose of this market is to diversify the risk when the great earthquake like Hanshin Daishinsai in 17th January in 1995 attacks the urban area. To diversify the property right, Special Purpose Company (SPC) is established and

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2 ) Needless to say, this proposal is debatable. First, when the bad performing assets are offered, the excess supply may result. If so this rescue program does not work. Actually some land site in Tokyo area can not find the buyer. Second, to start the program it is also considered to put the official funds into the market, that is, to purchase the bad asset by the official account. Here the official funds mean the money creation or the fiscal funds. If we follow the strict market discipline the use of official funds must be denied. So the actual use the official funds need a sufficient persuasive grounds.

it issues the security. Needless to say, the strict information disclosure about the property's quality, i.e., profitability, the degree of the earthquake resistant and so on, must be required. This market suggests us why the asset market can be work as the negative market. The focal point of this market is that the property holders (security holders) are plural and they are not necessary the land users<sup>3)</sup>. By so doing, the asset risk can be diversified.

In other words, the evaluation system of the asset quality is minimum required factor for operation. Then the task force also pointed out that the subjective evaluation system of the degree of the earthquake resistant is required.

## II – 2 the information asymmetry of the loan market

Now we can advance to next stage. Despite positive or negative, the loan market is able to improve the efficiency theoretically (which includes the rescue from the worst situations). The above discussion, however, requires the important assumption. The loan market can be contribute the efficiency *only if it perfectly works*. This sentence looks like a tautology so we must explain it in more detail.

The loan market is principally a free market. If not so, it is impossible to enjoy such the benefits listed above. A free entry means by definition “not to forced to enter”, that is, to enter or exit is the matter of bank's decision making. On the other hand, to sell their assets at the open market inevitably means to disclose their asset quality through the market evaluation, the market price. If the business enterprises including the bank is parsimonious in this disclosure of their business information, as the results, the loan market must face one of the following situations.

(1) Only the good performing banks enter the loan market. Such banks dose not need to conceal the business information, rather they intend to reveal it. By so doing they could enjoy the stock price appreciation and collect the deposit more easily. However, on the other hand, such banks might not need to sell off their asset immediately, unless the market overevaluates their asset than seller's book value or some market, especially the stock market, evaluates the bank's financial skill as the fund user directly, not the amount of asset itself<sup>4)</sup>. If it is natural to assume that the former case is normal case(=not to sell ), then the loan market can not be established.

The asset valuation is the one of the central issues of corporate finance and accounting. Thus far several methods have been proposing, for example, net asset value model, dividend valuation model, earning valuation model and so on. They are good neither for one thing nor

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3) This is the analogy of the segmentation of management and ownership.

4) This rises the additional problem that what the bank's objective variable is. If only the fund using is the main purpose of banking, put into differently, to search a prospective projects that have not funded, the bank with good assets sell off their assets. By so doing it can appeal his ability.

the other, mainly because it is not easy to define perfectly the asset concept without any contradictions to the other items on B/S or the other activities of the firms. Here we confront a serious problem, how the loan market solve this problem. In other words, what will be evaluated in the loan market? Dose the equilibrium price in the loan market reflect the information of bank total asset management?

The loan market can only bid a price of asset offered by banks and it must be a small fraction of total asset. Put it into differently, the definition of assets depends critically on the bank's financial strategy. In what follows, for simplification we assume the full series of asset is evaluated in the loan market. Anyway, the success or failure of the loan market hinges on the bank's financial strategy.

(2) No bank enter the loan market then the market can not be stood. As discussed above, if all banks have the strong incentives to conceal their information, no asset is offered to the market place then the market goes to failure. This is the analogy of the Prisoner's dilemma. If one bank discloses his asset information through the market and it is not so well, it may lose their customers or deposits at the benefit of the other banks. Whether this kind of Nash's equilibrium will result or not depends on how the asset manager of each bank anticipates their competitive situation under the limited information on the other bank's behaviour.

(3) All banks enter the market. This is the quite contrary case of (2), that is, the analogy of the generation of co-ordination in the sense of Axelrod. If depositors regard the bank's disclosure through the loan market as a signal that the bank has a reveal-able and high quality asset, the non-entered banks will lose their reputations and their current and potential profits. In this case, all bank is forced to enter the loan market and keep the appropriate asset value by the market forces.

As the results, only case (3) leads to the well behaved loan market. However, it is the most important emphasis that the market establishment depends firstly on the bank's decision making and the customer's decision making is reflected only after the market is established. In this sense the working of the loan sale market is the matter of bank's financial strategy. This superiority banks can enjoy stems from its dominance to depositors in the information structure.

### III Loan sale market with the liability market<sup>5)</sup>

#### III – 1 deposit inflow and outflow mechanism

As discussed in the previous section, the loan market has several informational pro-

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5) In what follows, we use the term "asset" as the loan offered to the market. In other words, we assume the bank's B/S is very simple where the asset is only the loan.

blems. However, if the loan market is not available, its social cost would be serious because we could not enjoy the benefit from the division of labor or specialization of the financial skills. So it is necessary to build up the new mechanism which can support the loan market, if possible, without any new regulation, i.e., the re-regulation. For example, the regulating authorities could force to banks to enter the loan market and disclose their loan's market value. But in this paper, we propose the other method, by which we can expect to be able to attain the same effects without any regulation.

We focus on the interaction between the asset and the liability on B/S, i.e., the interrelation between the fund raising activity and the fund using activity. Theoretically, the liability(asset) in the bank's B/S is backed by their asset (liability). So if the information of the asset quality is perfect (=the market evaluation of asset is perfect) and the deposits are transferred from one bank to other with no cost, the deposits in the bank whose asset is low evaluated in the loan market must flow out and flow into the bank whose asset is highly evaluated. As the results, the good performing banks will face with the deposit inflow and the bad performing banks with the deposit outflow. The bad banks will lose the profit opportunities then they should attempt to restore the market evaluation of their asset by the more strict loan screening or redeeming the outstanding loan etc. This gives the upward pressure on the asset value. On the other hand, the good banks must cultivate a new investment projects. Provided that the marginal efficiency is diminishing, this makes the average asset value decline.

Through the deposit inflow/outflow mechanism, the asset value at the loan market will reach the equilibrium. Consequently, when the loan market is well functioning the prudential behaviour of banks results.

How can we remove the informational problems under this framework? Remember here that the initial decision making to establish the loan market belongs to the bank's fund managers, that is, without bank's decision to disclose their information at the open market, the demand will not be met<sup>6)</sup>. Accordingly, we must transfer the market initiative from the bank's managers to those who need the market evaluation of the bank's asset or information disclosure. Needless to say, the depositors are the first ranked candidate for it<sup>7)</sup>.

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6) Note that this is not same to the normal market transaction. In normal microeconomics framework, the intensive demand (the bidding the high price) will induce the additional supply. Here, the factor the suppliers may concern is only the price bided. The perfect information is always assumed. But in the loan market, the suppliers can enjoy the informational dominance. Then despite the high bidding price by the demand side, the suppliers may not react it in the normal way.

7) In other words, depositors must also be self-disciplined. Even if they lose their deposits value, it is not covered when the loan market is well functioned. In the case of Kizu credit union, the subsidiary company which issued the mortgage security also failed. The mortgage holders are claiming to cover their loss because the salesmen dose not explain the term of mortgage. But this is non sense! It is holder fault to inquire that.

### III – 2 the liability market

We must refer the liability market. The liability market is defined as the market where the certificates which certify the bank's liability, mainly the deposits in the case of bank, are freely traded (in actual the CD has the feature like this. So our discussion might be understood as the expanded system of the current CD market).

Then the depositors bearing the certificate notes can sell those when they believe their bank is under the bad performance. If many depositors behave in same fashion the price of that bank's note is depreciated. At the time when the price drops below the face value, all depositors withdraw their deposit and re-deposit in the other bank. It is natural to assume that the depositors monitor the market price of notes constantly and sell and buy the note to keep their own asset value<sup>8)</sup>.

So not all depositors is necessary to engage in actual market trade of certificates. Most of them are only to monitor the market price and manage their deposit. Put it into differently, this needs some specialized market maker. Fortunately, we can expect the bank itself will do it because under this framework the bank must keep his certificate price sufficiently high to the extent that depositors do not withdraw their deposit<sup>9)</sup>.

Under which signal dose the depositors make their decision of note trading? By focusing the fact that the value of outstanding certificates are principally backed by the bank's financial skills for searching, screening and monitoring the prospective investment projects, we can say that the price of the bank's loan evaluated in the loan market works as the signal<sup>10)</sup>.

When the depositors can not receive the signal from the loan sale market directly, they may regard the bank not priced in the loan market as the bad performing one. Whether the bank is actually bad or not is not the matter for the depositors. For them, whether the signal from the loan market is observable or not is their concerns. Then, the banks are forced to offer the assets to market and this results the prudential behaviour of bank. All is caused by depositor's decision to maintain their asset value, not by the bank's decision making.

Now we must explain why the disclosure through the loan market is preferable than by authorized regulations. To settle up the regulation framework it is necessary to identify the kind of the information to be disclosed legally. However, which kind of information the depositors need are not determined ex ante, because the required information differ from person to person and time to time. Further, determining the disclosure process by the regulating authority means to determine the range of non-disclosed information. The information range

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8) Of course the issued bank must repurchase the note at par.

9) All bank may deny the trading the note each other. One bank brings down the other bank's note intentionally (it is called the note picking). But this will lead the competitive note picking then the public trust to the system will be collapsed. So it is not pay for the banks to behave like this.

10) The modern banking theory refers this function as the informational function of the banking firm.

the depositors need must be variable.

On the other hand, the loan sale market determines the unique price, which is the simple signal but reflects all factors the market concerns. The advantage of the market price which can serve as the signal for every agent is that it is a compound index, which summarizes the innumerable individual subjectivity into the one objectivity. Impossible is it any regulating authority.

#### IV The interaction between two markets — some lessons from the free banking theory —

##### IV – 1 the market interaction

Suming up the above, we can conclude that *the loan market without liability market* must fail. In this section, we consider the two market's interaction more in detail. Tell the truth, to inquire this issue we must develop the general equilibrium model. However, in what follows, by discussing the adverse system, i.e., the liability market without the loan market, we consider verbally the interaction between them.

The reason why we take such a manner is the liability market without the loan market is not an imaginary one only for the research on the desks. Here we can derive some lessons from the experiences in the free banking era. It is the one of points of this paper to re-evaluate the meaning of the free banking under this theoretical framework, i.e., the interaction between the asset and liability market.

Although there are many different versions across the nations or periods, the proto-type of the free banking can be characterized by the followings.

- (1) Anyone can start the banking business freely and issue their bank note, although they must held some reserve asset at the official vault. The depositors can access to the desirable note by depositing and withdrawing.
- (2) The outstanding notes can be freely traded in the note market. Their daily prices are opened.

According to the traditional discussion, the free issuing system was significantly instable mainly because the bankers were inclined to gather up the depository funds by overissuing the note and moved the bank's head office to the far-from county where only the wild cat could survive. In other words, the existence of the liability market where the banker could freely sell their note was thought as the main defect. This *wild cat hypothesis* has been the long lasting powerful explanation to deny the free banking. Actually, the free banking system has been replaced by the central banking system from 19 to 20 centuries.

Why were the wild cat bankers able to overissue their note, or why could not the depositors aware of it ? By considering the reason for it under our framework, it can be at



tributed to the lack of the evaluation mechanism for the bank's asset. Accordingly, the bankers fell into the moral hazard trap. When the depositors recognized it, they seceded from the currency system itself, because they could not keep their asset safely under such a situation. Or they hoarded the high quality note or physical asset and used the bad note in the dairy transaction (this is the analogy of Gresham's Law). Because it was difficult for general depositors to distinguish the good note from the bad one when the whole system was nearly collapsed, it was not strange that the free issuing system was abandoned.

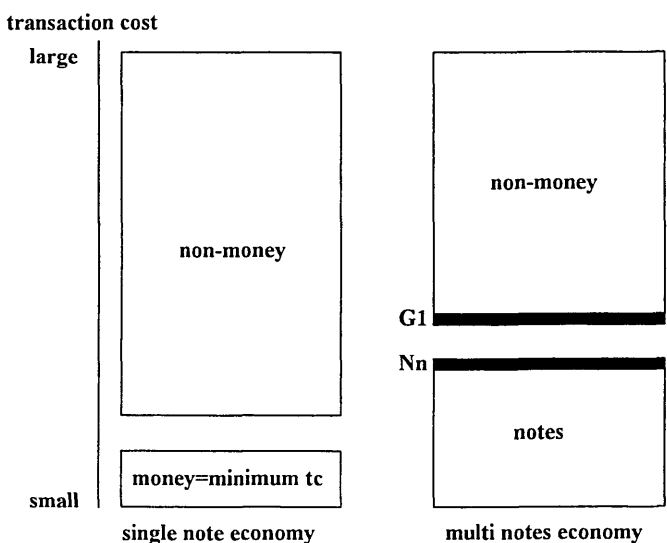
Provided that the asset evaluation mechanism works, the depositors can select the high quality note. Then the bad note is removed by market forces, i.e., the adverse Gresham's Law works. On the other hand, the bank which does not enter the loan market is labelled as the bad performing bank then his note is depreciated and flow back.

So we can conclude the reason why the historical free banking system's failure is not because of the existence of the note market (liability market) but because of the lack of the asset valuation mechanism which leads the bankers to the prudential behaviour and depositors to select the high quality note. This supports the stability of the whole monetary system<sup>11</sup>). In short, in our imaginary economy, the note market which is based on the free issuing and the free exchange system (deposit inflow/outflow mechanism) contributes to prevent the banks from the moral hazard and provides the prudential asset management in co-operation with the loan market.

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11) The criticism to a free issuing gives the ground for the introducing the central bank system. However, if our discussion is correct, the central bank system is not only the desirable system. The function of central bank are (1) to issue the central bank note monopolistically, (2) to maintain the reserve. In our view, (1) relates to the supply of medium of exchange and (2) to the determination of the unit of account. Private banks reserve a part of their fund into central bank, then the central bank evaluate it like \$ 1000 or £ 2000 and so on. This means the central bank is determining the unit of account. By accepting the unit, the private bank can operate their loan/deposit business. Theoretically speaking, this relates to the Warlusian numeraire. In the simultaneous equation system where the demand/supply conditions and prices for  $n$  goods are determined, the system is indeterministic without numeraire. If  $n$  banks issue  $n$  types of bank notes, this constitutes the  $n$  demand=supply simultaneous equations system. Then one of the notes must be chosen as a numeraire. The reserve system is working as a numeraire, by giving the accounting unit (\$, £ etc.) to private banks. Without the unit of account any trade is impossible, however, once the unit is selected, a private issuing is quite possible. That means the central bank must set the unit of account, however, this does not mean it must issue the central bank note monopolistically. Under such an economy, the central bank works as only the reserve vault. Then, when the transaction cost's structure changes drastically, which is not unrealistic under the high speed development of the computational technique, the public preference to the monopolist bank may change. As the results, the note as the numeraire may change. People can choose their most desirable note by observing the market exchange rate between the notes. Provided that the loan market which serves the evaluating mechanism of bank's asset, the note issued by the bad performing bank is not demanded and only the high quality notes can survive. Of course, the market mechanism leads eventually the situation where all notes are equally evaluated. Some writers are discussing that this eventual situation is substantially same as the one note economy, i.e., the monopolistic issuing by the central bank. But we must distinguish between the monopoly as the result and as the way. More detail discussions are given in Fukaura (1995).

Medium of exchange is defined as the good that the accompanied transaction cost to use it for exchange is minimum (Fukaura (1995)). To be 'minimum' leads the single money economy. Then, the process that the payment system is established equals substantially to the process to search the medium of exchange with minimum transaction cost under the given transaction structure. By following this, multi-note system, which is the main future of free issuing system, can be considered as a transition period to single note economy. Here we must confront following theoretical problem. In single note economy, it is possible to distinguish between money and non-money because the 'minimum transaction cost' condition identifies the unique good as the money. What if in the multi-note economy?



By lining up all goods along the transaction cost, we can easily identify the minimum transaction cost note. However, in multi notes economy, what is the substantial difference between maximum transaction note ( $N_n$ ) and minimum transaction cost non-money ( $G_1$ )? If the quantitative difference of transaction cost between them are small, why dose the public chose  $N_n$  as the money, not  $G_1$ ? Further, if people prefer  $N_{n-1}$  than  $N_n$ , then  $N_{n-2}$  is more preferable and  $N_{n-3}$  is same. As the results, multi note economy converges to the single note economy. Saying differently, it is not so important whether the economy is under the single note system or multi note system because the former can be the corner solution of the latter. Rather, it is the border line between money and non-money that is significant to understand our monetary system<sup>12)</sup>.

12) Note that this validity of single money economy depends critically on the assumption that the transaction cost structure is stable. If the transaction structure changes by, for example, the telecommunication technical development, single money dose not necessary survive further as the medium of exchange. In this point see also Fukaura (1995).

#### IV – 2 miscellaneous problems

We must apply above discussions, which is the theoretical appraisal to the free banking, to the current issues. Beside the central bank problem (see footnote 11) , we must consider the following points.

##### (1) note dealing:

Is it actually possible for depositors to exchange their holding note sufficiently often to keep their asset value like a foreign exchange dealer? It is difficult to answer this because it is an exceedingly practical problems. However, by referring the historical records we can make some predictions on it. In free banking era in U.S.A., daily report of the exchange rate between all notes was published on the newspaper and very available for citizens. People read the report and exchanged their holding note. It is impossible to apply this experience to the current economy, however, if we observe the flourish of the foreign exchange market we could expect the similar situation on the free issued bank note<sup>13)</sup>.

##### (2) no deposit people:

Imagine those who receives all his salary by cash and hold it as it is. Even in this case, the employer must have the deposit account and he must be careful in keeping their deposit value. So it is probable that the worker can receive the most valuable note when his boss is rational.

But what if his boss pays the worker by the bad note and keeps the good note to himself? This is the adverse Gresham's Law. In this case, the worker suffers the loss. So it is necessary to give the worker the right to receive the best note. It requires the special law but it's not an intervention but a keeping the market transparency.

##### (3) speculation:

Needless to say, it is quite natural that the speculative action will occur in the note market. But we must notice the profit seeking activity contributes to stabilize the price level, because for raising the arbitrage profit the speculators must buy (demand) when the price is low and sell (supply) when the price is high. In this sense, in the process to converge one dominant note the speculation is very important. And when the public confidence to the dominant note changes, again the speculation leads to the new equilibrium, that is, a selection of new dominant note (see footnote 12) . Generally speaking, in the free market the speculation is an inevitable factor. When it is regarded as the destabilizing factor, some conditions for the

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13) It is natural to think that the special dealer of note will emerged. It may be the bank itself the depositors deposit. Accordingly, we must account the additional transaction cost.

perfect competition must be violated.

(4) deposit insurance:

In the system discussed above, the depositors must control their deposit value by carefully observing the note market. In the discussions of free banking, especially the wild cat banking hypothesis, it was said that the depositors suffered the heavy damage by the wild cat banker's action. As the results, the protection of depositors were required partly in the point of view of the national welfare and partly of the stability of monetary system.

The S&L case, where many S&L failed like a line of dominoes, is fresh in our memory. After the case the deposit insurance scheme in U.S.A. was completely restructured and this is the symbolic event which shows the dominance of the deposit insurance as the deposit protection method.

Here it must be distinguished between the protection of *depositors' property* and *the macroeconomic function of deposit* itself. The former means the protection of depositors' personal property and the latter means of the function of payment system through the deposit and it is significantly related to the economic infrastructure so there is a room to intervene officially. In other words, the property of outsiders who have claims to the deposit in the unhealthy bank must be secured but the depositors' itself properties must not. In the following figure, depositors' claim shown by dashed line and outsiders' claim shown by solid line must be treated separately under the deposit protection scheme. For example, the issued checks by depositors are to be rescued by limited time. According to circumstance, the introducing of official funds may be rationalised<sup>14</sup>). If depositors intentionally withdraw their deposit before the maturity date, it must be legally secured to chase it. When without intentional withdrawing, the issued checks must be liquidated by the upper limit of the balance<sup>15</sup>). It is often said that depositors must be saved but not troubled institutions. However, readers can understand why this is not correct. Depositors are insiders and they must bear heavy responsibility for the deposit value.

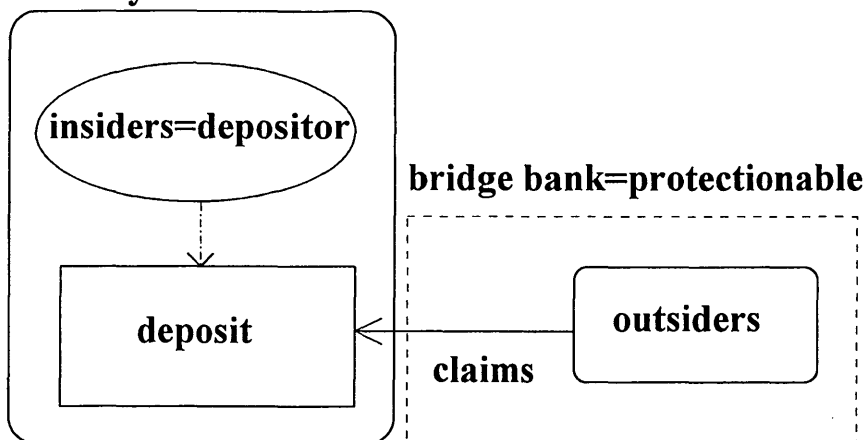
Anyway, if the authorized action is not for depositors' property protection but for the claims to the deposit, it can be regarded as the method for keeping the payment system stable.

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14) On Sep. 1995, the interim report compiled by a committee of Financial System Research Council suggested the injection of taxpayer's money is decided officially. This means the taxpayer's money is the last resort in debt crisis.

15) Of course we must consider the redeeming priority of issued checks. It is also possible that insiders and outsiders conspire and move the transaction account to the troubled bank and get the official fund.

## unhealthy bank=dissolve



To protect the outsider's claim, the bridge bank may be necessary. In Japan, such a bank was established, however, it was not followed a systematic rescue program but also ad hoc policy reaction<sup>16)</sup>. We also never say no rescue programs are required, rather it is necessary. However, it must be the program which *supports* the market mechanism or market discipline and not be *substitute* it<sup>17)</sup>.

### (5) market discipline and the association-type banks:

Following the market discipline means the acceptance the profit maximization principle as the first management principle. For most commercial bank, this is quietly plain. But some association-type banks, for example, credit union, dose not necessary follow this principle because the purpose is the mutual aid between members. However Japanese experience shows clearly such a purpose is an only illusion and leads the huge moral hazard of union managers. Accordingly, in the medium or log run, we believe it is desirable that the association-type banks will be converted to the commercial banks.

16) The bridge bank is the entity that takes over the failed bank business and all its asset. It evaluates the failed bank value and decides whether it must be survived or dissolved. However, the evaluation mechanism is also required.

17) Who must shoulder the costs for the bridge bank is controversial problem. What is indeed the public fund? Generally speaking, the fiscal fund and new money creation are the candidates. However, we believe the latter is preferable. That is, the bridge bank have the liability to the central bank. By so doing, the official fund may be recovered when the bridge bank performs well. The assets held by the bridge bank funded by the official fund are the nation's properties. This means the National Diet can make the decision making for disposal of that assets. In the case of U.S.A., these procedures led the good results.

## V Decentralization and loan sale market

If anything, the above five topics are referring the technical aspects accompanied in the loan market, which may be difficult to solve. However, in some extent, we can treat those by the legal measures. Of course it must be noted that measures must be consistent to the market principle or discipline.

More important and substantial point we must consider is how we can explain the loan market under the current torrent of the financial deregulation.

As noted in first section, the most distinguished factor of the loan market is related to the division of labour in the field of the financial intermediation, in short, unbundling, which means the segmentation between the fund raising and using. The current system is needless to say a bundling system in the sense that the banking firms are the most influential financial intermediary.

However, unbundling dose not mean only the segmentation of the skill. It has the potential to lead the resource reallocation or reshuffle of allocation. If the unbundling is advances, the agent which has the one specialized skill can enter the financial business. For example, the investment advising company, which nowadays the mere assistant company, can loan to the prospect project and then sell off the claims at the loan market. In this case, it plays an important role as the specialized fund user<sup>18)</sup>. In Japan, the city banks (money centre bank in U.S.A. sense) maintain the nation wide branch network, through which they can collect a large amount of deposit. On the other hand, the Industrial Bank of Japan (investment bank in the European sense) is prohibited to supply normal saving account. Instead it can issue the debenture to raise the fund. However, it's fund raising function is limited. Actually, the Ministry of Finance which can use the postal saving fund is the main customer. The fund flow from commercial banks to IBJ is not wide<sup>19)</sup>.

However, this debenture system is considered as the primitive loan sale market or the asset evaluating mechanism. As the facts, the screening skill of IBJ is highly evaluated and through the high growth era other commercial banks lent willingly the firms which borrowed from IBJ<sup>20)</sup>.

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18) In real, such a firm must borrow the fund from the bank. However, it can sell off the claims to the projects and repay its own borrowing.

19) The debenture market is partly functioning as the fund flow mechanism. But it is regarded as one kind of the time deposit. Or, it is the main fund using field of the postal saving. The postal saving is servicing by the Ministry of Post & Telecommunication but the using the funds are directed by the ministry of Finance. Anyway, the current fund flow through the debenture dose not function as the loan evaluation mechanism.

20) For example, When Kawasaki Group planned to enter the steel industry, Bank of Japan tried to stop that plan from the view point of national welfare and industrial order. Only JIB supported Kawasaki. We know now that IJB's decision is right. The epoch making merger between Yahata Steel and Nihon Steel and between Nissan Motors and Prince Motors were initiated by IJB. The public opinion was against it.

Intuitively speaking, we may define the loan market as the expanded market of current debenture market. If the loan market is perfectly an open market which means any economic agent can enter there and trade claims, even the financial intermediaries can sell their asset in the market and can diversify the total risk if they have sufficient fund using skill. Accordingly, the loan market leads the inter-industry resource reallocation. That is, the agents which have superior financial skill but can not engage in the financial activities under the current framework can realize their potential talents.

We are sure that the loan market accelerates the financial deregulation by initiative of the private sector and the economy wide resource re-allocation beyond the financial industry. Recently, it is discussed that present Japanese economic framework can be originated up to 1940's when the strict regulation oriented system was completed to pursue the Pacific War. After the political defeat in 1945, the basic regulation framework survived and provided the fundamental conditions for recovery. If we accept this view, it would be required to consider the recent movement of deregulation or restructuring in the historical view. We may now confront with the historical resource allocation or reshuffling of old fashioned system which was built 50 years ago.

## VI Concluding remarks

The loan sale market in Japan is still in infant stage. The sad reality is the loan market is considered as the special market for the bad performing loan. We believe that it is not desirable that the policy authority is content with this situation, because it spoils the substantial function of the loan market, i.e., the positive market. Further, under the financial distress like in Japan, without the bank asset evaluation mechanism, the authority is like betraying depositors by letting banks overestimate the asset value.

The bad loan problems in Japan are not only the problems of the banking system itself. We must consider them as the problem of overall economic structure whose foundation was constructed 50 years ago. Accordingly, it is important for us to understand the loan market in the context that the economy-wide deregulation.

The perfect deregulation in the field of money and banking contains the liberalization of bank note issuing. Logically discussing, the loan market is closely related to the free issuing system. In this sense, we can derive some lessons from the free banking era, which is the important theoretical findings of this paper. Needless to say, an introduction of free issuing system into the actual economy is difficult. But this does not mean the above discussions are meaningless. Rather, by establishing the loan market, we must firmly recognize that we are just on the direct way from the regulation oriented economy to the market oriented economy and there is no way to turn back<sup>21</sup>). Many Japanese are still reluctant to compete with each other and the monetary authorities are reluctant to abandon the existing regulations. Now Japanese economy

stands at a cross-roads on whether it can achieve the mature economic structure in the true sense.

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21) The main point of this note that the asset value is not reflected the amount of bank notes in the free banking system is instructive for current money supply system. In many countries, central bank sets the minimum reserve rate and this determines the money supply through the money creation mechanism. Theoretically by changing the reserve ratio, the central bank can control the money supply. Generally, the central bank is observing the many economic indicators and setting the proper ratio. Following the our discussion, the central bank should observe the commercial bank's asset value and reflect it to the each bank's reserve ratio. Alternatively, the book value of the reserve may be changed if the each bank's asset value change. Of course, it is very difficult to set the ratio (the book value) differently from bank to bank, however, we are sure that the asset evaluation is also key factor to control the money supply. In the most extreme discussion, the money supply control by monetary authority itself can be rejected. It is because that when deposit inflow outflow mechanism functioned perfectly, total amount of deposit will be adjusted by the bank's asset value, which reflects the loan value. These need a future research.



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