Annual Budget Tops 100 Tril. Yen

Japan Grows More Dependent on Borrowing

By Katsuhiko SAKAI

Japan's budget for fiscal 2009 is expected to feature two historic milestones. First, general-account spending for the year ending in March 2010 exceeds 100 trillion yen for the first time ever. Second, an emergency situation in which borrowing through new government bond issues (other than refunding bonds) exceeds tax revenues for the first time in postwar Japan is taking on a real possibility, although final figures are yet to be made available.

Since the global financial crisis grew more serious in the summer of 2008, the Japanese government has come up with economic stimulus packages one after another. Under his "three-stage rocket" initiative to overcome the economic crisis, Prime Minister Taro Aso put forward a record 88.5 trillion yen budget for fiscal 2009 following the first and second supplementary budgets for fiscal 2008. But even the record budget has been expected to fall short of covering an annual demand gap of some 20 trillion yen caused by a sharp decline in gross domestic product (GDP). In April when fiscal 2009 started, the government and the ruling camp worked out an additional stimulus package with total economic effects worth 56.8 trillion yen and formed a supplementary budget for the just-started fiscal year to fund the package.

The supplementary budget is worth 14 trillion yen, doubling the third extra fiscal 1998 budget worth 7.6 trillion yen, which was the largest in history then. The value is equivalent to some 3% of Japan's nominal GDP. At a financial summit of the Group of 20 major industrial and emerging countries in London in April, US President Barack Obama proposed 2% of GDP as a numerical target for economic stimulus measures. Although the proposal was dropped on opposition from such countries as Germany and France,

Prime Minister Aso emphasized Japan's strong determination to get out of the current recession and compiled the most aggressive stimulus package for an industrial country in terms of fiscal spending.

As a result, general-account spending in fiscal 2009 increases by 14 trillion yen from the initial size of 88.5 trillion yen to a record 102.5 trillion yen. In addition to record tax breaks for housing loan borrowers, a new tax incentive for buyers of gasoline-electric hybrid cars and other stimuli under the initial fiscal 2009 budget, the government has incorporated into the supplementary budget incentives for the replacement of electric household appliances with more energy-efficient ones, installation of photovoltaic power generation systems in schools and other measures to continuously stimulate domestic demand.

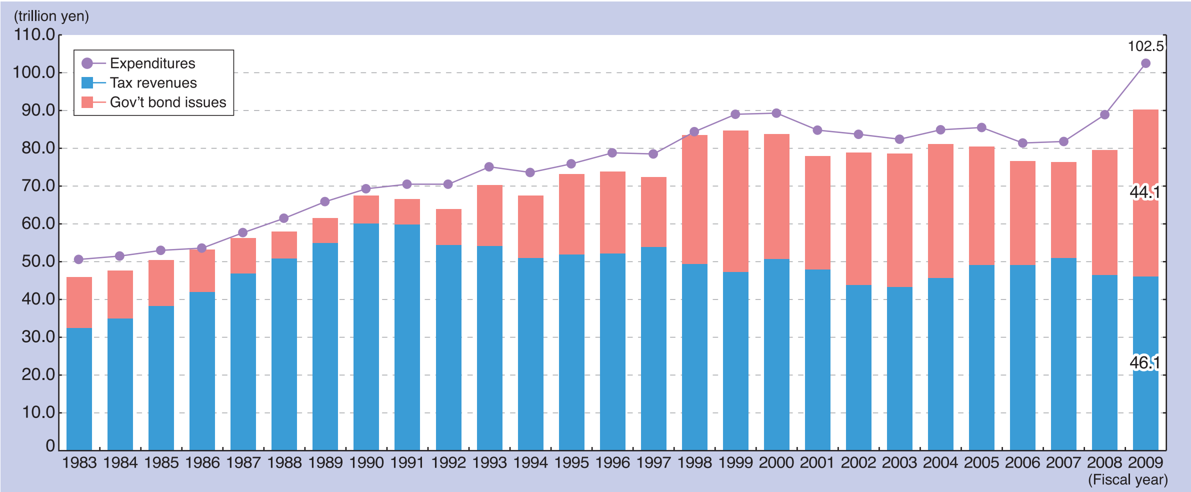
New Bond Issues Could Exceed Tax Revenues

But the huge supplementary budget for preventing an economic freefall will inevitably take a heavy toll on Japan's public finance. For the 14 trillion yen supplementary budget, the government has failed to find revenue sources other than over 3 trillion yen from reserves in the Special Account for the Fiscal Investment and Loan Program and has had no choice but to depend on additional government bond issues for the remaining 10.8 trillion yen, including 3.5 trillion yen in deficit-financing bonds. As a result, total new government bond issues in fiscal 2009 will swell to a record 44.1 trillion yen.

Meanwhile, the fast economic deterioration is projected to drive down tax revenues under the initial fiscal 2009 budget by 13.9% from the previous year's initial estimate to 46.1 trillion yen. Particularly, corporate tax revenues are estimated to plunge 36.9% to 10.5 trillion yen. The problem is that even the conservative tax revenue projection is now seen as difficult to achieve.

When the initial budget for fiscal 2009 was formed in December last year, the government projected real GDP growth at zero for the year. But it revised the GDP growth projection downward to a 3.3% contraction when compiling the supplementary budget. Private-sector economists expect the government to lower the total tax revenue estimate by 3-5 trillion yen during the rest of fiscal 2009. The bleaker economic outlook is based on the presumption that the additional economic stimulus measures under the supplementary budget would boost GDP by nearly 2%. If these measures fail to achieve the presumed effect with corporate earnings declining further, tax revenues may show an even steeper decline. If the government is forced to cut the tax revenue estimate, it may have no choice but to depend on extra government bond issues for covering a revenue shortfall. Borrowing through new government bond issues in fiscal 2009 is now believed almost certain to exceed tax revenues.

Japan's general-account spending, tax revenues & new government bond issues



Note: Figures through fiscal 2007 are final accounts & those for fiscal 2008/2009 include supplementary budgets.
Source: Prepared from Finance Ministry data

Outstanding Gov't Bonds Snowballing Faster

Japan's public finance law, put into force in 1947 just after the end of World War II, prohibits the government from issuing bonds for projects other than construction of public facilities, including roads. Japan thus learned lessons from the past in which outstanding government bonds exceeded gross national product (GNP) to cover wartime spending from the Japan-China War to the Pacific War and became as useless as waste paper on postwar hyperinflation.

Japan refrained from issuing government bonds under its balanced budget doctrine until fiscal 1964. Under a supplementary budget for fiscal 1965 when a revenue shortfall emerged amid a recession, the government issued deficit-covering bonds for the first time since the end of the war by enacting a one-year special law. In the next fiscal year when Japan shifted to a policy of aggressive fiscal expansion, the government began to issue construction bonds designed to fund public works projects. Japan has annually enacted a law to issue deficit-covering bonds since fiscal 1975, excluding the fiscal 1991-1993 span when tax revenues expanded on the asset-inflated economic "bubble."

Over the past decade, the excess of expenditures over tax revenues has grown more conspicuous as social security spending swells amid an aging society. At the same time, refunding bond issues have expanded to raise funds for redeeming bonds issued earlier, prompting the balance of government bonds to snowball. Outstanding government bonds took 19 years to top 100 trillion yen and 11 years to reach 200 trillion yen. But they took only five years to reach 300 trillion yen, three years to 400 trillion yen and another three years to 500 trillion yen.

At the end of March 2009, outstanding government bonds totaled 545 trillion yen. With bonds issued under the fiscal investment and loan program, cash borrowing and treasury bills added, total government debt came to a staggering 846 trillion yen, equivalent to 1.7 times the nation's GDP. Interest payments on government bonds under the fiscal 2009 budget are 9.4 trillion yen, meaning 1.1 billion yen is paid every hour in interest on debt.

Tough Challenge for Fiscal Reconstruction

We are sometimes questioned if Japan's public finance has gone bankrupt. "Our public finance is close to bankruptcy," Kiichi Miyazawa, a former prime minister and then finance minister, told a parliamentary meeting in March 2001, evoking a controversy. In fact, Japan's government debt as a percentage of GDP was then and is the highest among industrial countries.

In reality, however, we have no choice but to answer no to such a question. Doubts have never emerged or are unlikely to emerge about the capability of the Japanese government to redeem bonds. As indicated by the low yield below 1.5% on the benchmark 10-year Japanese government bond issue, banks and other Japanese investors have had persistent demand for government bonds as the safest investment tool. The market has so far absorbed massive government bond issues in a decent manner every year.

But the past easy dependence on government bond issues is weighing heavily on the government. Unless the Japanese economy expands smoothly, it will be difficult to curb a rise in outstanding government bonds as a percentage of GDP. If market players become conscious of credit risks for Japanese government bonds, credit rating agencies could lower ratings on these bonds to trigger an upsurge in bond yields – hence in long-term interest rates – and an expansion in interest payments on government bonds.

Everyone has recognized that the present situation should not be left untouched. A supplementary provision in a set of laws accompanying the fiscal 2009 budget calls for raising the consumption tax from the present 5% three years later – fiscal 2011 – for fiscal reconstruction on condition of an economic upturn. Japan now faces a tough challenge to pave the way for budget reconstruction while giving top priority to economic recovery. JS

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