

# Shifting into Expansionary Gear

By Susumu Kato

Since becoming prime minister, Yasuhiro Nakasone has made administrative and fiscal reform his number-one priority and staked his career on restoring the government's finances to health. As part of this effort, minus-growth budgeting was imposed on most areas of the government for the past four years, and budget request guidelines calling for 5% cuts in investment spending and 10% cuts in current spending were laid down. The government's general account initial budgets have increased only very slowly since 1984, with the increase in fiscal 1987 being a mere 0.5%. General expenditures, meaning the general account minus national debt service and tax grants to local authorities, have not increased at all since 1983.

The Nakasone push for administrative streamlining and fiscal restructuring in line with the recommendations of the Provisional Council on Administrative Reform has been remarkably successful in eliminating waste and downsizing the bureaucracy, an effort in tune with international currents. For example, the value of national bond issues in the general account has declined steadily since fiscal 1982, falling to only ¥10.5 trillion in the initial budget for fiscal 1987. Likewise, the ratio of national bond issues to total revenues (the bond issue dependency) has fallen from a peak of 34.7% in fiscal 1979 to less than 20% (19.4%) in 1987. At the same time, while the total value of national bonds outstanding is a high ¥152 trillion (44% of nominal GNP) this fiscal year, national bond debt service has been growing less slowly, and the growth rate will be down to 5.7% this fiscal year.

As a result of these very austere budgets over the past five years, the Japanese fiscal structure has been radically revised and is now in better shape than those of most other OECD countries. According to calculations by the OECD, the general government deficit for fiscal 1987 will be less than 1% of nominal GNP. One factor behind this, of course, is the fact that the social security fund is running major

surpluses because the demographic structure is still weighted toward the younger cohorts and the social security system is still immature. As a result, it is expected that the social security fund will go into the red in the not-too-distant future as the population ages, and it is thus impossible to be very optimistic about the fiscal situation.

## Imbalances crop up

While this fiscal restructuring has been very successful, the target for fiscal restructuring (that of reducing issues of deficit-financing bonds to zero by fiscal 1990) was so rigorously pursued that fiscal policy was unable to play its normal role when imbalances developed in the domestic economy and in external economic relations. Fiscal policy has a very important role to play in reallocating private-sector resources, and there is now a clear need for fiscal policy to stimulate demand in areas depressed by the yen's appreciation. In the longer term, fiscal policy should also be used to enhance the infrastructure and improve the quality of Japanese life.

In terms of the balance between savings and investment, the Japanese economic structure has been one of in-

creasing disparity through fiscal 1985 (the latest year for which figures are available). As shown in Table 1, the major deficit (investments greater than savings by 11.9% of nominal GNP) in the corporate sector was almost entirely met by the surplus in the household sector (11.6% of nominal GNP) and the general government and external sectors were roughly in balance in 1974 just before the rampant inflation induced by the first oil crisis. Yet after fiscal 1980, the corporate sector gradually reduced its deficit and the general government sector also brought its deficit under control following fiscal 1975's sharp upturn until it was down to 0.8% of nominal GNP in fiscal 1985. Because the excess of savings over investment in the household sector has held at approximately 10% of nominal GNP, these surplus savings were naturally absorbed by the excess investment by the external sector (the trade surplus). Although figures for fiscal 1986 are not yet available, it may be estimated from the international balance of payments statistics that the external surplus has risen to 4.7% of nominal GNP in line with the increase in the domestic savings surplus.

The various economic issues Japan faces at present are reflected in the sectoral imbalances in savings and investment,

**Table 1 Japan's Investment-Savings Balance by Sector**

(¥ trillion)

Sector	Fiscal year	1970	1974	1977	1980	1981	1982	1983	1984	1985
<b>Nonfinancial corporations</b>		-7.2 (9.6)	-17.8 (12.9)	-9.0 (4.7)	-14.9 (6.1)	-15.1 (5.8)	-14.0 (5.1)	-11.5 (4.0)	-14.8 (4.9)	-17.7 (5.5)
<b>Financial institutions</b>		1.0 (1.3)	1.4 (1.0)	0.1 (0.1)	1.0 (0.4)	-0.3 (0.1)	0.9 (0.3)	0.2 (0.1)	-0.2 (0.1)	-0.3 (0.1)
<b>General government</b>		1.4 (1.9)	-0.1 (0.0)	-7.9 (4.2)	-9.9 (4.0)	-9.7 (3.7)	-9.3 (3.4)	-8.4 (3.0)	-5.6 (1.8)	-2.6 (0.8)
<b>Households</b>		6.1 (8.1)	16.0 (11.6)	19.8 (10.3)	22.7 (9.3)	25.6 (9.8)	22.4 (8.2)	26.2 (9.2)	26.9 (8.9)	31.5 (9.8)
<b>External sector</b>		-0.8 (1.1)	0.6 (0.5)	-3.5 (1.9)	1.2 (0.5)	-1.7 (0.7)	-2.7 (1.0)	-6.1 (2.1)	-9.4 (3.1)	-12.5 (3.9)
<b>Statistical discrepancy</b>		-0.5 (0.6)	-0.1 (0.1)	0.6 (0.3)	-0.1 (0.0)	1.2 (0.5)	2.7 (1.0)	-0.4 (0.2)	3.1 (1.0)	1.6 (0.5)

Note: Numbers in parentheses are percentages of nominal GNP.

Source: Annual Report on National Accounts, Economic Planning Agency



and the kind of economic restructuring recommended in the Economic Council's report to the prime minister and elsewhere will be needed to rectify these imbalances. In effect, it will be necessary to change the Japanese economy from an export-led economy to one powered by domestic private-sector demand and housing investment. Yet economic restructuring cannot proceed smoothly unless appropriate fiscal consideration is given to industries and regions feeling the brunt of the stronger yen's deflationary impact.

In effect, fiscal policy cannot play its proper role so long as the government continues to adhere strictly to the austerity of balanced budgets, and fiscal spending has to be expanded to attain clearly defined aims. This is a very significant turning point for the Japanese economy, involving as it does a basic rethinking of the fiscal policies that the government has been pursuing. Specifically, this transformation of the government's fiscal policy thinking must involve abolishing the zero-increase ceilings on budgetary requests and postponing the elimination of deficit-financing bond issues beyond 1990. In fact, the government is already moving in these directions.

### Can fiscal policy be effective?

While the need for a more activist fiscal policy is clear, the next question is whether or not fiscal policy can still be effective and to what sectors it should be applied.

One of the main reasons for opposing increased fiscal disbursements is that fiscal policy's multiplier effect has deteriorated, in some cases dropping to less than 1.0. With the recent sharp increases in land prices, expanded public works budgets are likely to be almost entirely eaten up just in the process of site acquisition, and hence to make only a negligible con-

**Table 2 Annual Rate of Increase in Land Values**

(%)

	Residential sites	Commercial sites	Industrial sites	Average for all sites
Tokyo area	21.5	48.2	13.6	23.8
Osaka area	3.4	13.2	3.2	4.6
Nagoya area	1.6	6.4	1.3	2.4
Tokyo-Osaka-Nagoya average	13.7	30.1	7.0	15.0
Average for outlying urban areas	1.2	2.9	0.8	1.5
National average	7.6	13.4	2.8	7.7

Note: These figures are based upon the 1987 official land values as recognized for property tax assessment purposes.

Source: National Land Agency, January 1, 1987

tribution to real fixed asset formation. This may be somewhat too pessimistic a formulation, but it is definitely true that site acquisition would take a major portion of the budget were these public works to be concentrated in the Tokyo area. Yet the role that is being scripted for fiscal policy investment is not one of further concentration of facilities in Tokyo and fanning the fires of soaring land prices but one of allocating resources to outlying areas in an effort to achieve balanced development nationwide.

As shown in Table 2, the rapid increases in land prices have been pretty much restricted to the Tokyo area, and land prices have been very stable in outlying urban areas. Thus if public works are located in these outlying areas, they should continue to provide effective economic stimulation. In fact, to date only about 20% of public works spending has gone to site acquisition, and the remaining 80% has provided infrastructure enhancement and improved amenities for the general public. According to a Daiwa model simulation analysis, the multiplier effect of public works spending, while less than it used to be, is still around 1.3 and public works spending remains an effective short-term stimulus for the economy.

Yet no matter how effective public

works may be as economic stimuli, that short-term fix is not alone sufficient justification for their advocacy. Just digging holes and filling them contributes nothing to the longer-term goal of restructuring the economy. It is imperative that public works be planned and allocated in line with clear-cut goals. In this, the Economic Council is quite right in its directions and priorities. Specifically, we need:

- 1) Responses for structurally depressed regions that are highly dependent on specific export industries hard works giving the priority hit by the yen's appreciation and find themselves facing severe employment problems. There is a need to allocate public works giving the priority to such regions.
- 2) Priority improvements in outlying cities are needed to rectify the excessive concentration on the Tokyo area and to foster the growth of outlying regional cities so as to achieve regionally balanced development and improve the quality of life nationwide.
- 3) Policies to revitalize rural areas are an essential component in promoting the smooth restructuring of Japanese agriculture for greater international harmony.

Infrastructure maintenance is another area that should not be forgotten, as it will require considerable public works spending simply to maintain the many infrastructure facilities that were built in the late 1960s. This cannot be done under austerity budgets.

While most of the items above are correct from the demand side, it would be wrong simply to go about blindly approving ever greater fiscal expenditures. Rules and guidelines are needed. For example, the OECD has proposed that government fiscal policy maintain a growth-neutral stance with deficit spending, when necessary, held to within a certain percentage of nominal GNP. Granting the difficulty of setting actual policy guidelines, some way should be found to allow deficit spending so long as it does not stunt economic growth. ●



The last day of a coal mine. Consideration must be given to industries and regions facing special economic difficulties in turning Japan's economic orientation to a domestic-demand-led one.