

What Japan Is Doing To Reduce Fiscal Deficit

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Burdened with a deficit of more than 20% of budgetary expenditure and equivalent to 4% of GNP, Japan's national finances are in serious trouble. The government is making utmost efforts to reduce the fiscal deficit. This report explains (1) the causes of the deficit, (2) the problems that would arise if nothing is done to trim it, and (3) what the government is doing to achieve reduction.

Why the Fiscal Deficit Ballooned

Japan's fiscal deficit began to increase rapidly from fiscal 1975, the year when "special bonds" (bonds to finance current-account expenditure) were first issued (see Fig. 1). Subsequently, the amount of bonds issued increased year after year, reaching ¥14 trillion (\$60 billion) in fiscal 1980. Bond issues in 1981 and 1982 decreased considerably, but they are still very large.

Three reasons can be given for the increase in the fiscal deficit—the increase in social welfare expenditures, the increase in public works spending to cope with the economic stagnation following the 1973 oil crisis, and the increase in the national debt expense.

First, social welfare expenditures, which had been increasing steadily throughout the period of Japan's rapid economic growth, expanded greatly in fiscal 1973, known as "Welfare Year 1," when the level of social security benefits was raised significantly. Consequently, between fiscal 1973 and fiscal 1982, the state's financial burden of medical expenses increased 3.7 times, old age welfare annuity 6.7 times and social security expenses as a whole 4.3 times. On the other hand, during the same period, tax revenue increased only 2.8 times. A situation of expenditures continuing to increase even while the tax revenue growth rate slows down has been built into the system.



Finance Minister Michio Watanabe

Secondly, from the first oil crisis at the end of 1973 until 1978, the economy stagnated. To overcome this, public works were expanded tremendously. Though public works expenditures were not increased in fiscal 1975, in order to check inflation, subsequently they were increased by large margins: 21.2% in fiscal 1976, 21.4% in 1977 and 27.3% in 1978. The ratio of public works investment to GNP is conspicuously higher in Japan than in other advanced countries. It is believed that this rapid expansion of public

works had a considerable effect in accelerating Japan's economic recovery.

Thirdly, the increases in expenditures were met by issuing more bonds, resulting in a steep increase in the national debt expense for payment of principal and interest. The national debt expense in fiscal 1975 was 4.9% of total government expenditure but rose in the 1982 budget to 15.8%, or ¥7.8 trillion (\$34 billion). This percentage is higher than that of public works expenditures (13.4%) and next only to those of local public finance expenditures (19.4%) and social security expenditures (18.3%).

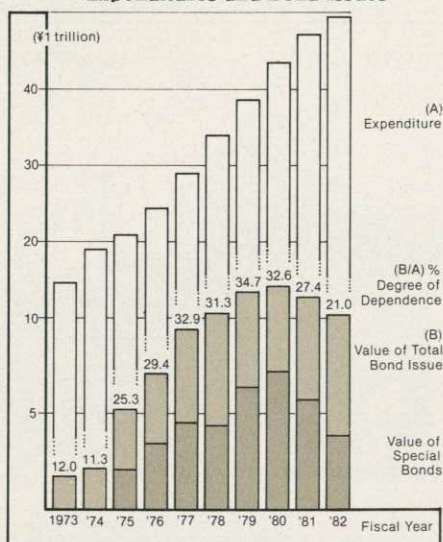
The Problems Which Fiscal Deficit Will Raise

The ballooning of the fiscal deficit since fiscal 1975 was, in a way, unavoidable in order to maintain the people's standard of living and to stimulate economic recovery.

However, if nothing is done about the huge fiscal deficit, various problems will arise. An increase in national debt expense represents a built-in increase in expenditure and will lead directly to *fiscal rigidity*. A more pressing problem is that a predisposition to depend on borrowed money weakens fiscal discipline, thus increasing the possibility of *fiscal inefficiency and budget inflation*. Because debt, unlike taxes, does not give the people a sense of immediate burden, an increase in budgetary expenditures tends to gain easy approval. As J.M. Buchanan, the American scholar of government finance, points out, those countries which abandoned the "balanced budget principle" and adopted a Keynesian fiscal policy have without fail experienced an increase in fiscal deficit and budget inflation.

When budgetary expenditures are financed not by taxes but by debt-incurring measures, future generations tend to be placed at a disadvantage, damaging the *principle of equal burden sharing by different generations*. This is clear from the fact that taxation reduces the lifetime consumption of the generation which carries the burden of payment whereas bonds do not have the same impact. Bond issues, moreover, can possibly hamper the capital formation of the private sector. This, too, works to the disadvantage of future generations. On the other hand, bonds issued to finance public works increase public assets whose benefits will be enjoyed by future generations also. Thus, in this case, the issue of unequal distribution of

Fig. 1. General Account Budget Expenditures and Bond Issues



(Note)
All these are audited figures, except budgeted figures (including supplementary budget) for fiscal 1981 and budgeted figures for fiscal 1982

burden between generations may not arise.

The biggest impact of fiscal deficit on macro-economic policy is that it raises the *dilemma of a choice between inflation and crowding out*. In other words, if the money supply is increased in order to accommodate fiscal deficit, it will fuel inflation, whereas if it is not increased, the issue of bonds will crowd out private investment. Of course, if it is possible to contract the fiscal deficit flexibly when such consequences result, there is not much of a problem. However, it is not easy to reduce budgetary expenditures or to increase revenue on a large scale. It becomes even more difficult if the fiscal deficit becomes chronic and fiscal discipline weakens.

Because Japan's fiscal deficit has reached a scale which is considerable even by international standards, it cannot be ignored any longer (see Fig. 2). The reduction of the fiscal deficit has now become a prerequisite to ensuring the stability of the people's livelihood and economic development.

The Steps Taken to Reduce Fiscal Deficit

Mindful that it is not sound to meet current-account expenditures with debt, the government has set, first of all, a target of zero issue of "special bonds" in fiscal 1984 as a concrete means of reducing the fiscal deficit. In the medium term, it will also be necessary to reduce the dependence on "construction bonds" which, after all, constitute debt though they are issued to raise funds for capital investment.

Fiscal deficit can be reduced either by cutting expenditure or by increasing revenue. How these two means are mixed is a matter of national choice basically determined by the people considering economic and social circumstances.

In fiscal 1981 when the first real effort to reduce fiscal deficit was made, the increase in budgetary expenditure was restrained while taxes, primarily corporate tax and indirect taxes, were increased considerably. In the fiscal 1982 budget, expenditure was thoroughly curbed with the result that the growth of total expenditure was kept at the lowest percentage in 26 years. Excluding national debt expense and the Local Allocation Tax which is obligatory under the law, the increase in General Account expenditure was a mere 1.8% (see Fig. 3). In real terms, this was actually a slight decrease.

In reducing the fiscal deficit, the government intends above all to cut and rationalize expenditures. The Ad Hoc Committee on Fiscal and Administrative Reform, a government advisory panel, is in the midst of working out a drastic reform of the administrative machinery and procedures. The committee's first recom-

mendation submitted in July last year pressed hard for curtailment of expenditures, and its suggestions were incorporated in compiling the fiscal 1982 budget. Future recommendations are expected to provide important guidelines for further restraining expenditures and achieving fiscal efficiency.

It will be necessary to review the revenue structure as well as the expenditure items, taking into account the actual socio-economic situation.

Finally, it should be emphasized that

reduction of the fiscal deficit, being a medium-term economic target, is not necessarily incompatible with short-term demand management policies. Naturally, short-sighted demand management policies which ignore the impact on the medium-term performance of the economy must be avoided. This is because makeshift demand control policies not based on future outlook are the very factor that causes inflation and economic stagnation. ●

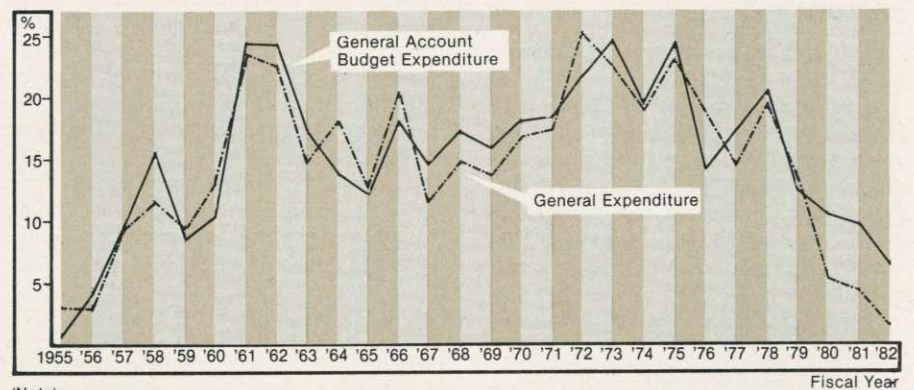
Fig. 2. National Comparison of Fiscal Deficit

	Japan (¥100 million)	U.S. (\$1 million)	U.K. (£1 million)	W. Germany (million marks)	France (million francs)
Fiscal Deficit	104,400 (\$45,590m)	91,500	9,957 (\$18,610m)	27,594 (\$11,688m)	84,127 (\$14,695m)
Fiscal Deficit / GNP	3.8%	2.7%	4.4%	1.8%	2.3%
Fiscal Deficit / Fiscal Expenditure	21.0%	12.1%	13.1%	12.8%	10.7%

(Notes)

1. Japan: fiscal 1982 budget; U.S.: fiscal 1983 budget message; U.K. and W. Germany: audited fiscal 1980 budget figures; France: fiscal 1982 budget
2. Dollar conversion based on average and arbitrary exchange rates in first half of 1982

Fig. 3. Growth Rate of General Account Expenditure



(Note)

General Expenditure = General Account Budget—National Debt Expense—Local Allocation Tax



Japan's Ministry of Finance