

Fiscal Discipline in Japan: An Urgent Issue

How should we maintain fiscal discipline in Japan? The experts interviewed for this issue of *My Vision* suggest that it will be important for citizens to share a sense of crisis, and to delineate the overall structure of the crisis that is manifesting itself. From the systemic perspective, they indicate that it will be necessary to effect radical reforms of the taxation system, comprehensively push ahead with decentralization initiatives, and control increases in social security expenditure as the nation's population ages.

MyVision

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What must We Do to Maintain Fiscal Discipline?

Japan's fiscal situation is worsening significantly as a result of factors including increasing social security expenditure as the nation's population ages.

In the absence of effective mechanisms to maintain fiscal discipline, Japan's already grave outstanding debt will only grow worse.

Why is Japan unable to maintain fiscal discipline? What should we do to enable us to do so?

In this issue of *MyVision*, we ask academics in the fields of Japanese political studies, public finance, and welfare politics, a politician who has formerly held key Cabinet positions including a term as Minister of Finance, and the Chairman of a university with vice-ministerial experience.

Interviewer: Manabu Shimasawa, NIRA Senior Researcher

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Lack of a sense of crisis is the real crisis

Junko Kato

Professor, Graduate School for Law and Politics,
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At the beginning of the 1990s, it appeared that Japan's public finances would take a turn for the better, but in fact the situation has grown steadily worse since then. We tend to focus on economic conditions, but the transformation of party politics over the past 20 years also forms a background to this situation. With the party split in the LDP in 1993 and subsequent coalition politics, the Liberal Democratic Party's attitude towards fiscal discipline became extremely lax in comparison to its long period of one-party government. Its experience as the ruling party has given the Democratic Party of Japan an awareness of the importance of fiscal discipline, but the reascendant LDP has continued to back away from the issue, and there has been no effective competition between the parties urging a response to the nation's fiscal situation.

The idea that taxes should not be raised because the government is extravagant with finances is strongly rooted in Japan. This blocking of the lines of supply might be effective in a country with a strong orientation towards small government, but it is untenable in Japan, where government is small in comparison to the mature welfare states of Europe, but large in comparison to the U.S. This structural contradiction has produced the nation's fiscal crisis.

In a period of high growth, there would be some expectation of return from increased taxes in the form of social services, but this is difficult to expect today, in a low-growth period against a background of fiscal deficit. In a situation of ongoing inability to effect the tax increases which are necessary for the recovery of fiscal discipline, the nation's low tax burden has reduced the public's sensitivity with regard to sound fiscal management. Public inattention to government expenditure has seen Japan's

fiscal status continue to deteriorate over a long period, and yet today the sense of crisis among the public is growing weaker. This is a dangerous situation.

During the administrative and fiscal reforms conducted at the beginning of the 1980s, the Ad Hoc Commission on Administrative Reform under Mr. Toshio Doko was successful in ensuring that the government and the public shared a sense of crisis. What is essential today is to give unwavering attention to the larger economic and fiscal picture and to develop a sense of crisis, in the government and among the public. This would provide a starting point towards fiscal reconstruction. ■

Professor Kato analyzes the formation of the fiscal foundations of the welfare state of mature democracies. She has also analyzed the process of introduction of consumption tax in Japan with a focus on the relationship between politics and the bureaucracy.

Make the status of public finances visible through decentralization

Toshihiro Ihori

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There are a number of factors behind Japan's failure to display fiscal discipline. To begin with, while the Ministry of Finance is pointing out that the nation's fiscal status is poor, the public puts no stock in it, pointing to wasteful expenditure and hidden assets. In other words, there is an asymmetry in terms of information regarding public finances between the government and the public, and between the ruling party and the opposition.

In addition, the outlook for the economic growth rate was exaggerated, and it has taken time to reach a position of awareness that the decline in the growth rate since the 1990s is the actual situation. We have been led by the unreal expectation that future

growth would naturally result in increased income, and momentum towards fiscal reconstruction has not developed.

Further, in Japan, there has been no pressure from the market and overseas, and the public does not have a real awareness of the deterioration in the nation's finances. With the Bank of Japan's monetary easing measures artificially controlling interest rates, market discipline has not developed, and unlike the situation in the EU, which shares a common currency, we have not had pressure from concerned countries to maintain fiscal discipline.

Against this background, the boldest move that we could make towards a solution would be to comprehensively advance decentralization. If we could visualize benefit and burden on a regional level, the public would be able to make choices autonomously. In Canada, which was successful in the fiscal reconstruction that it commenced in 1994, fiscal discipline is maintained by a system in which the national government provides the regions with fixed amounts, which form the scope within which they are expected to oversee medical care and welfare.

From the perspective of legally binding force, despite the fact that the Public Finance Act has applied constraints that urge fiscal discipline, it has had little effect. The exemption of the ceiling of the supplementary budget from the application of the Act has been a factor in weakening fiscal discipline. At the least, it will be necessary to apply legal constraints to the mechanism of formulation of the supplementary budget, and set the hurdle for the passage of draft legislation higher than it is for the initial budget. ■

Professor Ihori conducts theoretical research on government economic activities that are essential to the market economy. He stresses that fiscal reconstruction demands not merely increased taxes, but also control of social security expenditure.

Bring together private sector experts with a sense of mission

Kaoru Yosano

Former Minister of Finance

In order to maintain fiscal discipline, it is necessary to cut your coat according to your cloth. Deciding on a level of expenditure that suits your income and repaying loans, even over an extended period, are fundamental aspects of this. However, the fiscal deficit problem that we face today arises from the disease of population decline, which is characteristic of advanced nations. We must recognize that we are approaching a turning point for our society and our culture. Attempting to resolve this issue by means of the stopgap method of accepting immigrants would be a mistake.

There is an idea that if Japan can recover its international competitiveness and sell its goods in the future, public finances will improve, but this is nothing more than soft soap. The idea that relaxation of regulations will make everything alright is also a fantasy. Economic growth is important, but we should not believe that economic activity on the current scale can rebuild public finances. Such baseless optimism will only lead to tragedy.

We must steadily increase consumption tax to 10%. National debt is already approaching 200% of GDP, and the day is coming when interest rates will rise without our being able to absorb government bonds domestically. The public must understand that like the sinking of the Titanic, if we are inattentive, the Japanese economy will run aground and sink.

On the expenditure front, we must revise the idea that the government will supply what is lacking. In the area of welfare expenses, we should move towards making autonomy and self-reliance fundamental. Precisely now, what we must do is to bring together a group of private sector experts with a sense of mission towards salvaging Japan's public finances, to discuss radical reform of the taxation system, including consumption tax, the streamlining of social security expenses with no exceptions, and the comprehensive reappraisal of the coordination of national and regional finances. ■

Mr. Yosano is a former member of the House of Representatives. A consistent advocate of fiscal reconstruction, he played a central role in the coordination of the Comprehensive Reform of Social Security and Tax. He is known as one of the greatest experts on policy in Japanese politics.

Creating an overall picture of the structure of the crisis

Taro Miyamoto

Professor, Faculty of Law, Chuo University

Fiscal discipline has two meanings. One is that government expenditure is appropriate to government revenue, maintaining an equilibrium between revenue and expenditure and ensuring the sustainability of public finance. The other is to provide the public with fundamental infrastructure to enable working generations to work and pay social insurance fees and tax, ensuring that tax revenues are continuously obtained. This can also be termed "social sustainability," and it is an important function demanded of government and administration.

The fact that these two meanings are understood by taxpayers is a significant part of the reason that fiscal discipline is maintained in the Scandinavian nations. Because the tax burden is high, taxpayers feel that there must be a return in the form of tangible systems and policies, and this awareness motivates them to monitor public finances.

In Japan by contrast, precisely because the scale of public finances is small, public finance literacy (the ability to understand and make judgments regarding public finances) has not been fostered among the public. As a result, budgeting to support the child-raising and employment essential to the guarantee of social sustainability is put on the backburner, while political influence peddling that ignores fiscal discipline grows stronger.

There is an awareness of crisis in Japan, but the fact that the overall structure of the crisis is not visible represents a problem. What we have is a situation in which individual crises—the astronomically increasing debt, the low birth rate, the lack of daycare centers, the inability of women to work—repeatedly come into view and fade from sight. Because of this, we are trapped by the concept that realizing economic growth will balance public finances, which simply postpones the issue. What is essential now is to draw a picture of the overall structure of the crisis, and having done so, to establish an order of priority and allocate funds to methods of linking social sustainability and fiscal sustainability. ■

Professor Miyamoto's research focuses on the international comparison of political processes related to social security and employment policy. He specializes in welfare politics and welfare policy theory, and advocates a model of the welfare state based on the Swedish model.

Ultimately, we will need measures to address the low birth rate

Takeshi Erikawa

Chairman, Saitama Prefectural University,
Chairman, The Health Care Science Institute

Japan's enormous fiscal deficit arises from a lack of political (=public) readiness and resolve to adhere to fiscal discipline. As short-term administrations continue to come and go, parties are seeking to win elections rather than presenting the Japanese public with the hard choices, and Japanese society is paralyzed before the risk of an ever-mounting enormous debt. A political system that plays up to the electorate is fundamentally flawed. We are not, under such a system, fostering leaders with a sense of responsibility who will guide Japan's future.

The issues of realizing fiscal soundness, and also of economic growth and management of the national territory, will not be resolved unless we are ultimately able to overcome the problem of the nation's low birthrate. Stable employment for young people is the key to doing so. We should foster bilingualism within our education system, to ensure that its graduates are able to flourish in the international community. We should significantly reduce the burden of educational expenses to ensure that children are able to receive an education even if their families are poor. We should also provide more comprehensive social support to women, both in the home and the workplace.

Even if the birthrate recovers, it will take 20 years before it becomes of benefit to society. During that period, our only avenue to realizing fiscal soundness will be to control increases in social security expenses. According to the estimates of the Ministry of Health, Labour and Welfare, there will be a significant increase in medical and nursing care for the elderly in the future. What we need are policy efforts to control increased demand for services, for example by encouraging the maintenance of health and the prevention of lifestyle diseases. End-of-life care and the issue of living and dying with dignity in a long-lived society should be considered by society as a whole. With regard to pensions, we should push ahead with measures such as delaying the age at which the pension begins to be received and partial employment for the elderly. To secure resources for the expenditure that will nevertheless be necessary, we will have no choice but to increase consumption tax (perhaps to around 20%).

To ensure public understanding towards such severe policies, it will be necessary for the government to publish administrative data and to present data when making policy proposals. Taking pride in their role as administrative professionals, government officials must offer appropriate choices that will convince both the public and politicians. ■

Mr. Erikawa held positions as an Administrative Vice Minister of the Cabinet Office, an Administrative Vice Minister of the Ministry of Health, Labour and Welfare, and President of the National Personnel Authority.

This is a translation of a paper originally published in Japanese. NIRA bears full responsibility for the translation presented here.

About this Issue

Fiscal Discipline in Japan: An Urgent Issue

The gravity of the state of Japan's public finances reveals the limits of democratic politics. During its long postwar period in government, the Liberal Democratic Party introduced a universal health insurance system and implemented a series of Comprehensive National Development Plans against a background of high economic growth, winning broad public support. These policies were possible precisely because of the state of high growth and population increase. However, it appears that even in today's situation of low growth and population decline, the public still holds unreal expectations of the government.

In 1975, "Group 1984," centering on the late Professor Kenichi Koyama of Gakushuin University, pseudonymously authored a paper sounding a warning for Japanese society. Entitled "Japan's Suicide," this paper argued that the collapse of civilization would not occur as a result of attack from without, but rather as a result of a process of disintegration from within. It also

stressed that the real danger for Japan was that the Japanese would lose the ability to correctly understand crises and trials, and that they would become unable to consider the long-term future and lose the ability for self-determination.

40 years have passed since the publication of this paper, but the crisis of Japanese society has only increased in severity. Democratic politics is not able to impose burdens on the public commensurate with the level of benefit currently being received. Japan's continually worsening fiscal deficit will lead to a loss of confidence from the market, and sooner or later this will mean market sanctions on a nation becoming a super-aged society.

How should Japan answer the call of Group 1984 and overcome its public finance crisis? In this issue of *My Vision*, we hear five expert opinions on the subject of fiscal discipline.

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