Fiscal Management and the COVID-19 recovery: case study of Japan

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Background - Large Accumulation of Debt

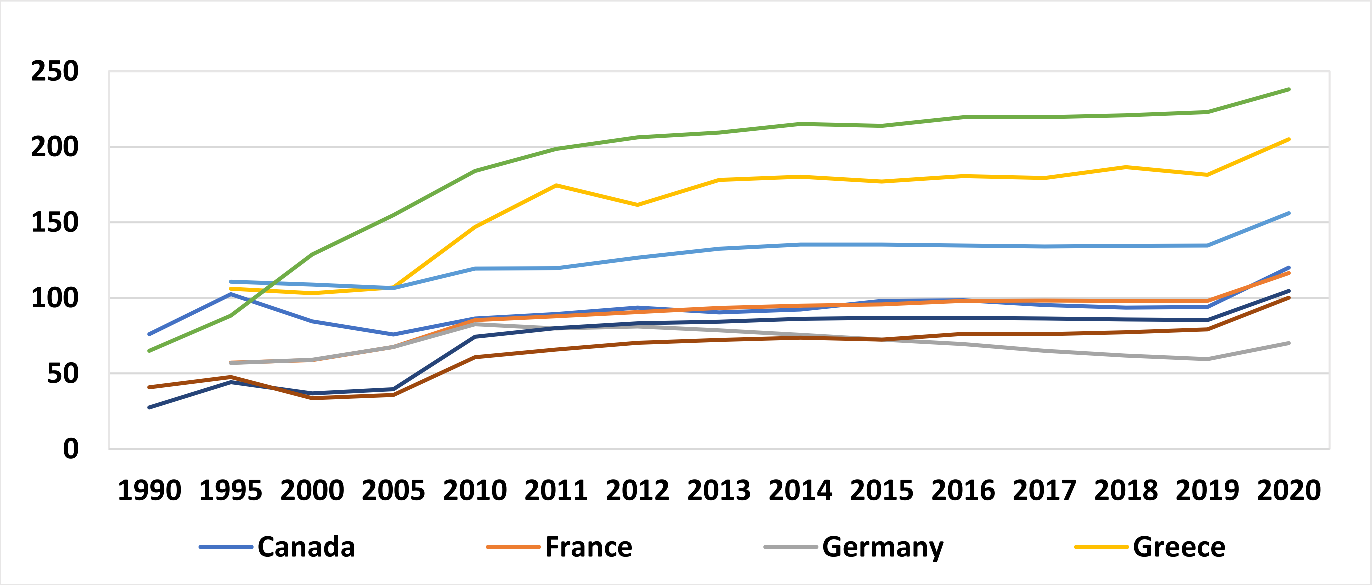
Global government have spent vast amount fiscal stimulus to protect their people and defending their economies against COVID-19.

In Asia, fiscal policy response to COVID19 pandemic is larger than that in 2008 global financial crisis, which caused wider fiscal deficits from 5% in 2019 to 9.8% in 2020 and government debt to GDP raised to 64.7% in 2020.

The debt to GDP ratio of developing countries in Asia increased significantly to 64.7% in 2020 from the decreasing trend since 2018 (55.8%) and 2019 (53.6%).

Similar to developing economies, many advanced countries are also exposed to large debt accumulation.

Public Debt/GDP in G7 countries and Greece



Background – Japan survived with huge debt

- Surprisingly, with debt levels more than twice the size of its economy, Japan's debt is still sustainable, keeping the government bond market stable and interest rates surprisingly low.
- This presentation will provide:

- A case study about Japan's effort to manage its debt through fiscal policy

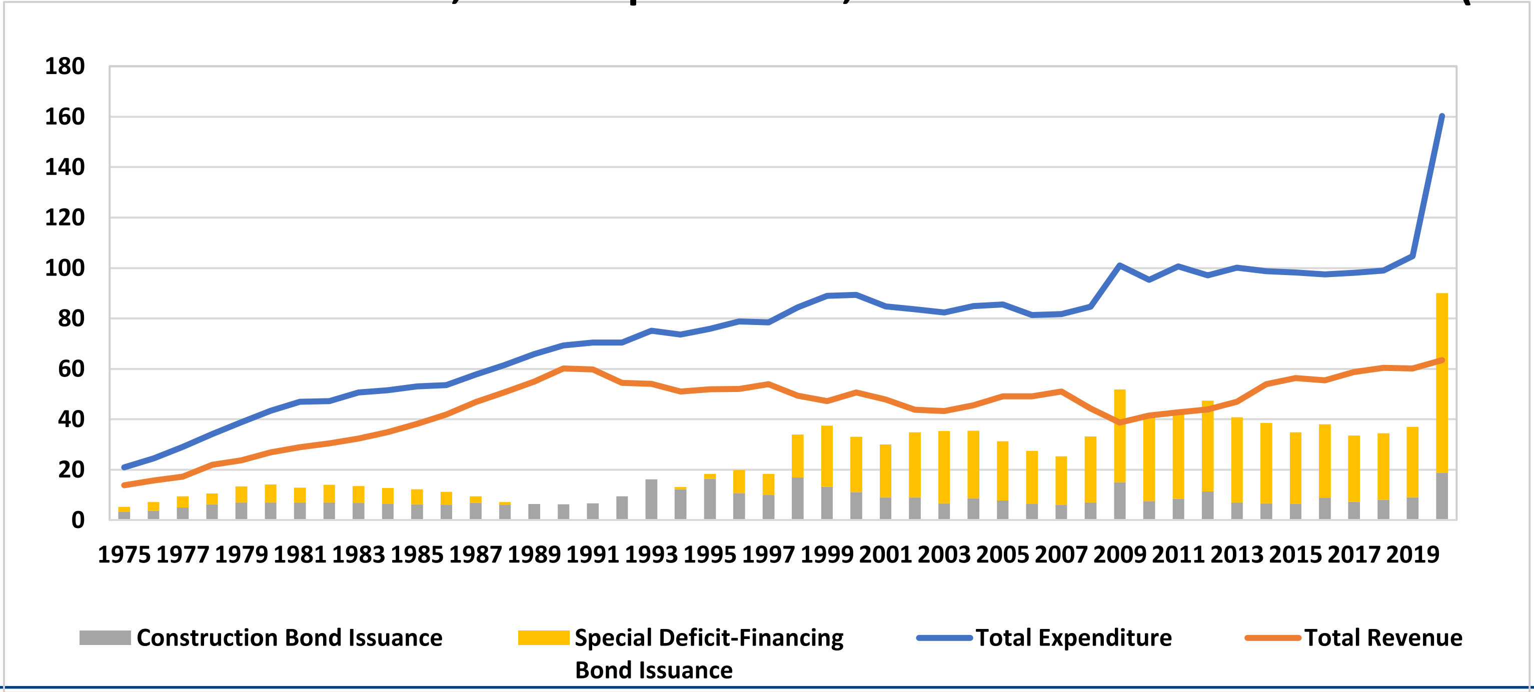
- Some policy recommendations about debt management for developing countries using Japan experience.

How did Japan pay its debt?

In principle, annual government expenditure should be covered by annual government revenue generated from tax revenue.

When there is a gap, the government to raise money by issuing **construction bonds** for public works and "**Special Deficit-Financing Bonds**" to make up the gap.

General Account Tax Revenues, Total Expenditures, and Government Bond Issues (trillion Yen)



Fiscal Management Policies in Japan

Resource Assurance Rule. Whenever introducing a policy involving an increase in expenditure or decrease in revenue, stable resources to compensate for such increase or decrease shall be assured by permanent reductions in expenditures or permanent revenue-raising measures.

Fiscal deficit reduction through measures, such as raising the consumption tax.

Stable revenue shall be secured for structural expenditures such as social security costs required for pension and medical and caregiving benefits.

Reviewing expenditure to eliminate any unnecessary expenditure, including those of the special accounts.

Stable management of local government finance.

Debt Management Policies in Japan

Establish bond redemption system

- Fiscal resources for government bond redemption are all managed through the Government Debt Consolidation Fund (GDCF) from reception and accumulation to disbursements.

- 60-year redemption rule

Liquidity Enhancement Auctions to issue JGBs for which liquidity is structurally lacking, and liquidity is in a temporary shortfall due to rising demand.

Buy-back Program to retire debt by purchasing existing bonds at a price agreed upon with the respective holders willing to take part in the deals before the maturity of the bonds

Dialogue with Market Participants

- Advisory council on government debt management-

- Meeting of JGB market special participants

- Meeting of JGB investors

- Meeting of JGB top retailers

Why Japan's Huge Debt is Sustainable?

Domestic investors constitute the major holders of Japanese government bonds

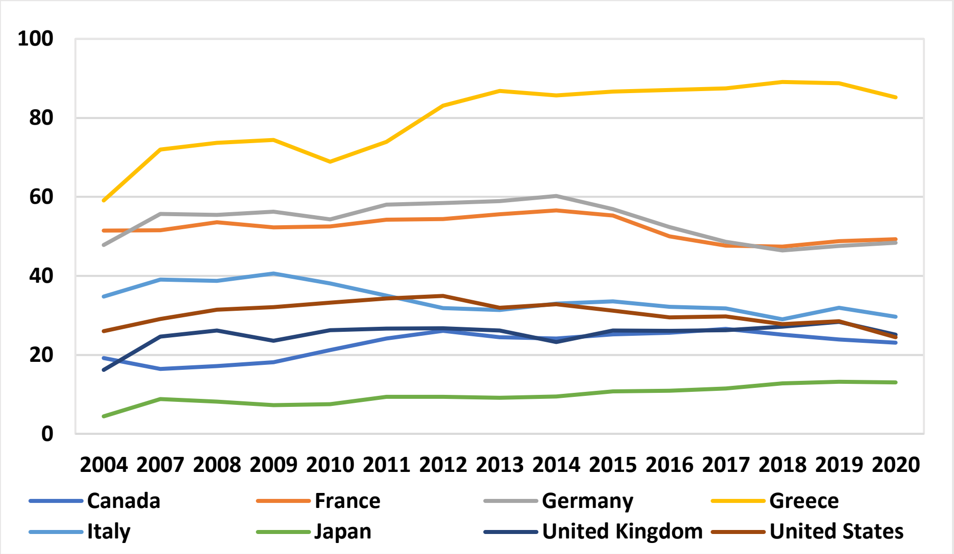
The central bank of Japan holds a large amount of JGBs

Low interest rate created by Quantitative Easing (QE) policy

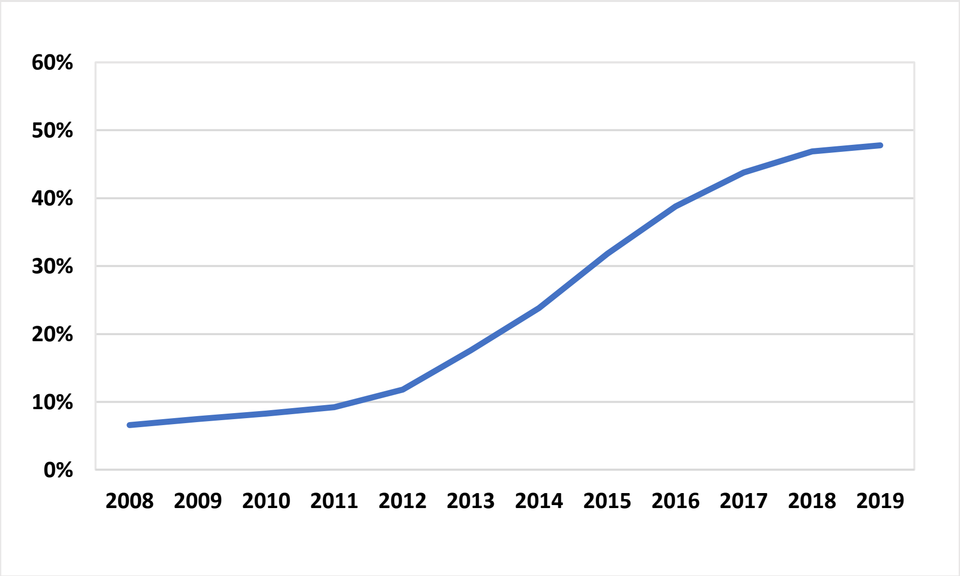
Japan is the world's biggest creditor

Japan has a complete JGB Future market for hedging

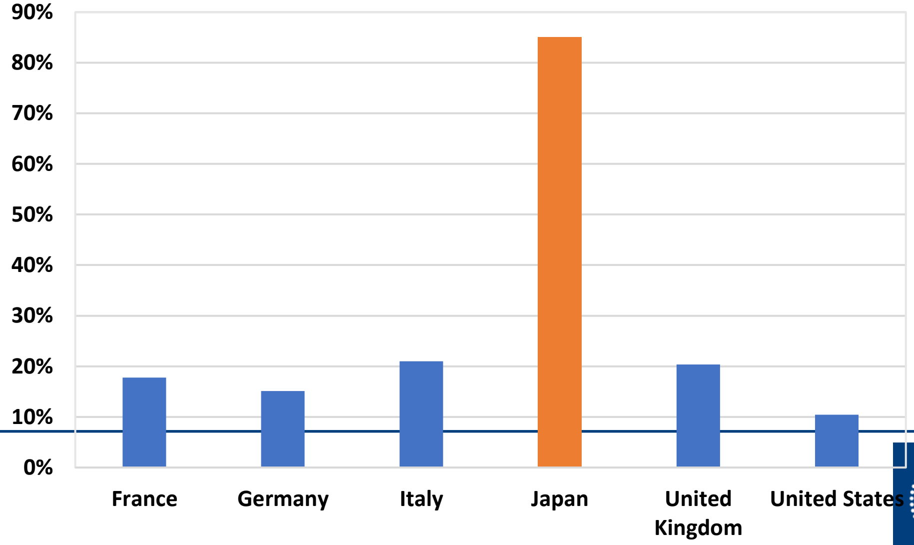
External Debt Ratio



BoJ's share in JGB market



Government Bonds Held by Central Banks (as end of 2018)

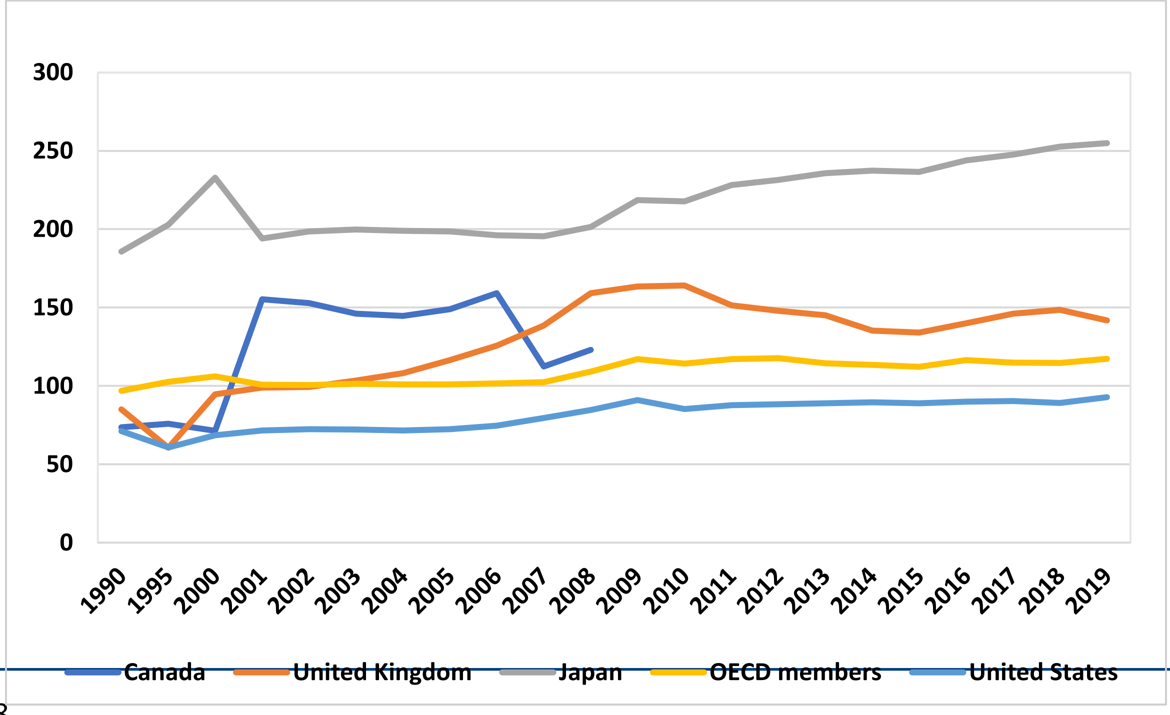


Japan's Money Supply and Outward FDI

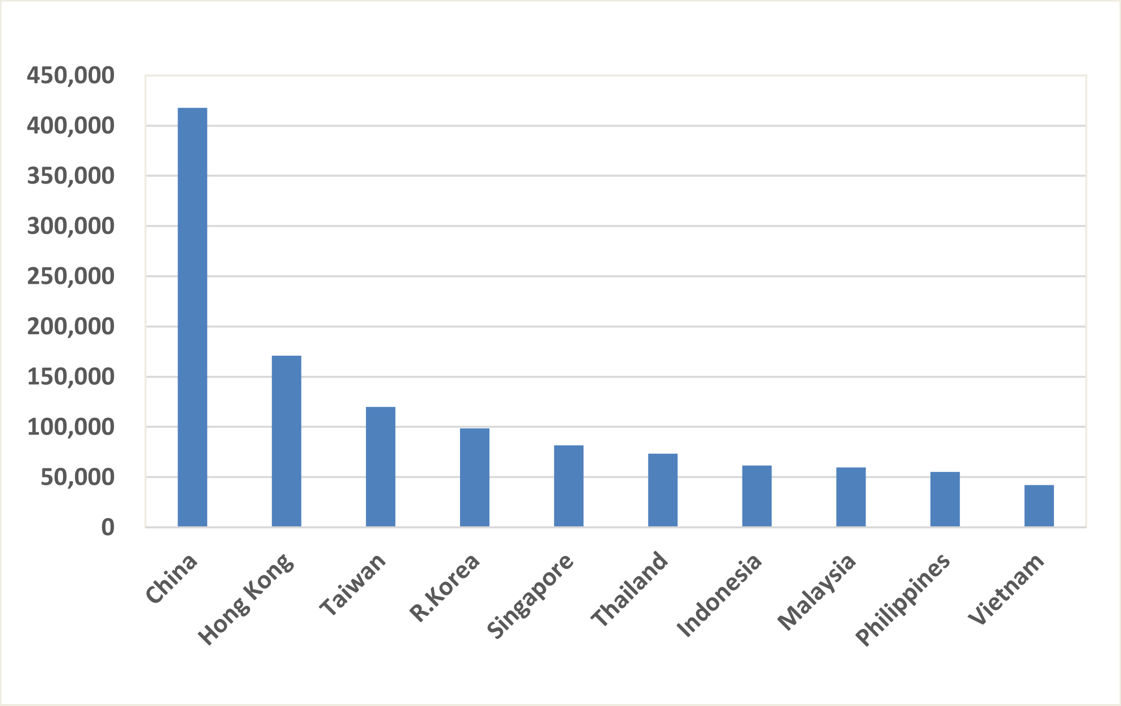
The money supply in Japan is huge, double the average level of OECD countries, recording more than 200% since 2008 global financial crisis.

Asian developing countries are the main FDI recipients from Japan.

Money Supply in Japan (as a percentage of GDP)



Top FDI Recipients from Japan (2010-2020 accumulation)



Recommendations

- Japan should also help DMCs develop their local bond market. Well-functioning local-currency bond market enables governments and corporate finance domestically, which in turn enhance economic and financial stability of the country.
- Establish sophisticated fiscal and debt management system to ensure the credibility of the government.
- Given the huge size of outward FDI from Japan, developing countries may make use of it for economic development, as FDI could trigger technology spillovers, assist human capital formation, facilitate international trade integration, and help create a more competitive business environment.