# The Government and the Financial System: an Overview

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## Abstract

This paper surveys the relationship between the government and the financial system in Japan, mainly from the viewpoint of financial stocks, to gain an overall perspective and identify where any problems lie. During this decade, it seems that the relationship between the government and the financial system in Japan has changed significantly. The government has generally become more deeply involved in the financial system. As a result it is no exaggeration to say that current Japanese financial system has become "a financial system of the government, by the government, for the government." This was for the most part, promoted by the fact that there occurred a huge redistribution of wealth during the realignment process after the bursting of the bubble economy. Considering such circumstances, the aspects of "of the government," "by the government," and "for the government" will be surveyed in turn. Furthermore, postal system privatization will be discussed in terms of public debt management. Lastly, reference will be made to the possible problems accompanying the change in trend of investment-savings balances.

## I. Introduction

In advance of other papers, this paper surveys the relationship between the government and financial system in Japan, mainly from the viewpoint of financial stocks, and attempts to identify where problems exist. In short, the purpose of this article is to present a clear, overall perspective, while other papers on this issue tend to examine individual aspects.

In this decade and some years, it seems that the relationship between the government and the financial system in Japan has changed dramatically. Consequently, the current situation of

Japan's financial system could be expressed as "financial system of the government, by the government, for the government," with a little exaggeration. This was, for the most part, promoted by the fact that there occurred a huge re-distribution of wealth during the realignment process after the bursting of the bubble economy.

In Section II, this paper looks back on this decade and some preceding years to confirm just how large the magnitude of redistribution of wealth was among sectors in the period. Based on this, we survey the aspects of "of the government"(Section III), "by the government"(Section IV), and "for the government"(Section V) in turn. Furthermore, Section VI discusses postal system privatization from the viewpoint of public debt management. Finally, reference to possible problems accompanying the changing trends in investment-savings balances will be made by way of a conclusion.

## II. Perception of Reality – "A Financial System of the Government, by the Government, and for the Government"

The Japanese economy has faced major problems since the bursting of the so-called bubble economy. Too much liability compared with the assets themselves has been left because of the decline in asset prices after the expansion of both real assets—which include stocks as claims on them—and financial liabilities. In short, there emerged excess liability in the Japanese private corporate sector.

Being wise after the event, the first phase of escape from this was the process of shifting the excess liability of the private corporate sector to the government. From 1990 to the beginning of the 2000s, the liabilities held by the private corporate sector were transferred to the government little by little through artificial effective demand created by successive economic policy packages, the offering of public money to the banking sector, and so on.

In consequence, restructuring of private corporate sector proceeded owing to the reduced burden of excess liability, which led to the foundation of the current recovery trend in the Japanese economy. In this sense it was not meaningless to transfer private corporate liability to the government for a while. Rather it was an inevitable process for alignment. However, it is clear that such transfer alone does not mean the end of the problem. Write-offs of the liabilities shifted to the government are indispensable to the final solution of the overall problem.

The current situation seems to move gradually into a second phase when we think of writing off the liabilities shifted to the government. As for monetary policy, to get out of a quantitative monetary easing policy has been recognized as one task, which means that we cannot expect a long lasting zero-interest rate situation. If normalization of interest rates is realized in the near future, maintaining the huge amount of public debt by the government sector becomes extremely difficult. That is, the emergence of symptoms of interest rate normalization demonstrates the

inevitability of a change of phase[1].

Since this paper does not intend to forecast future situation to no purpose, we only point out that the present time can be understood as a transition period from the first phase to the second phase in the sense described above. Following is a further study on what occurred during the first phase in more concrete detail.

### *II.1. Quantitative Assessment of the First Phase*

Without a change in asset price or capital transfer, the sum of total net worth should be equivalent to that of the accumulated value of the previous net savings. If the sum of net worth becomes more/less than the amount of accumulated saving of each year, we can consider that there has been gain/loss by asset appreciation/depreciation and/or acceptance/payment of capital transfers. Credit losses with write-offs of bad loans are included in capital transfers from creditors to debtors in National Accounts.

Therefore, we can see the general impact of changes in asset prices by comparing the increase in net worth with accumulated savings. Such comparison using stock data of national economic account statistics is as follows.

First, in regard to the Japanese household sector (including private unincorporated enterprises), its net worth was 874,825.3 billion yen at the end of 1980. We only get 1,191,790.8 billion yen adding accumulated net savings from 1980 to 1990 to the value above. But the actual net worth of the household sector amounted to 2,418,291.1 billion yen at the end of 1990. This means that the Japanese household sector obtained capital gains (plus net capital transfer) of as much as 1,226,500.3 billion yen.

In fact, the value of the household sector's net worth was then at its peak and declined thereafter to 2,173,466.9 billion yen by the end of 2002. Taking account of accumulated net savings from 1991 to 2002, the household sector suffered from capital losses (minus net capital transfer) of 648,389.6 billion yen during that period. Nonetheless, it is only a little more than half of the capital gains obtained from 1980 to 1990. The calculation reveals summed up capital gains of 583, 110.7 billion yen from 1980 to 2002 belonging to the household sector. In this sense the household sector is in the "winners group."

Seemingly, such results derived from the situation that the financial assets held by the Japanese household sector were concentrated in cash and deposits, which means a low ratio of risky assets whose prices are revised marked to market with the change in value of the underlying asset. Conversely, the damage of a fall in asset prices wholly concentrated in financial institutions, which guaranteed the principal value of cash and deposits as intermediaries, before they reached the household sector—the final owner of the corporate

[1] A similar recognition about the alignment process is also expressed by Mr. Hajime Takada (Chief Strategist of Mizuho Securities).

sector.

It can be shown that all sectors except households are "losers" using the same estimations (i.e. general government, non-financial corporations, financial corporations, and private non-profit institutions serving households; see Table 1). The general government suffered the greatest damage. Its net worth amounted to only 107,244.0 billion yen at the end of 2002. Probably the general government has had a practical deficiency of net assets, considering that it does not record actuarial reserves for obligation of payment by public pension funds[2].

The second greatest damage afflicted the financial institution sector. On the other hand, the damage to the corporate sector was unexpectedly small. We can guess that this quite significant relief from the impact of the fall in asset prices is owing to the abandonment of credit (which means capital transfers) by financial institutions.[3]. In short, the decline in asset price hit the corporate sector directly, but its damage was shifted to the financial sector in the form of bad loans. Moreover, the government sector shouldered a serious burden in the process of support to corporate and financial sectors. The facts above provide an outline of what occurred in the first phase.

There has been a net loss (minus net capital transfer) of 1,423,787.1 billion yen from 1991 to 2002 while there was a net gain (plus net capital transfer) of 1,581,039.3 billion yen as a whole from 1980 to 1990. Both values balance roughly with each other. We can say that in the beginning of the 2000s, cleaning up after the bubble economy is finishing at last for the entire Japanese economy.

However, the Japanese financial system (which functions as a tool for wealth management) and the fiscal system (which functions as a tool for wealth re-distribution) were both remarkably influenced by the large-scale redistribution of national wealth among the various sectors, even if cleaning up after the bubble economy almost finished in terms of the macro-economy. In brief, the government became more deeply involved in the financial system during the process. Thus current situation of the Japanese financial system is just like "financial system of the government, by the government, for the government," just like the phrase in the famous speech by Abraham Lincoln.

Part (i), "of the government," here points out that confidence in the financial system has been mainly maintained by government guarantee (which is represented by a deposit pay-off moratorium) since the financial crisis in the 1990s. Next, part (ii), "by the government," means the high proportion of the public channel (including activities concerning the public pension fund and central bank) in financial intermediation, and part (iii), "for the government," refers to

[2] *The Japanese government Balance Sheet (Trial Work) for FY2002* estimated that negative net worth of the central government in general government was 227.4 trillion yen at the end of FY2002. Here, the meaning of "negative net worth" for the public sector is different from that of the private sector, but at least it shows that the current structure of assets and liabilities is not sustainable.

[3] As shown in Table 1, the financial sector lost net worth of 95 trillion yen through write-offs of bad loans from 1991 to 2002.

the fact that the biggest debtor is the government itself, whose fiscal deficit is expanding.

Normalization of this distorted relation between the government and the financial system is one of the major problems to be solved in the medium term. More details of each aspect of (i)–(iii) are provided below.

## Table 1: Difference between Increase in Net Worth and Accumulated Savings

Full Period:1980–2002 (Trillion Yen)

| | Change in Net Worth | Accumulated Savings | Capital Transactions during the Period | | | | | 'Change in Net Worth'–'Accumulated Savings' | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | Real Asset | Financial Instrument | | | | Volume of Financial Instruments | | | | | | Revaluation | | | | Others | Fiscal Capital Transfers | Discrepancy |
| | | | | | | Asset (increase) | Debt (decrease) | | | Real Asset (increase) | Financial Asset (increase) | Debt (decrease) | Write-off of Bad Loan | | Real Asset (increase) | Financial Asset (increase) | Debt (decrease) | | | |
| General Government | −36 | 156 | 150 | 430 | −280 | 344 | −624 | −193 | −7 | −6 | −2 | 1 | 0 | −117 | −89 | 5 | −33 | −63 | −45 | 39 |
| Households | 1299 | 721 | 789 | 14 | 775 | 1050 | −275 | 578 | −4 | −2 | −24 | 23 | 18 | 629 | 583 | 45 | 0 | −115 | −51 | 119 |
| Non-financial Corporations | 144 | 223 | 365 | 616 | −251 | 266 | −517 | −79 | 26 | −5 | −25 | 56 | 57 | −134 | −21 | 69 | −181 | −113 | 79 | 62 |
| Financial Corporations | 0 | 136 | −25 | 16 | −41 | 2150 | −2191 | −136 | 0 | 0 | −90 | 90 | 13 | 5 | −15 | 91 | −71 | 20 | 7 | −168 |
| (Change caused by write-off of bad loan) | | | | | | | | | | | ( −98) | | | | | | | | | |
| Private Non-Profit Institutions | 29 | 42 | 33 | 17 | 16 | 27 | −11 | −13 | −3 | 0 | −4 | 2 | 2 | 5 | 4 | 1 | 0 | −7 | 1 | −10 |
| Total | 1435 | 1278 | 1312 | 1093 | 218 | 3837 | −3619 | 157 | 13 | −13 | −145 | 172 | 90 | 389 | 463 | 211 | −285 | −279 | −9 | 42 |

1980–1990

| | Change in Net Worth | Accumulated Savings | Capital Transactions during the Period | | | | | 'Change in Net Worth'–'Accumulated Savings' | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | Real Asset | Financial Instrument | | | | Volume of Financial Instruments | | | | | | Revaluation | | | | Others | Fiscal Capital Transfers | Discrepancy |
| | | | | | | Asset (increase) | Debt (decrease) | | | Real Asset (increase) | Financial Asset (increase) | Debt (decrease) | Write-off of Bad Loan | | Real Asset (increase) | Financial Asset (increase) | Debt (decrease) | | | |
| General Government | 205 | 124 | 124 | 156 | −32 | 151 | −183 | 81 | 0 | −2 | −2 | 4 | 0 | 104 | 94 | 1 | 9 | −23 | 0 | 0 |
| Households | 1543 | 317 | 367 | −4 | 371 | 571 | −199 | 1227 | −14 | 0 | −24 | 10 | 1 | 1241 | 1148 | 93 | 0 | −51 | −18 | 68 |
| Non-financial Corporations | 308 | 109 | 124 | 334 | −210 | 322 | −532 | 199 | −27 | 0 | 2 | −29 | 2 | 253 | 392 | 125 | −264 | −42 | 15 | −1 |
| Financial Corporations | 77 | 23 | −44 | 19 | −63 | 1459 | −1522 | 53 | 79 | 0 | 2 | 77 | 0 | 38 | 72 | 102 | −135 | 3 | 0 | −67 |
| (Change caused by write-off of bad loan) | | | | | | | | | | | ( −3) | | | | | | | | | |
| Private Non-Profit Institutions | 39 | 18 | 20 | 8 | 13 | 21 | −9 | 21 | −4 | 0 | −4 | 0 | 0 | 26 | 26 | 0 | 0 | −4 | 0 | 2 |
| Total | 2173 | 592 | 592 | 513 | 79 | 2524 | −2445 | 1581 | 34 | −2 | −26 | 62 | 3 | 1663 | 1731 | 322 | −391 | −115 | −1 | 1 |

1991–2002

| | Change in Net Worth | Accumulated Savings | Capital Transactions during the Period | | | | | 'Change in Net Worth'–'Accumulated Savings' | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | Real Asset | Financial Instrument | | | | Volume of Financial Instruments | | | | | | Revaluation | | | | Others | Fiscal Capital Transfers | Discrepancy |
| | | | | | | Asset (increase) | Debt (decrease) | | | Real Asset (increase) | Financial Asset (increase) | Debt (decrease) | Write-off of Bad Loan | | Real Asset (increase) | Financial Asset (increase) | Debt (decrease) | | | |
| General Government | −241 | 32 | 26 | 274 | −248 | 193 | −442 | −274 | −6 | −3 | 0 | −3 | 0 | −220 | −182 | 3 | −42 | −41 | −45 | 39 |
| Households | −245 | 404 | 422 | 18 | 403 | 479 | −76 | −648 | 11 | −2 | 0 | 13 | 17 | −613 | −565 | −48 | 0 | −65 | −34 | 52 |
| Non-financial Corporations | −164 | 114 | 241 | 282 | −41 | −56 | 15 | −278 | 53 | −5 | −27 | 85 | 55 | −386 | −413 | −56 | 83 | −71 | 64 | 63 |
| Financial Corporations | −77 | 113 | 18 | −3 | 22 | 691 | −669 | −189 | −79 | 0 | −92 | 13 | 13 | −33 | −87 | −11 | 64 | 17 | 7 | −101 |
| (Change caused by write-off of bad loan) | | | | | | | | | | | (−95) | | | | | | | | | |
| Private Non-Profit Institutions | −10 | 24 | 13 | 9 | 4 | 6 | −2 | −34 | 1 | 0 | 0 | 2 | 2 | −21 | −22 | 1 | 0 | −4 | 1 | −11 |
| Total | −737 | 686 | 720 | 580 | 140 | 1313 | −1174 | −1424 | −20 | −11 | −119 | 109 | 87 | −1274 | −1269 | −110 | 105 | −163 | −7 | 41 |

Note 1: "Capital Transactions during the Period" = "Savings" + "Fiscal Transfers" + "Discrepancy"
Note 2: Write-off of bad loan is sum of direct write-off and additional individual loan-loss reserves.
Note 3: "Others" are differences due to differences between estimation method of depreciation of closing stock and that of transaction flow.
Note 4: "Fiscal capital transfer" is "capital subsidy" etc.
Note 5: "Discrepancy" is difference between "balance of saving and investment" in SNA and "financial surplus or deficit" in Flow of Funds.

## III. The Cost of the Financial Safety Net

After the bursting of the bubble economy, the Japanese banking sector bore huge amount of non-performing loan. Although the decline in land prices came later than the decline in stock prices, people had more recognition that asset prices in general were falling and the first anxieties over the financial system emerged around the fears for the financial situation of the banking sector, in the summer of 1992.

However, at first there was little understanding of the seriousness of the situation among financial institutions, regulatory authorities, and the general public throughout the nation. This was because there was an expectation of an imminent recovery based on deep-rooted prospects for the recovery of asset prices. That was why the policy response was only to patch situations up and to play for time throughout 1992–94, and no drastic measures were taken to resolve the non-performing loan problem.

In fact, however, far from recovery there was a further decline in asset prices. The response of playing for time produced a result completely opposite to what was expected, only causing a deterioration of the problem. Beginning with the bankruptcies of two credit unions in Tokyo in December 1994, failures of other financial institutions succeeded, and at last this resulted in the situation of several high-level bankruptcies of financial institutions in the autumn of 1997.

During this period there was strong antipathy against any injection of public funds among people, because of the process of dealing with the failed housing loan companies between end-95 to mid-96. But finally confronted by a large-scale financial crisis, public sentiment arose to allow the government to use public money. Thereafter, the situation has continued that the extensive safety net supplied by the government has supported national confidence in financial system.

This represents the aspect of (i) "of the government," while things have gradually improved as the freeze on the payoff system (which made deposit guarantee's scope unlimited) introduced in 1995 was at last completely lifted in April 2005. As for the major banks, however, there still remains a big difference between the financial ratings, which include the possibility of public support, and those that do not. In addition, as for small and medium-sized, or regional financial institutions, a wide variance exists and there seems to be some institutions that still have problems.[4]. Thus the situation mentioned above has not been completely resolved.

We must also notice that an enough safety net naturally leads to quite large fiscal expenditure in a direct or indirect way. Let us examine the cost of the safety net next. In this context it is too restrictive to deal with only (a) public funds injected into the banking sector. In other words, important components of policies to stabilize the financial system are regarded as including (b) measures to back up corporate cash flows by government-affiliated financial

[4] For the current situation and perspective of regional financial institutions, see the paper by Yasushi Horie.

institutions, and (c) a credit guarantee system. At the same time these two might also produce a new large direct or indirect fiscal burden.

### *III.1. Public Funds into Banks*

Various fiscal measures have been implemented through the deposit insurance system in order to use public money for supporting banks. Some point out that the amount of public funds (including some deposit insurance premiums as a funding resource) directly used to stabilize the financial system is 35.8 trillion yen. Capital injection is 12.4 trillion yen (2.2 trillion yen has been repaid), financial assistance by grants is 18.6 trillion yen (taxpayers' burden of 10.4 trillion yen has become certain), and assistance by asset purchases is 9.6 trillion yen (5 trillion yen has been repaid).

Not only public debt but also an actual loss has come into being, and some part has become a burden on taxpayers, the amount of which has been fixed as mentioned above. Table 3 shows such situation. On the other hand, it is certain that such assistance to banks by the government has to some extent contributed to recovering confidence in the financial system. As in Figure 1, the risk premium (which is measured by the difference of borrowing interest rate between Japanese banks and foreign banks) has gradually reduced.

Recently it is estimated that as a result of capital injection there is now unrealized gain of about one trillion yen in stocks held by the government, thanks to the increase in stock prices. This suggests the possibility of avoidance of the taxpayers' burden concerning the funds using for capital injection.

Table 2: Situation of Each Accounts of Deposit Insurance Corporation of Japan

Trillion Yen

| | Spent on | Funding | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | | FY1999 | FY2000 | FY2001 | FY2002 | FY2003 | FY2004 |
| General Account | Payment of insurance claims, financial assitance, purchase of asset, capital subscription, loan, etc. | Ceiling | **2** | **4** | **6** | **13** | **19** | **20.14** |
| | | Fiscal Funding (Initial Budget) | – | 4 | 6 | 13 | 19 | 19 |
| | | (Actual use) | (1.31) | (2.46) | (3.12) | (3.92) | (5.31) | n.a. |
| (Special Operations Account) | Special financial assistance, asset purchase, loss compensation for contracted banks, etc. | Ceiling | **10** | **10** | **10** | **6.5** | – | – |
| | | Fiscal Funding (Initial Budget) | 17 | 23 | 23 | 19.5 | – | – |
| | | (Actual use) | (3.57) | (3.49) | (3.37) | (3.09) | – | n.a. |
| Crisis Management Accout | Share subscription, financial assistance, etc. | Ceiling | – | – | **15** | **15** | **15** | **17** |
| | | Fiscal Funding (Initial Budget) | – | – | 15 | 15 | 15 | 17 |
| | | (Actual use) | – | – | (0) | (0) | (1.96) | n.a. |
| Financial Reconstruction Accout | Asset purchase, loans to contracted banks for subscribing shares, etc. | Ceiling | **18** | **18** | **10** | **12** | **15** | **15.2** |
| | | Fiscal Funding (Initial Budget) | 18 | 18 | 10 | 12 | 15 | 14 |
| | | (Actual use) | (3.92) | (5.12) | (5.27) | (5.66) | (4.66) | n.a. |
| Early Strengthening Accout | Loans to contracted banks for subscribing shares, etc. | Ceiling | **25** | **25** | **16** | **10.5** | **13.02** | **12.66** |
| | | Fiscal Funding (Initial Budget) | 25 | 25 | 16 | 10.5 | 6.9 | 6 |
| | | (Actual use) | (8.04) | (8.10) | (8.22) | (8.20) | (7.93) | n.a. |
| Financial Institutions' Management Base Strengthening Account | Loans to contracted banks for subscribing shares, loss compensation for contracted banks, etc. | Ceiling | – | – | – | – | **1** | **1** |
| | | Fiscal Funding (Initial Budget) | – | – | – | – | 1 | 1 |
| | | (Actual use) | – | – | – | – | (0.01) | n.a. |
| Industrial Revitalization Account | Subscription of equity of the Industrial Revitalization Corp. etc. | Ceiling | – | – | – | – | **0.15** | **0.15** |
| | | Fiscal Funding (Initial Budget) | – | – | – | – | 0.15 | 0.15 |
| | | (Actual use) | – | – | – | – | (0) | n.a. |
| Total | | Ceiling | **55** | **57** | **57** | **57** | **63.17** | **66.15** |
| | | Fiscal Funding (Initial Budget) | 60 | 70 | 70 | 70 | 57.05 | 57.15 |
| | | (Actual use) | (16.85) | (19.18) | (19.98) | (20.87) | (19.88) | n.a. |

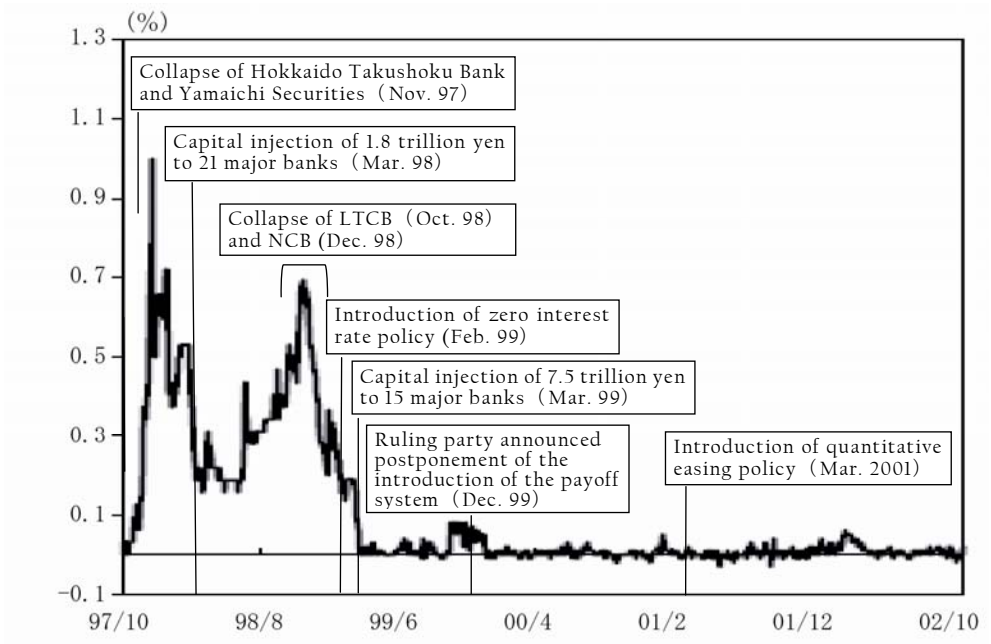
Note1: "Fiscal funding" consists of government-guarantee and government bond granted.
Note2: "Actual use" is actual financed amount against the ceiling.
Source: Deposit Insurance Corporation of Japan, Annual Report of each year

Table 3: Injection of Public Funds (as of end-January 2005)

| | Injected amount | Collected amount | Remaining outstanding |
|---|---|---|---|
| Capital Injection | 12.4 | 2.2 | 10.2 |
| Early Strengthening Law | 8.6 | 1.0 | 7.6 |
| Financial Function Stabilization Law | 1.8 | 1.1 | 0.7 |
| Deposit Insurance Law | 2.0 | 0.0 | 2.0 |
| Financial Reorganization Promotion Law | 0.006 | 0.0 | 0.006 |
| Monetary Grant | 13.8 | 0.0 | 13.8 |
| (total with deposit insurance premiums) | (18.6) | 0.0 | (18.6) |
| Purchase of Assets | 9.6 | 5.0 | 4.6 |
| Total | 35.8 | 7.2 | 28.6 |
| (Locked-in Losses) | | | (10.4) |

Source: Web site of Deposit Insurance Corporation of Japan, etc.

Figure 1 Japan Premium



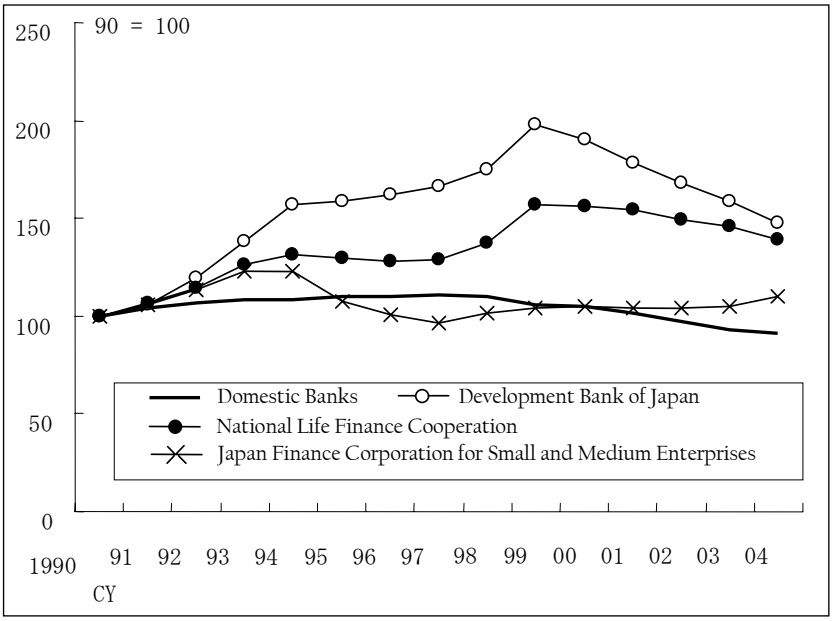

Note: Japan premium is calculated by "interest rate (3 month) quoted by Bank of Tokyo-Mitsubishi - interest rate quoted by Barclays Bank in the Eurodollar market (London)".
Source: Bank of Japan, Monthly Report of Recent Economic and Financial Developments, etc.

### *III.2. Support to Cash Flows by Government Financial Institutions*

Throughout the 1990s government financial institutions actively gave support to corporate cash flows. Such support was an important part of measures in successive policy packages for stimulating the economy. Table 4 shows that frequent and various policies were implemented in the latter half of the 1990s when the financial system particularly lost some stability.

Their main target was small and medium-sized enterprises, while their contents changed depending on time. At the early stage they had quite a strong characteristic of impartial support to corporate cash flows, such as through a reduction of interest payments and an extension of loan facilities in September 1995. But after 2000, in more cases public support came to require restructuring of the financial and corporate sectors due to bankruptcies of financial institutions or reconstructions of concerned companies.[5]. Hereafter we should not avoid to objectively assess the magnitude of benefits and cost of such financial support by government financial institutions when we discuss reform of government financial institutions.

Figure 2: Outstanding Amount of Lending by Government-Affiliated Financial Institutions




[5] The paper by Fujiwara in this issue investigates whether the activity of government financial institutions allowed enterprises that should in fact leave the market to survive (bringing the soft budget problem).

Table 4: Major Supporting Measures for Private Companies' Finance after mid-1900s

| | | | |
|---|---|---|---|
| 95 4 | Emergency Economic Measures | Support to SMEs' finance | Capital injection to government financial institutions which deal with loan for SMEs in response to yen appreciation (70.3 billion yen). Setting up new low-interest loan by NFC and JASME, and special treatment of small business credit insurance which doubles insurance limit. Extension of treating period of emergency management support loan and special measures of employment adjustment subsidy |
| 9 | Economic Measures | Reduction or moratorium on interest payment by government financial institutions | One-year reduction or moratorium on interest payment of SMEs which were lent by government financial institutions (JASME, etc.) during high-interest rate period |
| | | Support to working capital | Expansion of support to working capital by government financial institutions, etc. |
| | | Expansion of credit guarantee | Raise the insurance limit of new business development insurance, non-collateral insurance of small business credit insurance, etc. |
| | | Measures for small-sized enterprises | Expand loan system relating to funds for improving management of small-sized enterprises (Maru-kei loan) and credit guarantee system |
| | | Diversification of SMEs' finance | Set up direct finance system though prefectures' foundations, etc., utilizing advancement loan of Japan Small Business Corporation. Expand loan system relating to new business, etc. |
| | | Measures for agriculture, forestry and fishery | Smoothing finance such as expansion of reduced-rate loan, etc. |
| 97 11 | Emergency Economic Measures | Expansion of loan facility of government financial institutions (improvement of loan system for SMEs) | Set up separate loan facility of amount of 210 million yen by government financial institutions (additional loan against ordinary one by National Finance Corporation, etc. to SMEs whose finance are not smooth because of business slump of creditor banks) |
| | | Expansion of credit guarantee | Include additionally 26 industries among those which can benefit from doubling credit guarantee corporations' guarantee and expand non-collateral and non-guarantee loan facility |
| 98 4 | Comprehensive Economic Measures | Financial measures for SMEs, etc. | Expand target of financial measures for SMEs: review definition of retail, wholesale, and service industry and raise the upper limit of paid-up capital |
| | | | Set up new loan facility of government financial institutions for SMEs' finance and inject additional capital for it |
| | | | New loan facility of government financial institutions for supporting business development of SMEs |
| | | | Expand loan size and extend payment period of "Maru-kei" loan |
| | | | Build up reserve fund of Small Business Credit Insurance Corporation and subsidy for Credit Guarantee Corporations fund |
| | | | Request local governments to expand loan facility additionally by 50 billion yen, strengthening managerial foundation of credit guarantee corporations |
| | | Financial measures for medium-sized enterprises, etc. | Strengthen measures by government financial institutions such as establishment of "Guarantee System for Dealing with Changes in the Financial Environment", etc. |
| | | Quick and smooth disposal of debtor-creditor relationship | Examine promoting measures for issuance of corporate bond such as credit guarantee to SMEs' corporate bonds, etc. |
| | | Improvement of environment for finance by ventures, etc. | Expand guarantee fund of ISIF (Industrial Structure Improvement Fund), etc. |
| | | | Support to ventures by government financial institutions (underwriting corporate bonds of ventures, etc.) |

| | | | |
|---|---|---|---|
| 98 8 | Outline of Anti-Credit Crunch Measures for Small and Medium-sized Firms | Expansion of Guarantee System (Introduction of Special Guarantee) | (i) expansion of credit insurance limit (establishment of separate facility of ordinary insurance:200million yen, and non-collateral insurance:50 million yen ‹total amount: 250 million yen›), (ii) reduction of credit insurance premium, (iii) easing requirements for insurance |
| 11 | Emergency Economic Package | Measures to alleviate the credit crunch | Expand loan system (introduction of agency loan, diverting funds loan, etc.), strengthen credit guarantee system and utilize non-real estate collateral in government financial institutions' lending |
| | | | Utilize government financial institutions' function of long-term working capital loan and corporate bonds redemption funds loan |
| | | | New credit guarantee system for medium-sized enterprises by credit guarantee corporations |
| | | | Reduction or moratorium on interest payments and utilization of credit guarantee in lending to SMEs by Hokkaido-Tohoku Development Finance Public Corporation |
| 99 11 | Policy Measures for Economic Rebirth | Facilitating and diversifying access to sources of financing by increasing the modalities of direct financing to promoting business entrepreneurship and venture firms | Provide credit guarantee to private placed bond issued by SMEs which satisfy certain requirements |
| | | | Expansion of capital injection by public institutions to venture funds |
| | | | Set up a system under which JASME underwrites warrant bonds issued by SMEs |
| | | | Utilize intellectual property rights-collateral loan of DBJ, etc. |
| | | | Set up non-interest-bearing loan for equipment funds and lease system for entrepreneur and small-sized enterprises, etc. |
| | | | Expand start-up cost support loan by National Finance Corporation |
| | | | Extend special measure of "Maru-kei" loan system such as start-up companies procure funds loan, etc. |
| | | | Expand financial support to female and elder entrepreneurs |
| | | Facilitating appropriate response to dramatic changes in the financial and economic environment | Extension (1 year) and expansion (10 trillion yen) of modalities of the special guarantees scheme |
| | | | Extend government financial institutions' loan system and reduction or moratorium on interest payments for small and medium sized entrepreneurs and agriculture forestry and fishery persons |
| 00 10 | A Policy Package for New Economic Development toward the Rebirth of Japan | Financing measures for small and medium enterprise | Expand the general credit guarantee system by raising the upper limit on uncollateralized credit guarantees from 50 million yen to 80 million yen |
| | | | Expand the range of application of special credit guarantees to protect small and medium sized enterprises from obstacles to stable management arising from the bankruptcies of trading partners, or of trading partners' financial institution |
| | | | Prepare a similar loan system of government financial institutions for SMEs and fulfill the system and implementation about collateral claims, etc. |
| | | | Extension of reduction or moratorium by government financial institutions, etc. on interest payments by small and medium sized entrepreneurs and agriculture forestry and fishery persons |
| 01 4 | Emergency Economic Package | Smooth DIP finance, etc. | Utilize DBJ's loan system (business rehabilitation loan system) relating to DIP finance in Civil Rehabilitation Law and Corporate Rehabilitation Law |

| | | | | |
|---|---|---|---|---|
| 10 | Front-Loaded Reform Program | Safety-net for SMEs | | Establish a new credit guarantee system for promoting loan collateralized by trade receivables |
| | | | | Fortify special small-amount insurance system for smooth finance by small entrepreneurs |
| | | | | Improve the system and implementation of safety-net guarantee by credit guarantee corporations and safety-net loans by government financial institutions |
| | | | | Establish a system in which government financial institutions for SMEs lend in cooperation with private financial institutions for DIP finance |
| | | support to the establishment and business innovation | | Fortify a guarantee system by credit guarantee corporations for founding entrepreneurs (guarantee system relating to creating new business) |
| | | | | Smooth finance for innovations: review of requirements for guarantee for privately-placed bonds by SMEs and loans by government financial institutions to firms allowed to applying Law on Supporting Business Innovation of Small and Medium Enterprises |
| | | Structural reform of business confronting environmental change | | Expand the program of construction company's debt guarantees as a safety net for subcontractors |
| | | | | Strengthen the financial basis of agriculture credit guarantee fund association of each prefecture, etc. |
| | | Corporate restructuring | | Request the DBJ and RCC to set up and/or participate in funds for restructuring companies |
| 02 2 | Emergency Countermeasures to Deflation | Expansion of safety-net loans and guarantee | | Ease the certification standards of safety-net guarantee. Expand and reinforce safety-net lending by extending the eligibility of borrowers and by creating a new lending facility in the Shoko Chukin Bank featuring unsecured loans of up to 30 million yen for small- and medium-sized enterprises experiencing funding difficulties |
| | | Actively utilizing the guarantee system of loan collateralized by trade receivables | | Government ministries and agencies shall cooperate to promptly eliminate restrictive contract clauses prohibiting the transfers of receivable accounts owed by the government and by major corporations |
| | | Greater flexibility in revising repayment terms under special guarantees | | Greater flexibility shall be added in revising repayment terms under special guarantees |
| 10 | Comprehensive Measures to Accelerate Reforms | Revitalization of industry and enterprises as quickly as possible | | Upgrade the system of lending to the corporation reconstruction fund, and expand the loans system for third party businesses acquiring or inheriting the assets of enterprises undergoing reconstruction will be implemented |
| | | Support to formations and start-ups of new business | | Create an uncollateraled loan system for small and medium businesses opening new business fields (Shoko Chukin Bank) |
| | | Expansion of safety-net loans and guarantee | Utilization of policy finance | Raise the maximum limits under the "credit crunch uncollateralized financing system." (Shoko Chukin Bank) |
| | | | | Include in the DIP finance target group those SMEs being restructured under the private-sector adjustment guidelines (Japan Finance Corporation for Small Business, Shoko Chukin Bank and Okinawa Finance Corporation) |
| | | | | Establish a system to provide finance to viable SME's whose credits have been transferred to the Resolution and Collection Corporation (RCC) (Japan Finance Corporation for Small Business, Shoko Chukin Bank and Okinawa Finance Corporation) |
| | | | Expansion of credit guarantee system | Provide additional safety net guarantees for new target group |
| | | | | Establish a business recovery guarantee system (DIP guarantee) for SME's that have initiated legal reconstruction procedures and have been issued an approved recovery plan |

| | | | | |
|---|---|---|---|---|
| 02 12 | Program to Accelerate Reforms | smoothing provision of funds to the operators of small and mid-sized firms | Utilization of policy finance | Introduce lending programs, such as safety-net loans and DIP financing, for the operators of SMEs who undertake the rebuilding of their businesses |
| | | | | Establish a new business start-up financing system for the purpose of supporting the opening of new operations by women and by workers who are middle-aged and older as well as the launching of new businesses that utilize IT |
| | | | Expansion of credit guarantee system | Expand safety net guarantees |
| | | | | Establish a guarantee system that will assist with the management of funds |
| | | provision of funds to the operators of small and mid-sized construction firms etc. | | Expand the program of debt guarantees as a safety net for subcontractors |

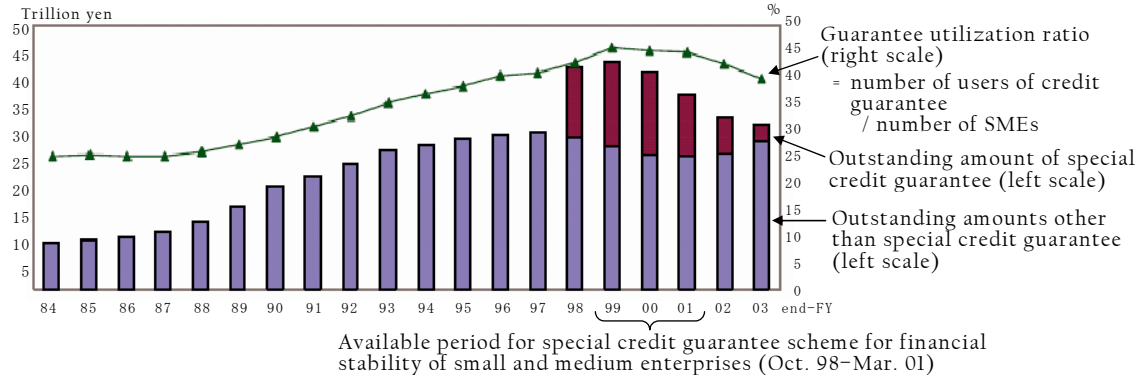
## *III.3. Credit Guarantee*

Credit guarantee can be considered as one tool of in the safety net of corporate finance. The "Special Credit Guarantee" of 1998 is conspicuous among recent policies. This credit guarantee system (credit guarantee scheme for financial stability of small- and medium-sized enterprises) was introduced in 1998 when the fear of tight financial conditions for such enterprises emerged due to the instability of the financial system.

The necessary conditions for use of this guarantee system were much looser than the previous system. Applications for guarantee were submitted via financial institutions but in the previous system credit guarantee corporations and financial institutions were doubly screened. On the other hand there was almost no assessment for offering guarantees in the new scheme unless the company concerned was in the particular situation where banks had suspended business with it, for example. In addition the proportion of the guarantee of the new scheme was 100%, unlike the previous scheme which guaranteed only some portion. (Figure 3)

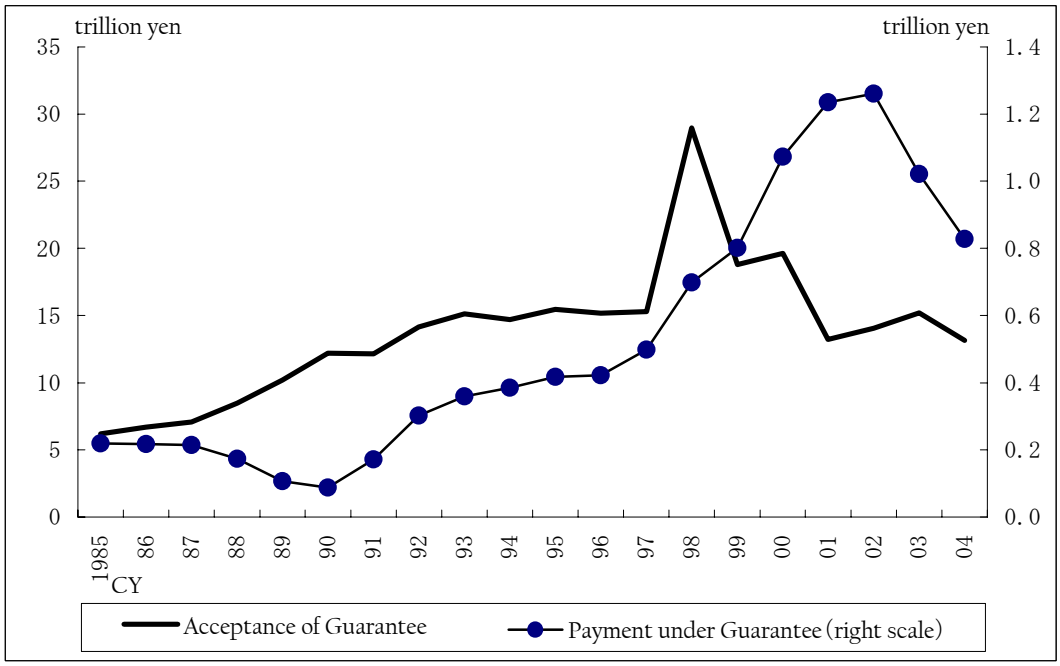
However, payment in subrogation by credit guarantee corporations increased temporarily because irrecoverable loans increased as more credit guarantees were offered. This resulted in losses of hundreds of billions of yen for the credit insurance programs of Japan Finance Corporation for Small and Medium Enterprises (JASME), which offers reinsurance to each local credit guarantee corporation. This loss was finally covered with capital put in by the central government (see Figures 4 and 5).

Figure 3: Guaranteed Obligation Outstanding and Guarantee Utilization Ratio



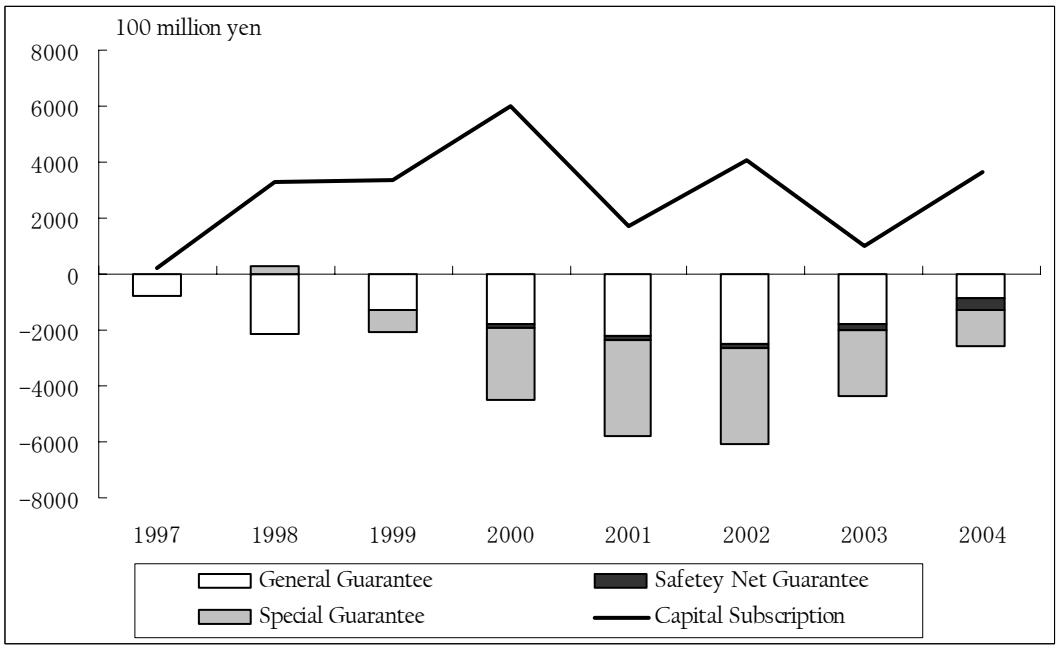

Source: IR material of Japan Finance Corporation for Small and Medium Enterprises

Figure 4: Payment in Subrogation by Credit Guarantee Corporations




Source: Website of National Federation of Credit Guarantee Corporations

Figure 5: Losses by Credit Insurance Programs of JASME and Capital Subscription by Government




Source: IR material of Japan Finance Corporation for Small and Medium Enterprise

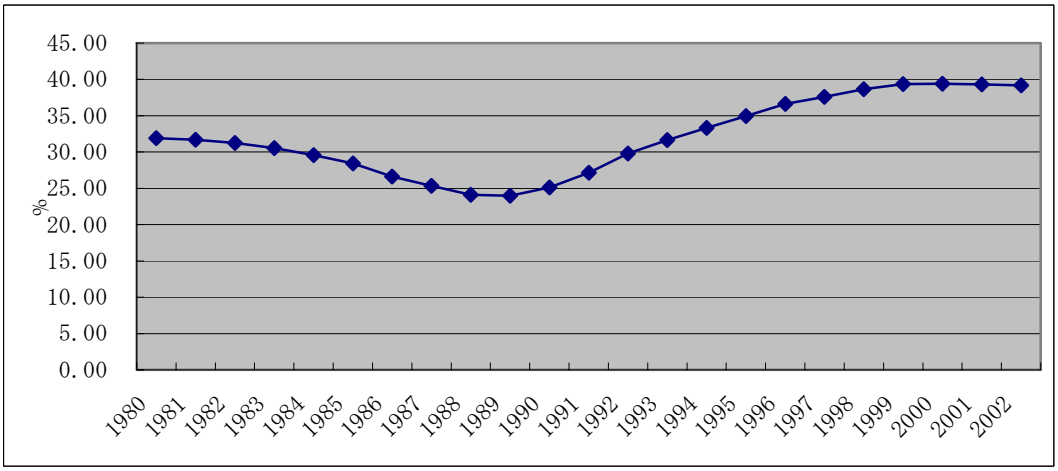
Besides these direct safety nets, a policy to prevent financial crisis through monetary easing was widely implemented. The Bank of Japan introduced a zero interest rate policy in February 1999. After ending this policy, BoJ has implemented a quantitative easing policy since March 2001. The target of this policy is summed-up amount of current account balances of financial institutions at the Bank of Japan, replacing an interest rate that cannot be reduced below zero percent. At first the target level was set at 5 trillion yen which exceeded the required reserve by one trillion yen, while it is at 30–35 trillion yen now in the summer of 2005.

Seemingly this quantitative easing policy has significantly contributed to an orderly financial system, although its effect as an economic stimulus policy is not clear. Anyway as a result of the policy, the Bank's asset outstanding is around 150 trillion yen, which means BoJ has become the largest central bank in the world and has contributed to the expansion in the share of public financial services.

## IV. Public Financial Intermediation

As for aspect (ii) "by the government," or public financial intermediation, the Fiscal Investment and Loan Program (FILP) in the narrow sense has been drastically streamlined in recent years owing to the FILP reform implemented in FY2001. For example the FILP plan for special corporations is now reduced to less than 12 trillion yen, one third of its peak. But the share of public financial institutions (which include BoJ) in total assets held by all financial institutions is still high, as shown by Figure 6. One reason is that the balance sheet of BoJ has become larger under its quantitative easing policy, as mentioned earlier.

Figure 6: Share of Public Finance



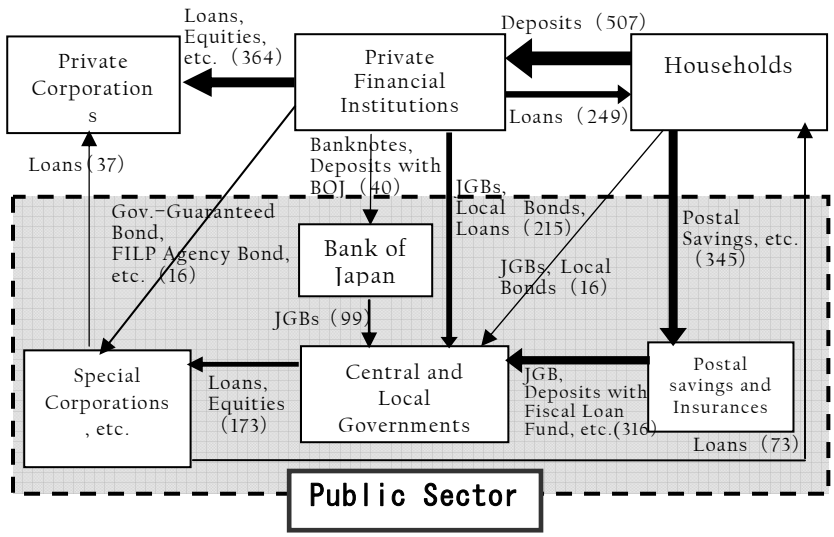

Outstanding assets of the public financial corporations in accounts classified by institutional sectors / outstanding assets of financial corporations in SNA

The current situation of the debtor–creditor relationship of each sector in Japan is summarized in Figure 7. Liabilities (including equities) outstanding for the corporate sector amounts to 519 trillion yen, while that of government sector is 646 trillion yen, which means the latter figure surpasses the former. This fact endorses the argument pointed by (iii) that the current financial system is "for the government." Such tendency is clearer when we see the movement of flow (differences in stock) in recent years. The monetary flow tends to go "towards the public from private." Therefore some argue that this trend should be reversed and we must reverse the direction of monetary flow from public towards private.

In this context, at the same time we see some arguments that we should reform organizations relating to public financial intermediation in order to reverse the monetary flow. However, this sort of argument is considered as a confusion of (ii)'s problem with (iii)'s problem. Though both (ii) and (iii) have respective problems, there is no relation in which correcting (ii) leads to an automatic improvement in (iii)'s problem. In short, even if we realize reducing the share of public financial intermediation, it is quite possible that funds still continue to flow into the public purse via private financial intermediate system or market. Actually in these years postal savings and postal insurance have decreased a little, but private financial institutions' holding of government bonds has increased greatly.

In other words, to correct the tendency of (iii) it is essential to reduce financial demand in fiscal expenditure itself. As far as fiscal demand itself remains without restructuring, there

Figure 7: Relationship Between Assets and Liabilities among Sectors




Note: Stock basis and unit is trillion yen
Source: Bank of Japan, "Flow of Funds"

remains a need for the public to finance fiscal expenditure. If it becomes difficult to utilize the public financial intermediate system for such financing, it means that private financial intermediation or market channels may be used. There cannot be the case in which government sector whose creditworthiness must be the highest, becomes unable to borrow. Thus it is essential to remove the need for borrowing.

We should, however, emphasize that the above is equivalent to the argument that we do not have to correct (ii)'s tendency. It should be reformed from the viewpoint of its own problem, not as an improvement for (iii). Here we want to confirm that it is important not to misunderstand the objective of reform. We can say it is more essential than usual to grasp precisely where the problem is, now that discussion on what policy-based financial institutions should be like is being planned again, accompanied by postal privatization.

Then how should we understand (ii)'s problem. Of course policy-based financial institutions also exist other than in Japan. Focusing on institutions owned by governments, we see their existence right across the world. Regarding such policy-based financial institutions, there are major four viewpoints.[6].

The first is called the "social view." This view emphasizes the imperfections of the market, insisting on the significance of policy-based finance as a complement to "market failure" in the financial field. The second is called the "development view." It argues that intervention by the government is effective for resolving problems in the development stage. In this stage, since the market system itself is not well developed, it might be difficult to discuss market failure in a narrow sense while we cannot expect the full functioning of the market. Moreover, in such stage, externality of investment relating to provision of a social infrastructure is prone to be large and there is a strong tendency that social benefit substantially exceeds (private) benefit which investors themselves can enjoy (i.e. there often occurs market failure). That is why investment might be too little if we only depend on the private sector's decisions, and we should recognize the significance of promoting investment using policy-based finance.

While these arguments are positive to policy-based finance, the third, the "political view," and the fourth, the "agency view," are both negative. The political view considers policy-based financial institutions as an instrument for realizing politicians' own intentions. According to this view, since politicians' intentions is usually to get wider political support for themselves, policy-based finance is apt to be utilized for the purpose of giving favorable treatment to the industry or region relevant to their own political power base. Thus the political view argues there are only a few cases in which such measures to grant some favor are reasonable in the economic sense. On the other hand the agency view insists on the necessity for valid consideration of the possibility of "government failure" in addition to market failure. In short, even if there are market failures, we must not ignore the existence of agency costs accompanied

[6] Levy-Yeyati, Eduardo, Micco, Alejandro and Pnizza, Ugo G., "State-Owned Banks: Do They Promote or Depress Financial Development and Economic Growth?" 2004, http://ssrn.com/abstract=629384

by bureaucracy. Taking account of this, the net benefit of government intervention may not necessarily be positive.

Each view has respective grounds to some extent. Perhaps not a few people recognize the validity of the development view, because policy-based finance originally has a strong relationship with the concept of development, as symbolized by the fact that in Japan the representative policy-based financial institution is the Development Bank of Japan (even after changing its Japanese name from "*Nihon Kaihatsu Ginkou*" to "*Nihon Seisaku Toushi Ginkou*," its English name remains the same as before). Even if the development view is right, however, the present Japanese economy is not in the stage of development, there the current situation cannot be justified.

Meanwhile the social view tries to seek the validity of policy-based finance in the possibility of failure even in a developed economy. Actually we cannot deny there often are market failures. But as emphasized by the agency view, governments also often fail. Markets do not fail without reason. They fail when there is some cause, such as restricted information and so on. Even the government cannot always be free from such causes. Considering these conditions, the case in which government intervention effectively complements market failure is supposedly quite limited. At the same time it seems to be true that we cannot completely deny such tendency as insisted by political view in Japan.

The above line of thought suggests the scale of policy-based finance justified in current Japanese economy is extremely limited. That is to say, the government financial institutions that exist now should reduce or abolish their operations, or should be reviewed in consideration of privatization. Even in the case when the role of such an institution is finished, if there remains a beneficial resource or other accumulation, it is desirable to utilize such an institution again by privatization. On the other hand, as for the part left as a government financial institution, it is important to avoid softening budget constraints by clearly defining the role (mission) and establishing a proper governance structure as well as posing rigid accounting and accountability on the content of fiscal support from government.

There is already certain progress in the review of policy-based financial institutions from this viewpoint. As for all FILP agencies, including policy-based financial institutions (but excluding local government), they nowadays make financial statements based on accounting standards for private corporations and are participated by audit by certified public accountants etc. In addition, "policy cost analysis"[7] was introduced in FY1999 and now it is promoted to expand the range of applications and improve analysis techniques. But of course a review on the

[7] "Policy cost analysis is used in trial calculations of the following under certain assumptions (interest rate, operation scale, and prospect of utilization), based on the estimation about some factors in the future including cash flows about projects of FILP agencies utilizing FILP system: total national cost (taxpayers' burden = policy cost), i.e. (i) future subsidies supplied by central government, and (ii) total amount (discounted present value) of effect for reducing interest payments (opportunity cost) by capital already introduced." Cited from *Total Review on FILP Reform* by FILP Sub-committee of Fiscal System Council, December 10th, 2004.

validity of operations and so forth should be done at any time, and reform is still needed.

Therefore it is expected by current discussions on the review of policy-based financial institutions that the viewpoint above will achieve more success. Now, as for postal privatization, since it is a topic strongly related to public debt management, we will discuss it in a section below after reviewing the current situation of public debt and fiscal deficit.

## V. Current Situation of Public Debt and Fiscal Deficit

Turning our eyes to the last aspect of (iii) "for the government", the perspective for trimming the fiscal deficit is still far from certain and the public debt amount already very high. But it should be noted that the whole picture of public debt might not be precisely understood by the majority since total unified management of public debt is not completely realized in Japan. For example, although government bonds (JGB) are often mentioned as representative of public debt, Japanese public debt is not composed solely of JGBs.

Firstly, we should review an outline of Japanese public debt in view of covered objects and outstanding balance. A respective outline of each type of public debt is explained in the Appendix at the end of this paper, as it includes some detailed topics. As for contents in relation to institutions or design, they are as of the end of March 2005. Since the Debt Management Report 2004 edited by the Financial Bureau of Japanese Ministry of Finance also provides a proper explanations about them, refer to the report when needed.

Table 5 focuses on the main points. Here we can see a general view of the debt amount for each unit: (a) central government, (b) local government, and (c) government-affiliated organizations. As for the change over time , both amount outstanding and the GDP ratio of all debts—except that of Japan Post—continue to expand, as shown in Figure 8.

Although the public debt outstanding is so extremely high, there appears little sense of crisis among people in general, and the problem has not come to the surface. Of course this is because the debt service burden is very light thanks to low interest rates. Since the mid-1990s, expansion of the public debt and decline in long-term interest rates under the proceeding monetary easing policy have compensated for each other. Such circumstances have realized almost unchanged interest expenses. Therefore in spite of a larger public debt, the sense of burden has not grown. Once interest rates begin to rise, however, the situation might change drastically.

The level of long-term interest rates cannot be fully controlled by monetary policy alone. It is strongly affected by the expectations of market participants concerning the future economic situation. That is why in order to prevent a surge in long-term interest rates it is not sufficient only to continue monetary easing, but it is necessary to establish some prospect for an improvement in the fiscal balance. Even without immediate improvement, there is big difference whether we have such prospect or not.

Table 5: Outstanding of Japanese Public Debt (as of end-FY2003)

(Trillion Yen)

| | | |
|---|---|---|
| Central Government | **Government Bond** | **556** |
| | Ordinary Government Bond | 457 |
| | Construction Bond | 226 |
| | Special Deficit-Financing Bond | 211 |
| | Fiscal Investment and Loan Program Bond | 92 |
| | Other Government Bond (Government Bond Granted, etc.) | 8 |
| | Borrowing | 61 |
| | Financing Bill | 86 |
| | Total | 703 |
| Central Govt. | (Government Guarantee・・・as contingent liability) | (58) |
| Local Government | Local Bond | 199 |
| | Ordinary Account Bond | 139 |
| | Local Public Corporations Securities | 61 |
| Japan Post | Postal Savings | 227 |
| | Postal Insurance | 188 |
| | Total | 415 |
| Public Pension (Central Govt.) | Case1: Only reserve is recognized as liability and appropriated as deposit of public pension. | 158 |
| | Case2: Only reserves and Government subsidies are to be recognized as liabilities. | 295 |
| | Case3: The present value of benefits corresponding to the past period is to be recognized as liabilities. | 802 |
| Special Corporation etc. | Government Guaranteed Bond and Borrowing | 58 |
| | FILP Agency Bond | 7 |
| | Total | 65 |

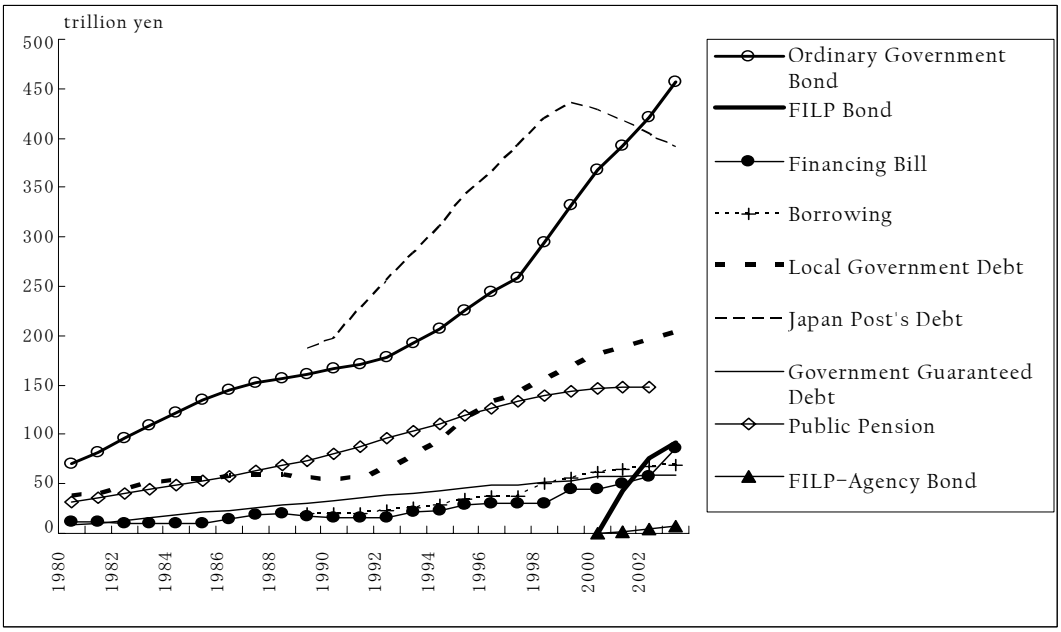
Note 1: Postal saving is the outstanding amount of postal savings. Postal Insurance is the sum of life insurance and annuity policies in force.

Note 2: Only the figure for public pensions is trial calculation as of end-FY2001. How to divide this into the three cases and concretely calculate it depends on "The Japanese Government Balance Sheet (Primary Trial)" by Ministry of Finance.

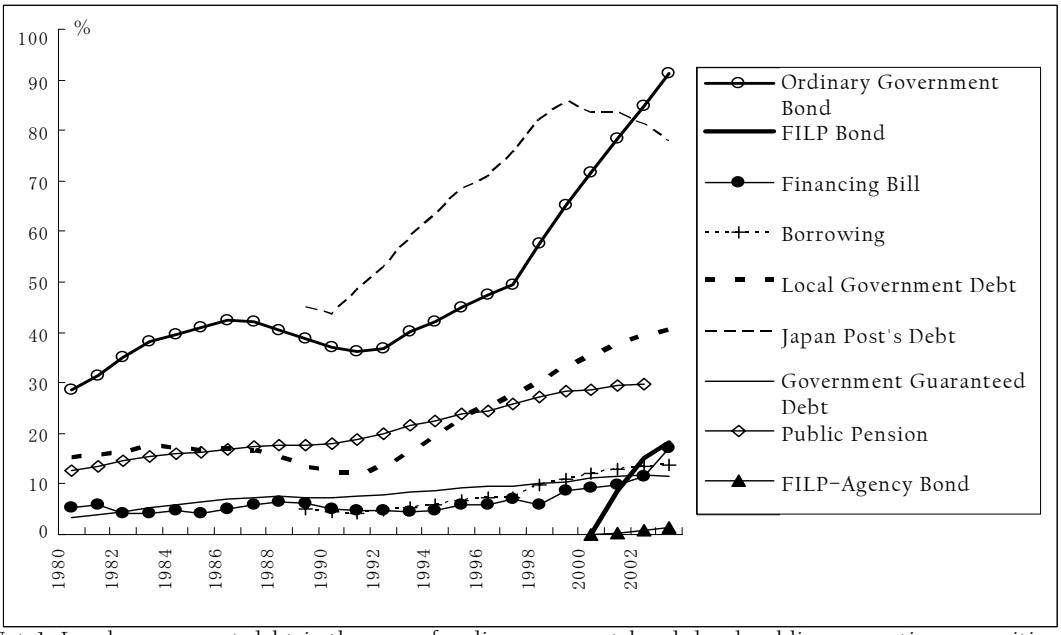
Note 3: The figure for FILP-Agency bond is the accumulated value of the issued amount.

Figure 8: Time Series of Outstanding Public Debt

(i) Outstanding




(ii) Ratio to nominal GDP




Note1: Local government debt is the sum of ordinary account bond, local public corporations securities, and local government's share of special account for grants of allocation tax and transferred tax.
Note2: Borrowing excludes that of special account relating to postal services.
Note3: Japan Post's debt is the sum of postal savings outstanding and reserve for postal insurance.
Note4: Public pension is the sum of reserve of employee pension insurance and national pension insurance.
Note5: FILP-agency bond is the accumulated amount of new issuance.

Still, the prospect for achieving a surplus in the primary balance (basic fiscal balance) is not certain. The current primary balance is expected to improve minus 5.4% to minus 4.4% (GDP ratio for central and local government: SNA basis). But this is only because of cyclical recovery (conversely economic recovery alone also brings about such a small improvement) and it is not considered that this is a steady improvement in the structural primary balance.

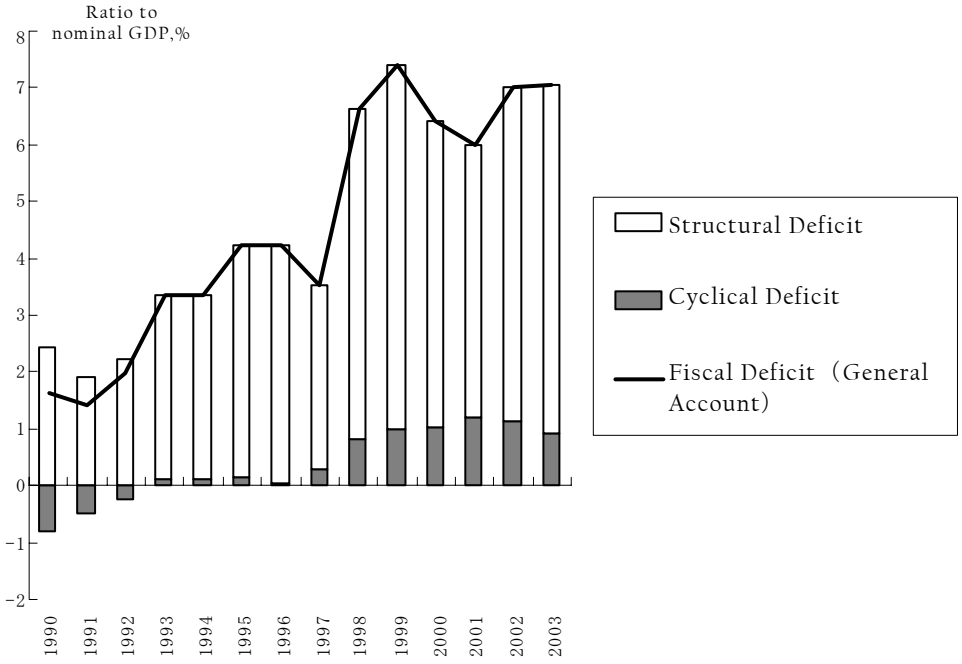
As a trial, Figure 9 indicates a breakdown of fiscal deficit regarding general account into structural and cyclical parts. Estimations may vary depending on the estimated value of the elasticity of taxes to national income. For instance, it is possible that corporate tax will increase

Table 6: Prospects for Primary Balance

| Fiscal Year | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 |
|---|---|---|---|---|---|---|---|
| A. General Account | ▲19.6 | ▲19.0 | ▲20.5 | ▲20.2 | ▲22.4 | – | – |
| B. Central Govt. | ▲5.2% | ▲4.8% | ▲4.5% | ▲3.8% | ▲3.2% | ▲2.8% | ▲2.3% |
| Local Govt. | ▲0.1% | 0.4% | 0.5% | 0.6% | 0.6% | 0.7% | 0.8% |
| Total | ▲5.4% | ▲4.4% | ▲4.0% | ▲3.1% | ▲2.7% | ▲2.1% | ▲1.5% |

Note: A is an estimate by the Ministry of Finance (case of figure in a natural manner). Trillion yen
B is from "Mid-Term Perspectives for Structural Reform and Economic and Fiscal Management -FY2004 Revision" (which considers the efforts for fiscal improvement). Ratio to nominal GDP. Only the figure for FY2003 is from the FY2003 Revision.

Figure 9: Composition of Fiscal Deficit




Source: Cabinet Office "National Account"

drastically with today's economic recovery of, taking into account that during the period in the table there were many companies that did not pay corporate taxes owing to falling into the red through appropriating many special losses etc. Furthermore at the same time there may be a remarkable tendency of decline in the fiscal deficit. But even if such situation is realized, we should see it as a result of temporary factors and should continue efforts for structural improvement.

Actually the prospect by Japanese Cabinet Office that fiscal balance turns to surplus in the early 2010s includes efforts for improving the fiscal balance (and a recovery in the economic growth rate) beforehand. Realization of such a vision depends also on the political situation etc. hereafter. Further, the ratio of outstanding debt to GDP does not stop diverging only through an equilibrium of fiscal balance, considering the possibility of higher nominal interest rates than nominal growth rates.

The condition for stopping this divergence is:

$$\frac{B}{Y}\times(r-g)\leq\frac{P}{Y}$$

Here, B indicates public bonds outstanding, P is the primary balance, Y is GDP, r is the nominal interest rate, and g is the nominal growth rate, respectively. This means that if the nominal interest rate is lower than the nominal growth rate, a primary balance of more than zero satisfies the condition, but if not, even such primary balance is not necessarily enough. Suppose nominal interest rate − nominal growth rate = 2%, public bonds outstanding/ GDP = 2, around 4% of surplus of primary balance to GDP is necessary for stopping divergence ($2\times 2=4$).

## VI. Public Debt Management and Privatization of Postal Services

Owing to the fiscal situation described above, the management of Japanese public debt, which is already huge and still is expanding should be an important subject. If we fail, it is inevitable that we will experience tremendous turbulence, not only in the financial system but also in the whole Japanese economy. While there can be some important points about which management policy of public debt we should adopt, here we limit discussions to those relating to matters regarding postal privatization, now being promoted.

Among the public debts, the possession structure of JGBs in Japan is pointed out as having remarkable feature compared with the US etc. One is that most JGBs are purchased in the domestic market and are held mainly by residents, which means non−residents have only a small percentage. In recent years the ratio of JGB held by the foreign sector is only around 4%. The other feature is that the proportion of direct holdings by households is small and a lot of JGBs are indirectly held by way of financial institutions.

The former is simply a fact that cannot be denied, but the latter can be understood in different ways depending on the position of postal savings (especially fixed−amount postal

savings). Postal savings have been a liability for Japan Post since 2003, but it was a debt of one account of the Japanese central government called the postal savings special account before that. In addition, the designed characteristic of fixed-amount postal saving is very close to that of the JGB for individual investors that the Japanese Ministry of Finance began to issue by itself, and also very similar to the savings bonds issued for individual household in the United States.

In short, according to the vertical division which is one feature of Japanese governmental organization's structure, authorities for owing debt are not unified and thus the debts issued by the former Ministry of Posts and Telecommunications was not sufficiently recognized as a government bond. The debts issued by the Ministry of Finance alone have been considered as a central government bond. If the authority to owe liabilities was unified, however, postal savings (at least fixed-amount postal savings) are naturally viewed as JGB for individual investors.

Actually the reason why the proportion of individual investors' holdings of JGB is small is due to the existence of fixed-amount postal savings, which is a close substitute. If we regard fixed amount postal savings as a substantial government bond for individual investors, the ratio of households' holdings of JGB is not low at all. In terms of its function, since most of the assets held by postal savings are public debt (Table 7), postal savings can be seen as a kind of public debt transformed into a form whose portion is small and liquidity is high for individual investors to readily hold.

Until very recently the Ministry of Finance itself has not issued government bonds designed for individuals to hold easily, while postal saving's function of asset transformation has been utilized. In the sense above, fixed-amount postal savings is considered as no other than a kind of government bond for individual investors in terms of its function. This implies that privatization of postal services has a close relationship with public debt management problem. That is, it should be clear in postal privatization whether we may expect privatized institutions to supply an asset transformation function as before, and if not, what kind of substitute mechanism should be prepared with regard to holding the public debt.

Postal savings and postal insurance formerly functioned as financing device for FILP, but now they are concerned with the overall finance of fiscal deficit of the Japanese government, not limited to FILP (as mentioned previously the size of FILP in the narrow sense has been significantly reduced). A simplified picture of the current situation is shown in Figure 10.

Here the outstanding of public debt of the Japanese government is equal to the accumulated value of fiscal deficit till now (plus asset value, in reality). Japan Post possesses one part of that public debt (the part marked JGB I in the figure) and transforms it into fixed-amount postal savings (and postal insurance in reality), which at last household sector possesses.

Table 7: Asset Portfolio of Postal Savings

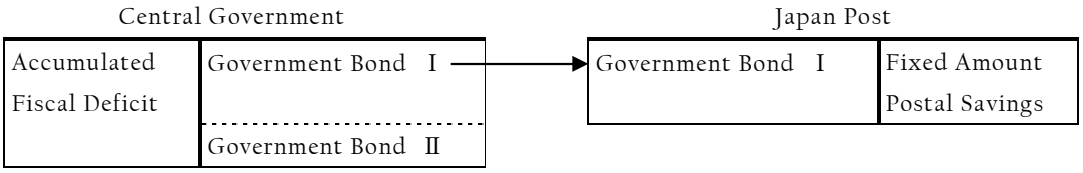
(As of end-March 2004)

| | | | Balance of Assets (billion yen) | proportion of total (%) |
|---|---|---|---|---|
| Deposits with Fiscal Loan Fund | | | 112720.0 | 49.57 |
| Securities | | | 105896.4 | 46.57 |
| | Government Bonds | | 86009.1 | 37.82 |
| | Local Government Bonds | | 9483.4 | 4.17 |
| | Corporate Bonds | | 6902.6 | 3.04 |
| | | Public Corporate Bonds, etc. | 3837.0 | 1.69 |
| | Foreign Bond | | 3501.1 | 1.54 |
| Money Held in Trusts | | | 3776.0 | 1.66 |
| Loans | | | 2786.1 | 1.23 |
| | to Local Governments | | 2041.1 | 0.90 |
| | to Depositors, etc. | | 576.0 | 0.25 |
| | to Postal Services | | 169.0 | 0.07 |
| Deposits, etc. | | | 2219.5 | 0.98 |
| Total | | | 227398.2 | 100.00 |

| | | |
|---|---|---|
| Total of Public Debt | 214090.6 | 94.15 |

Source: "Postal Services in Japan 2004"

Figure 10: Picture of Current Situation




(Government Bond I here includes deposits with Fiscal Loan Fund in a broad sense)

Therefore the part of JGB I must be reduced if we plan to decrease fixed-amount postal savings. In order to decrease JGB I, there is no way other than (a) reducing the accumulated fiscal deficit (plus holding asset value) and/or (b) increasing the part shown as JGB II. The former means attaining fiscal surplus or selling the government's assets, while the latter is refinancing in different measure. In other words, the fund collected by postal savings and postal insurance are not reserved somewhere as cash, but most of it is lent to the Japanese government. To reduce the debt outstanding, at first the government must accept the paying back of funds to

return to postal savings' depositors.

In this sense, as for the issue— the flow of funds which were previously directed into the public sector (e.g. special corporations etc.) being reduced, which will make it possible for people's savings to take part in leading the economy towards revitalization and for the government to improve fiscal situation,"[8] —probably postal privatization alone does not realize this, although the subject itself is urgent. Even if the Japanese government becomes unable to finance as easily as before, this does not mean there is less need for finance. As mentioned previously, (ii) "by the government," and (iii) "for the government" should not be confused. They are related to each other but should be resolved as independent problems.

For fiscal health, tax hikes and spending cuts are central and there should be big supplementation of logic for postal privatization to function as a mainspring. Moreover, even if the flow of fiscal demand is reduced, the problem of managing the public debt stock, which has mounted up, still remains. In order for postal savings and postal insurance to transfer their cash of 350 trillion yen to the private sector, the same amount of credit must be collected from the public sector ahead of this. Here the key point becomes whether the public sector can bear such a collection.

As for this point, however, the postal privatization bills of this time prepare quite a long transition period. As for the existing account (except ordinary savings) provided government guarantee in postal savings and postal insurances, the account is planned to be succeeded by the Management Organization for Postal Savings and Postal Insurances, which will be established as an independent administrative institution, but its fund management is to be managed by the Postal Savings Bank and Postal Insurances Company. Under such management, the assets to be invested will be limited to public debt such as government bonds, etc. (this treatment is a kind of collateral). Thus as to existing account, asset transforming function continues to be a duty.

Seemingly it will take quite long to shift savings and insurance in the existing account to the new account. The maturity term of fixed-amount postal saving is ten years (actual average term is four or five years) and there is a commodity whose maturity is thirty years as for postal insurance. Moreover, taking account of the period necessary for postal savings bank and postal insurance company to obtain the skills to invest in assets other than public debt, probably the asset transforming function will, as before, be offered for around ten years.

Thus the Japanese government only has to make efforts to construct a substitute system regarding possession of the public debt during this transition period. This means that there is some time to spare, but using this time means there will be a delay of the same length to achieve the goal—"the flow of funds that were previously directed into the public sector will be shifted towards the private sector, which will make it possible for people's savings to take part in leading the economy towards revitalization."[9]. Furthermore, if the substitute system for possession of

[8] Cited from Interim Report on Privatization of Postal Services published April 26, 2004.
[9] Cited from *Basic Policies for Privatization of Postal Services* published on September 10, 2004.

the public debt is substantially replacing postal savings and postal insurance with government bonds for individual investors, in consequence, the macroeconomic flow of funds does not change at all.

In the sense above we would just repeat that we cannot change the flow of funds "from public to private" without fiscal surplus or the sale of government assets.

## VII. Conclusion

Let us review the saving–investment balance of Japan during the postwar period. First, during the early period, the household savings rate was high against a basic backdrop of population composition whose main part was the young generation. The household sector consistently generated surplus of funds (excess savings) which was around 10% of nominal GDP. On the other hand, as the corporate sector's willingness to invest was exceedingly vigorous, its deficit of funds (excess investment) would sometimes exceed household sector's surplus of funds.

The public sector was basically keeping a balanced budget and the extent of the deficit of funds was small. Thus as the momentum for expansion of the fund deficit of the corporate sector became so strong as to surpass the surplus of funds of household sector, current account deficit (surplus of funds of foreign sector) was brought about. Under the fixed exchange rate scheme of those days, the current deficit was compensated for by drawing down the foreign reserves of the government.

Then when foreign reserves began to decrease, monetary policy was usually tightened, intending to restrict firms' investment and to promote current account surplus. In other words, the balance of payment constraints was the biggest factor interrupting further economic growth during this period. However in the latter half of the 1960s, as the international competitiveness of the Japanese economy increased, the tendency of the current account surplus became almost fixed under the fixed exchange rate of 360 yen per one US dollar, and it became necessary to consider the shortage of foreign reserves.

With such a saving–investment balance, the biggest mission of the financial system was to collect as much funds—which tended to be low—and to provide firms with the funds for investment. Financial system and mechanism of Japan was improved for performing this mission for about one hundred years after the Meiji Restoration. Only if some fund was financed one did not have difficulty to find how to spend it, because there existed enough investment opportunities till the former half of postwar period.

But since the 1970s the situation began to change dramatically. With the end of the high-growth period investment, opportunities became scarcer than before and the willingness of corporate sector to invest drastically declined. However, the household savings rate did not decline instantly. These changes brought about a major transformation in the saving–investment

balance of Japan. That is to say, since the household savings rate kept a high level in spite of the fall in the investment rate of companies, the saving–investment balance of Japan basically turned into a surplus fund.

During the 1970s, such underlying change was not easily recognized as it became confused with the influence of the oil crises etc. But in the 1980s, the change finally became broadly recognized and people began to use the expression "excesses money," which had never existed before. At this time, the emphasis on the role to be taken by the Japanese financial system dramatically changed. Namely, it became more important to have expertise in investing than in financing. Without fully meeting such need, however, the banking sector in Japan expanded excess lending, which led to the outbreak of the bubble economy.

In terms of macroeconomic monetary balance, the surplus of funds of the domestic private sector should be absorbed by the financial deficit of the government sector (i.e. fiscal deficit) or the foreign sector (i.e. current account surplus of Japan). In fact, after around 1975 the government sector rapidly expanded its fiscal deficit, and the current account also tended to gain a large surplus in the 1980s when the effect of the oil shock disappeared.

This pattern of saving–investment balance has continued for these past25–30 years. But there is a possibility that the time is coming when the trend of saving–investment balance dramatically changes. That is, we are experiencing a drastic decline in the household savings rate against a background of an aging population and the surplus of funds in the domestic private sector is decreasing. If this tendency becomes fixed as a trend there remains less room for the government to maintain a large financial deficit. Without the financial surplus of the domestic private sector, the government's fund deficit can only be compensated for by financial surplus of the foreign sector (i.e. current account deficit).

If the trend in saving–investment balance is changing in the direction as domestic private sector's financial surplus declines, it becomes more necessary to maintain a healthy fiscal situation. Here, we can say a rise in the national burden rate itself accompanied by a healthier fiscal situation leads to a decrease in the financial surplus of the domestic private sector. What then is the essential role for the financial system in such a future?

Provided that the financial positions of both the household sector and the corporate sector reach balanced positions taking each sector as a whole, there should be less need for financial intermediation, such as by collecting funds from households and lending it to corporations. Rather financial intermediation that redistributes funds within the sector seemingly becomes more needed. This is because the total balance is getting closer to zero while variance inside sectors is expanding in reality.

The fact that the macroeconomic growth rate has declined does not mean every company or industry is growing only at low rate. In reality there are some companies and industries growing rapidly, but on the other hand some continues to decline. The sum total of them creates a low value of growth rate as a result. Thus such financial redistribution becomes more important as

collecting loans from decaying industries and companies whose potential growth is low and lending to industries and companies whose growth can be expected. Also within the household sector it is more necessary to coordinate the financial surplus and the deficit of the generations.

However, for this financial redistribution, a genuine capital market is indispensable, one that gathers information covering the whole economy and expresses this data through price announcements. Without such a firm capital market which works for information dissemination, it is impossible to redistribute funds properly among industries. Furthermore, to cope with the increase in variance among the generations, the existence of a capital market that enables diversified investment is effective.

For the establishment of a genuine capital market, building an institutional infrastructure is indispensable. Such establishment cannot be realized only by deregulation or liberalization. For getting information ex ante and ensuring execution ex post—which are essential for financial transactions, no one can avoid bearing cost in any case. In bilateral-style finance, concerned parties directly take on the burden of such costs through respective contracts. Meanwhile, in market-styled finance, getting information and ensuring execution should be supported by provision of "public goods" through an effective legal environment and information infrastructure. The cost for the provision of such public goods must be met collectively.

In this respect, the role of the government is important but it is different from traditional case. In short, it is now necessary to redefine the government's role. This is not to try to "substitute markets," but to shift to "preserving markets" by improvement and maintenance of the institutional infrastructure and a competition policy needed for the market mechanism to work. Specifically, we must maintain our efforts, such as by enacting the Financial Services Act.

In short, it should be expected that the situation like a financial system "of the government," "by the government," and "for the government" be terminated, and the relationship between the government and the financial system should be changed in the direction outlined above.

## Appendix: Outline of Public Debt[10]

### *I) JGB (Japanese Government Bonds)*

JGBs are the core of Japanese public debt and consist of (i) construction bonds, (ii) special deficit-financing bonds (or simply, deficit-finance bonds), and (iii) fiscal loan bonds. Since they are all bonds whose characteristics are the same and which are issued by the central government, there is no difference in their treatment in the market. The differences are in the use of the financed funds. Construction bonds are for improving social capital, and special deficit-financing bonds are for the purpose of financing fiscal deficits, while outstanding value of these bonds is at a level of between 200 and 250 trillion yen. Issue of fiscal loan bond

[10] Unless noted otherwise, figures are as of end of the relevant fiscal year.

started during the opportunities of FILP reform in FY2001. Since the issuance reflects institutional reform (abolition of deposits of postal savings etc.), the increase in issuance does not necessarily mean an increase in net liability of the government sector, but its outstanding value is already close to around 100 trillion yen.

The outstanding value of construction bonds and deficit-financing bonds are rapidly expanding against a background of the recent severe fiscal situation. Particularly special deficit-financing bonds, which are issued for filling fiscal deficits, are rapidly increasing by an average of around 10% each year since the 1990s.

### *II) FB(Financing Bills)*

FB is a bond that the central government issues and whose maturity is short. Because of the restriction of cash use, it is distinguished from government bonds, but the market treats it as the same as a short-term government bond (i.e. treasury bond). Though its maturity is tentatively three months, it is actually refinanced. Thus there always is more than a certain level of outstanding as lying accumulation (since FY1990 at least around ten trillion yen). Because FBs reach maturity in a short term, there exists a tendency that interest payments might increase rapidly when market interest rates rise with monetary tightening by the BoJ.

The amount outstanding has been increasing rapidly since 1990s. This reflects solely foreign exchange intervention of selling yen and buying US dollars by the government (foreign exchange fund special account). The amount outstanding of FB as of end-FY2003 was 86 trillion yen and 85 trillion yen was for that special account.

### *III) Government Borrowing*

Though Government borrowing is a debt of the central government, like the government bond, the accounts that finance funds are not usually the general account but ten special accounts as of end-FY2003. In 61 trillion yen of the total outstanding, a little less than 50 trillion yen is for the special account for grants of allocation tax and transferred tax. Because maturities of a lot of government borrowings also are quite short (around six months), interest payments might grow drastically during the period of rising interest rates.

The amount outstanding is increasing, reflecting only the special account for grants of allocation tax and transferred tax. The amount outstanding for other special accounts remains at almost the same level. The sharp increase in borrowing by the special account for grants of allocation tax and transferred tax is against a backdrop of a shortage of local governments' revenue source (the fund is added to a part of local allocation tax). Because borrowing by the postal savings special account was inherited by Japan Post in FY2003, it is not easy to grasp the basic overall trend, but on average, total government borrowing has increased by a little less than 10% per year, even excluding postal savings special accounts.

### *IV) Local Bonds*

Though the local bond is a liability by the local government and distinguished from central government's debt, it is not necessarily completely a self-responsible liability because of direct and indirect engagement by central government. There are various classifications of local bonds but the major ones are by (i) accounts or (ii) funds. In the case of grouping by account, there are bonds for the ordinary account, which is similar to the general account of central government (139 trillion yen as of end-FY2003), and local public corporations securities which finance funds for operations of local public corporations managed by local governments (62 trillion yen as of end-FY2003). One feature of local bonds is that many of them are substantially close to borrowing, following a form of debt with a certificate, in spite of their name, "bonds." Genuine public-issued bonds that are issued publicly in the market make up only around 10% of the total. After the 1990s (especially FY1994) local bonds sharply increased owing to the sluggishness of tax revenue, cuts in taxes, and expansion of expenditure. In particular, the average annual growth rate of ordinary account securities since FY1990 has been around 8%.

### *V) Pension Liability*

Public pension is often considered as a kind of liability of the government but its character is quite different from those of other public debts. The nature of public pension as a liability itself is a major focus of discussion.

"Liability" in accounting is a current debt derived from past events and its realization is anticipated as an outflow of some resources, which brings about an economic benefit from companies. Thus present value of benefits that correspond to the past period is temporarily considered as a pension liability but there can be some standpoints depending on the extent the government is responsible. For example the "Japanese Government Balance Sheet" until FY2001 cited how to appropriate debt amount of pension liability, with three points of view as follows:

(i) Future pension benefits corresponding to the past period are not recognized as liabilities, but solely reserves that the Government holds at present are recognized as the "deposits of public pensions" among liabilities on the balance sheet (158 trillion yen as of end-FY2001).

(ii) It is judged by revenue resource whether it is considered as a liability or not. Only reserves and Government subsidies are to be recognized as liabilities, since the future insurance premium income is expected to be paid by employers and contributors who are outside the Government under the current system (295 trillion yen as of end-FY2001).

(iii) In addition to Government subsidies, the Government has an obligation to raise future premiums to finance future pension benefits. Therefore, the total amount of the present value of benefits corresponding to the past period is to be recognized as liabilities on the balance sheet.

Further, Hatta and Oguchi(1993) also consider in their analysis of net pension liability that payment liability is a benefit already determined among the current value of future benefits,

which is equivalent to the current value of the benefit corresponding to the past premium.[11].

Opposing these views there are standpoints. Takayama (2004) includes the present value of benefits corresponding to the future period in the liabilities. That is, it includes also a lump-sum benefit calculated from employees' pension payments insured by future premiums. In the paper, the benefit obligation for the past premium is estimated at 800 trillion yen and that for the future premium at 1,100 trillion yen (assumptions are as follows: wage growth: 1.0%, discount rate: 3.2%, premium: 13.58%; all of these figures are fixed and estimation is as of end-FY2004).[12]. "Prospects and Policies about Social Security System of Japan in the 21st Century" (2004) by the Japan Center for Economic Research considers both the present value of benefit corresponding to the past period (720 trillion yen) and that corresponding to the future period (1420 trillion yen) as net pension liability, based on "Social Security Towards the 21st Century" (October 2000) by the government's Deliberative Council of Experts on Modalities for the Social Security Structure.

### *VI) Government-Guaranteed Debt*

Government-guaranteed debt has the characteristic of a settled liability for the debtor (special corporation etc.) and as contingent liability for the guarantor (nation). There are bond types and borrowing types, as for government-guaranteed debts. Since the credit quality of government-guaranteed bonds is as high as that of the government bond, it is handled as almost the same financial instrument as JGB in the financial market. The issue amount outstanding of government-guaranteed bond is 45 trillion yen as of end-FY2003. Representative institutions that issue these are: (i) Japan Finance Corporation for Municipal Enterprises (the proportion of outstanding in total public-issued is 46%), (ii) Deposit Insurance Corporation of Japan (25%), (iii) Japan Finance Corporation for Small and Medium Enterprise (8%), (iv) Japan Highway Public Corporation (6%).

On the other hand, the amount outstanding of government-guaranteed borrowings as of end-FY2003 is 13 trillion yen, and the overwhelming proportion (something over 80%) is occupied by the Deposit Insurance Corporation of Japan.

Until around 2000, government-guaranteed debt showed a stable increasing trend but after 2001 it reached its peak because of debt payments by the Deposit Insurance Corporation and a reduction in FILP agencies' activities against the background of FILP reform.

### *VII) FILP-Agency Bond*

The FILP-agency bond, introduced during FILP reform in FY2001, is a bond that each special corporation etc. issues by itself without a government-guarantee. Generally, its spread is fairly small against the backdrop of credit quality of public institutions, while its maturity

[11] Hatta and Oguchi(1999), *Nenkin-Kaikaku-Ron: Tsumitate-houshiki he Ikou Seyo*, Nihon Keizai Shimbun.
[12] *Weekly Economist*, the Mainichi Newspaper, July 6, 2004.

and .commercial value is diverse. Such situation that credit ratings or spreads are advantaged compared with their financial positions is expressed as the existence of an "implicit government-guarantee" in the market.

An overwhelming number of the total bonds are issued by the Government Housing Loan Corporation. This corporation is planning to become an independent administrative institution whose main task is securitization support of lending in FY2006, and will issue RMBS (residential mortgage-backed securities) backed up with its own residential mortgage as FILP-agency bonds. Among other FILP agencies, for example, the issuance of the Japan Highway Public Corporation is noteworthy.

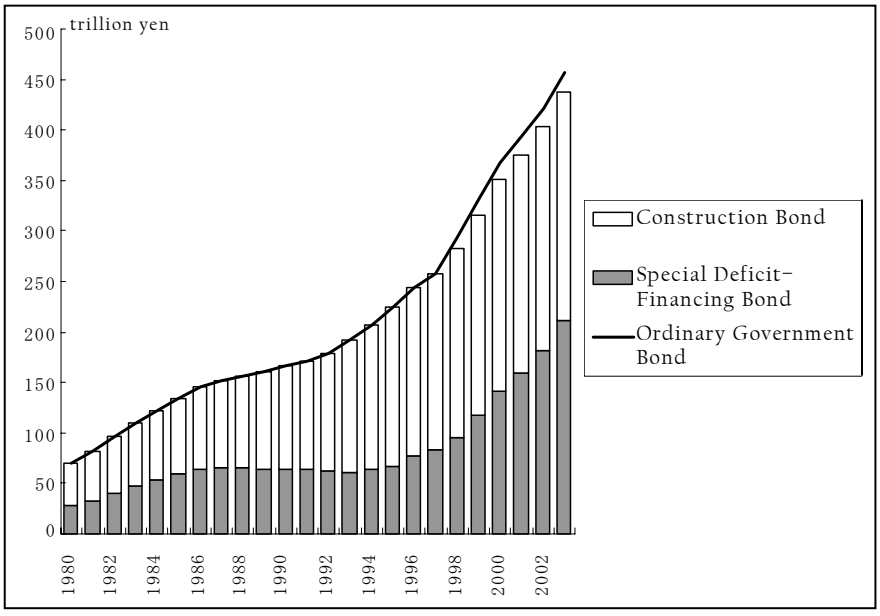
FILP-agency bonds continue to rapidly increase, although the total amount outstanding itself is still small since the issuance started only a short time ago. Average growth in the two years since the beginning of issuance is 2.6 times above the previous year. This is due to the transfer of the previous FILP fund and does not mean an increase in net liability, but exposure to market does increase.

A-1: Outline of JGB

| Name of debt | Ordinary Government Bond | | Fiscal Loan Fund Special Account Bond (FILP Bond) |
|---|---|---|---|
| | Construction Bond | Special-Case Bond | |
| Other name | Article 4 Bond | Deficit-Financing Bond | Fiscal Loan Bond |
| Purpose | Financing fund for government activity which brings about long-term benefit | Financing revenue shortage | Financing Fiscal Loan Fund |
| Subject for finance | General Account | General Account | Fiscal Loan Fund Special Account |
| Maturity | 6 months-30 years | 6 months-30 years | 2-30 years |
| Character of product | coupon bond, discount bond | coupon bond, discount bond | coupon bond |
| Outstanding (as of end-FY2003) | 226.4 trillion yen | 211.4 trillion yen | 91.8 trillion yen |
| Growth rate (FY90→03 average) | 6.3% | 9.6% | n.a. Reference: FY01→03 average 44.9% |

Note : Issuance of FILP bonds started in FY2001.

A-2: Outstanding Amount of Ordinary Government Bonds (as of end-FY)



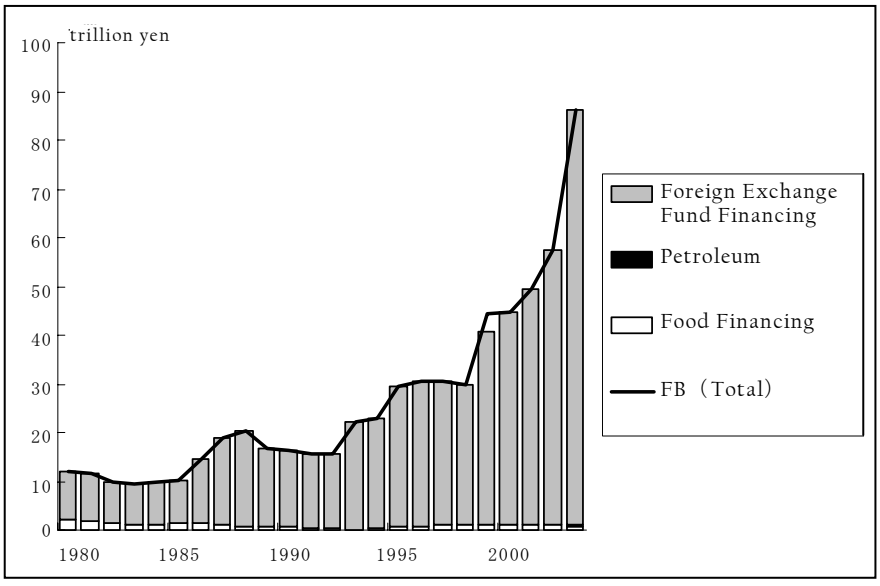

Note: Difference between total ordinary bonds and the sum of construction bonds and deficit-financing bonds corresponds to Japan National Railways' Debt refinancing bond, National Forest Service's debt refinancing bond, and Local Allocation Tax – Succeeded debt refinancing bonds.

Source: House of Councilors, Committee on Budget, Research Office, "Materials Related to Fiscal Matters *(Zaisei-Kankei Shiryou-Shu)*"

A-3: Outline of FB

| Name of Debt | Financing Bill (FB) | |
|---|---|---|
| | Treasury Financing Bill | Food Financing Bill, Foreign Exchange Fund Financing Bill, Etc. |
| Other name | - | Ryo-ken, Tame-ken, etc. |
| Purpose | Covering temporary shortages of funds between revenue and expenditure | |
| Subject for finance | General Account | Each Special Account<br>- 7 special accounts have legal basis for issuance. Among them actual issues have been made for special accounts for (i) Food Control (Ryo-ken), (ii) Foreign Exchange Fund (Tame-ken), (iii) Petroleum and the More Sophisticated Structure of Demand and Supply of Energy Policies (Petroleum bill), (iv) Fiscal Loan Fund (Fiscal Loan Fund bill).<br>- Special accounts for National Forest Service and trade (re)insurance have legal provisions but have not actually been issued. |
| Maturity | Basically 13 weeks (3 month) | |
| Character of product | Discount bond | |
| Outstanding (as of end-FY2003) | 86.1 trillion yen (Foreign Exchange Find Financing Bill: 85.0 trillion yen) | |
| Growth rate (FY90□03 average) | 13.6% | |

A-4: Outstanding of FB (as of end-FY)

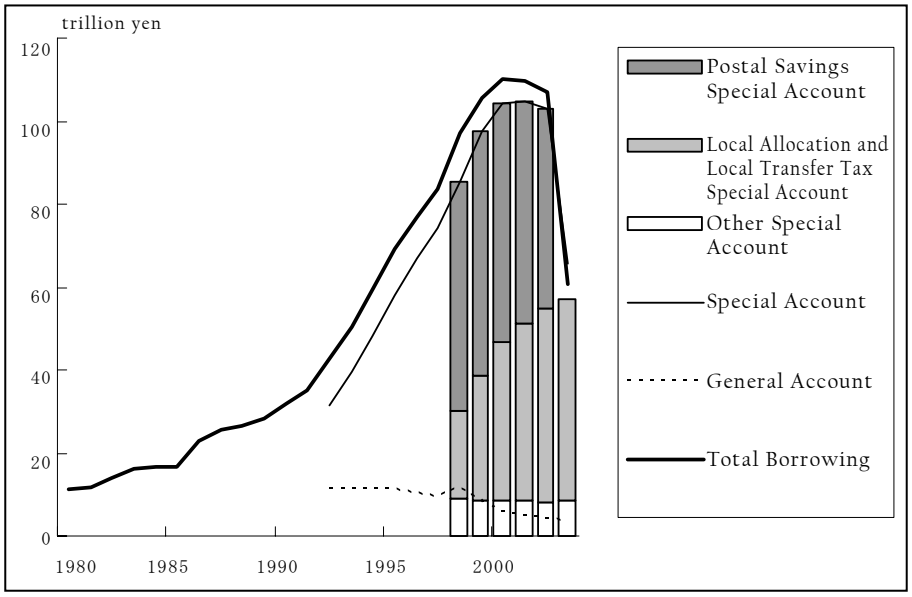



Source: Ministry of Finance, "Annual Statistic Report on Government Bond *(Kokusai Toukei Nempou)*"

A-5: Outline of Government Borrowing

| Name of Debt | Government Borrowing |
|---|---|
| Purpose | Financing expenditure demand together with government bonds |
| Subject for finance | Mainly each special account (exceptionally, general account)<br>– At the end of FY2003 ten special accounts had outstanding amounts. In FY2004 nine special accounts undertook new borrowings.<br>– Borrowing of general account corresponds to succession from other accounts, such as former Japan National Railways' debt.<br>– After FY2003 Japan Post succeeded to the large borrowings of the postal savings special account. |
| Maturity | ・Temporary borrowings for financing temporal shortage of fund・・・ should be redeemed within the same fiscal year.<br>・Borrowing in the narrow sense which finances shortages of revenue・・・ basically extends ever a number of fiscal years. Maturity varies depending on each special account.<br>– Local Allocation and Local Transfer Tax special account: mainly around six months, National Forest Service special account: five years, Measures For Petroleum and the Advance of Energy Demand and Supply Structure: six month, one year, etc. |
| Character of product | Borrowing on deeds as for auction. Also, in some cases, syndicated loans. |
| Outstanding (as of end-FY2003) | 60.6 trillion yen<br>(Local Allocation and Local Transfer Tax special account: 48.5 trillion yen) |
| Growth rate (FY90-03 average) | Excluding postal savings special account: 8.4%<br>Including postal savings special account: 5.1% |

A-6: Outstanding of Government Borrowing (as of end-FY)

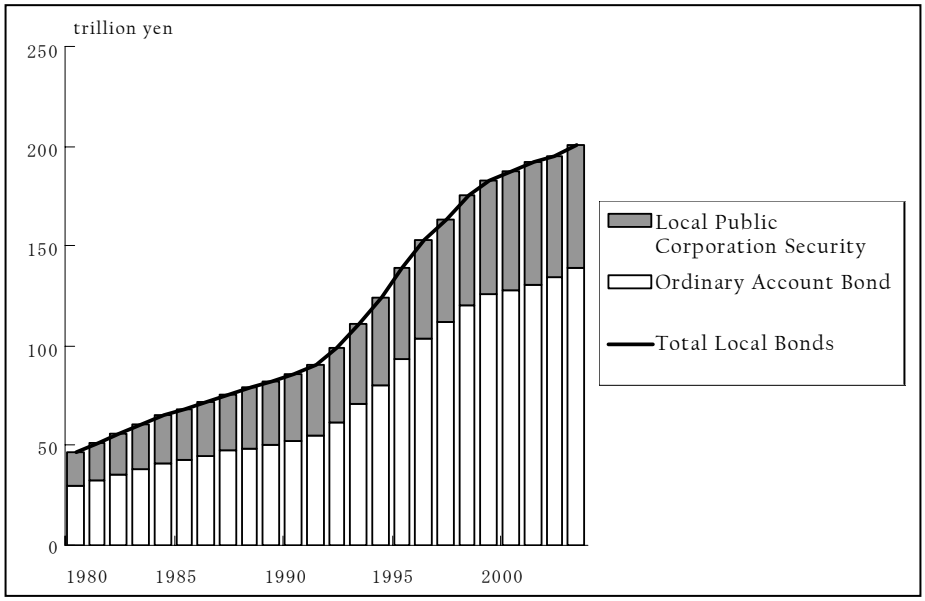



Source: Ministry of Finance, "Debt Management Report", House of Councilors, Committee on Budget, Research Office, "Materials Related to Fiscal Matters *(Zaisei-Kankei Shiryou-Shu)*"

A-7: Outline of Local Bonds

| Name of Debt | Local Bonds | |
|---|---|---|
| | Ordinary Account Bond | Local Public Corporations Bond |
| Purpose | Financing revenue shortage of ordinary account | Complementing revenue of local public corporations |
| Subject for finance | Ordinary account and special accounts, excluding public corporation account of local government | Public corporation account of local government |
| Maturity | Basically 5–30 years<br>– maturity of major debt・・・Among private funds, public offering: 5, 10 years / private subscription: 10–20 years, government funds: 5–30 years, Japan Finance Corporation for Municipal Enterprises (JFM) funds: 5–28 years | |
| Character of product | Bond-styled or Deed-styled<br>– Public offering in private funds and some parts of private subscriptions are bond-styled. Government fund, JFM fund, and some part of private subscription are deed-styled. | |
| Outstanding (as of end-FY2003) | 138.7 trillion yen | 61.5 trillion yen |
| Growth rate (FY90–03 average) | 7.8% | 4.8% |

A-8: Outstanding Amount of Local Bond (as of end-FY)




Source: Ministry of Finance, "Debt Management Report", House of Councilors, Committee on Budget, Research Office, "Materials Related to Fiscal Matters *(Zaisei-Kankei Shiryou-Shu)*"

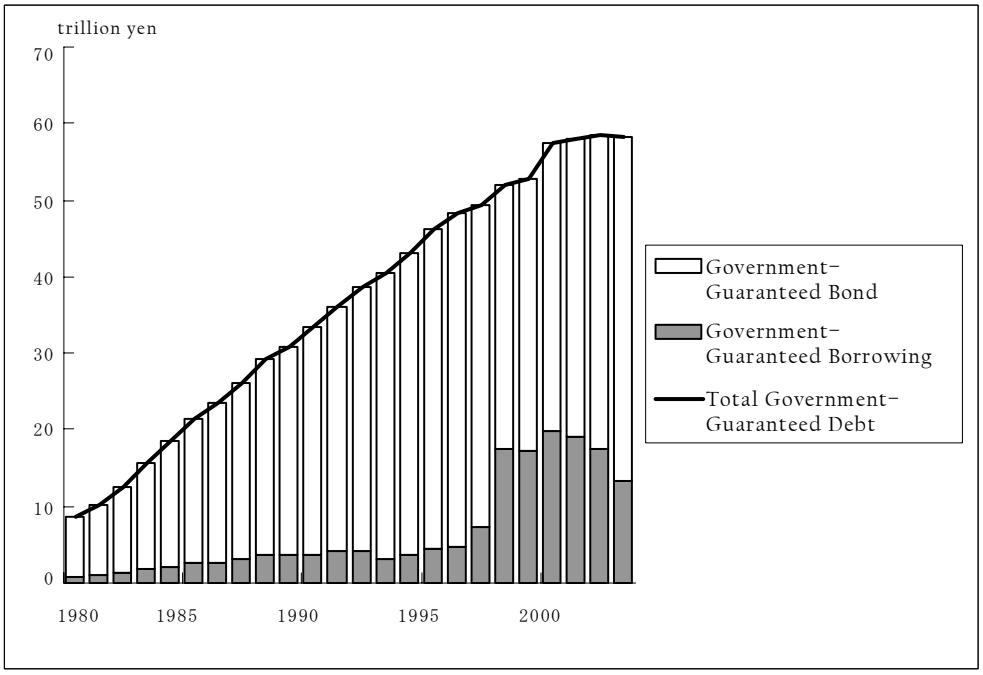
A-9: Outline of Pension Liability

| Name of Debt | Pension Liability |
|---|---|
| Purpose | Certain provision of funds utilizing insurance system in order to remove or reduce anxiety of members of society and secure their well-being |
| Subject for finance | Central government (Welfare Insurance special account and National Pensions special account) |
| Maturity | When each insured person satisfies eligibility requirement, such as reaching a certain age etc. |
| Character of product | Annuity insurance |
| Outstanding (as of end-FY2002) | 161.6 trillion yen |
| Reference: growth rate (FY2001→2002 average) | 3.9% |

A-10: Outline of Government-Guaranteed Debts

| Name of Debt | Government-Guaranteed Debt | |
|---|---|---|
| | Government-Guaranteed Bond | Government-Guaranteed Borrowing |
| Purpose | Smoothing finance for operation by special public institutions, etc. | |
| Subject for finance | Government-related agencies such as special public institutions, independent administrative institutions, etc. | |
| Maturity | ・Medium-term bond (2, 4, 5, 6,or 7 years)<br>・Long-term bond (10 years) | Bilateral negotiation |
| Character of product | Coupon bond | Basically syndicated loan and partly interest auction (Deposit Insurance Corporation, etc.) |
| Outstanding (as of end-FY2003) | 45.0 trillion yen | 13.3 trillion yen |
| Growth rate (FY90→03 average) | 3.3% | 10.2% |

A-11: Outstanding Amount of Government-Guaranteed Debt (as of end-FY)

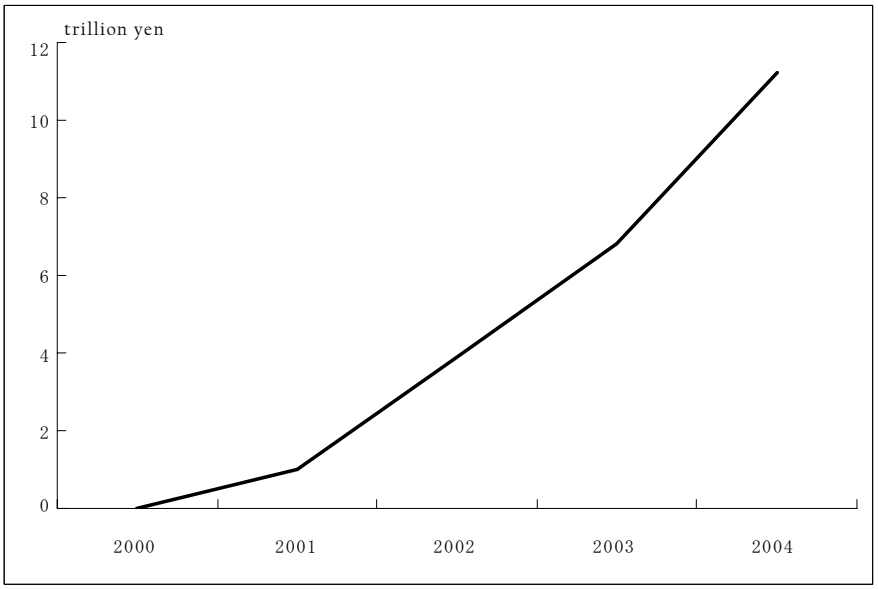



Source: Ministry of Finance, "Annual Statistic Report on Government Bond (*Kokusai Toukei Nempou*," "Debt Management Report

A-12: Outline of FILP Agency Bonds

| Name of Debt | FILP Agency Bond |
|---|---|
| Purpose | Financing funds necessary for activity of special public institutions, etc. |
| Subject for finance | Special public institutions, etc. (special public institutions, independent administrative institutions, and authorized organizations)<br>- FILP agency is a special institution, etc. that utilizes FILP funds |
| Maturity | Medium-long term (2-30 years) |
| Character of product | Coupon bond (fixed-rate, floating-rate, and inflation-indexed) |
| Outstanding (as of end-FY2003) | 6.8 trillion yen |
| Growth rate (FY90→03 average) | n.a.<br>Reference: FY01→03 average<br>160.9% |

A–13: Outstanding Amount of FILP Agency Bond (as of end–FY)




Note: Accumulated amount of each fiscal year's issuance
Source: Ministry of Finance, "Debt Management Report"

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