Japan slides back into recession

Nick Beams
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A year ago the predictions were that the Japanese economy had finally turned the corner and was about to come out of the deepest and longest recession of the post-war period. And the confidence of government officials that the economy was beginning to respond to massive expenditure packages seemed to be confirmed by figures for the first two quarters of 1999, which showed positive growth.

But doubts began to emerge when the figures for the September quarter came in showing that the economy had contracted at an annualised rate of 3.8 percent. However, the air of official confidence was maintained, with the head of Japan's Economic Planning Agency, Taichi Sakaiya insisting as recently as three weeks ago that the economy would show an expansion in the December quarter.

Sakaiya has now reversed his predictions, warning on a television show last Sunday that the December quarter Gross Domestic Product figures, due to be released next month will show a “considerably large negative figure”, putting Japan back into recession, defined as two successive quarters of economic contraction. Some analysts have already predicted that the GDP decline could be as much as 5 percent on an annualised basis.

Sakaiya put the blame on slack consumer spending, resulting from the decline in winter bonuses paid to workers and managers. Whatever the immediate cause, the expected decline underscores the underlying problem—the failure of successive government stimulus packages to revive the Japanese economy.

The slide back into recession will fuel concerns that the government stimulus packages are creating an unsupportable level of debt. At the start of the last decade gross public debt was estimated to be 69 percent of GDP. At the end of last year it was almost 130 percent, according to estimates by the IMF, with the prediction that it will rapidly rise to around 150 per cent, with the annual government budget deficit approaching 10 percent of GDP.

Even these figures do not tell the full story for they exclude the Fiscal Investment and Loan Program (FILP) through which the government channels money from the postal savings system and public pension funds into public sector institutions. If the bad debts of the FILP are added in, the debt is calculated to have already reached 150 percent of GDP. To this must be added state-pension commitments, estimated to be 100 percent of GDP, bringing the total level of indebtedness to around 250 percent.

Commenting on the debt problem in an address to the Diet (Japanese parliament) on January 28, Prime Minister Keizo Obuchi said: “I regard the fact that government debts will reach $6 trillion by the end of the fiscal year as a very serious matter.”

But he was not able to offer any prospect that they would be wound back. The official government position is that spending packages must be continued to counter recession. But they are clearly not working and are adding billions of dollars to the debt mountain.

Obuchi's remarks would have hardly inspired confidence. “We are not able to pursue the two goals of putting the economy onto the track of fully-fledged recovery and working on the important task of fiscal restructuring simultaneously,” he said. “I believe he who runs after two hares will catch neither.”

The problem for the government, however, is that while it has been able, to this point, to draw on large supplies of loan funds to finance its stimulus packages, this process cannot continue indefinitely.

Concerns that the growth of indebtedness could spark a financial crisis have been strengthened by the government's recent announcement that it would borrow funds directly from the banks in order to finance cash-starved local government bodies.

The problem has arisen because local authorities have

been suffering a fall in their tax revenues due to the economic recession.

The government had previously financed them through the FILP with funds provided from the postal and savings system. But this method of financing will be no longer possible in the coming period.

It is estimated that accounts worth some $900 billion in the postal and savings system will mature in the next two years and with interest rates on these savings at only 1 percent about $460 billion is expected to exit the system, seeking higher rates of return in mutual funds or other investment avenues.

The amounts involved in the government loan program are not small. After borrowing $1.35 billion last year, the government is planning to ask the banks for $75 billion this year-more than the GDP of Singapore—and equivalent to about half the amount it has injected into the nation's top 15 banks over the past year.

There are potential problems in the method of financing as well. While the government is planning to borrow money from the banks short-term—for a one-year period—the local authorities require assistance over an extended period.

The operation has prompted warnings from financial analysts that the Japanese financial system may be starting to crack. According to Jesper Koll, the chief economist at Merrill Lynch Japan: “The whole pyramid structure of public finances is starting to give.”

David Asher, a research fellow in the Japan Program at the Massachusetts Institute of Technology echoed this assessment. “The funding mechanism is breaking down,” he told the *New York Times*.

“The dam is showing more and more stress fractures and they're trying to put plaster on them.”

With the failure of the spending packages to revive the economy, voices are being raised with the ruling Liberal Democratic Party and elsewhere that the program must be reversed and action taken to reduce the debt.

These views were given expression in an address last Friday to the Foreign Correspondents' Club by Akio Ogawa, a lecturer in the Graduate School of Public Policy at Tokyo's Chuo University.

Warning that the Japanese debt was a time bomb, which could wreck the world economy, he said: “We are looking at a danger signal blinking near and bright.”

He denounced the public spending program for building bridges to sparsely populated islands, concrete linings for rivers and the construction of roads leading to nowhere. It benefited neither the economy nor the Japanese people but only an “iron triangle” of powerful politicians, bureaucrats and businesses.

“Now we face a dire choice between huge tax increases or hyperinflation to help reduce, if not wipe out, the debt that has already got out of control,” he said.

However, any measures to reduce the debt could have significant global consequences. The last time the government tried to rein it in, by lifting consumer taxes in April 1997, the economy moved into a recession—one of the factors blamed for the eruption of the so-called Asian financial crisis later that year.