Abenomics and Fiscal Issues in Japan

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Abstract. We have observed that the Japanese economy has maintained a zero-growth trend since the 1990s. Despite this, Japanese society has not experienced any significant unrest. Surprisingly, speculators worldwide are investing in Japanese yen, a peculiar phenomenon considering that the yen does not constitute a long-term stable investment. For instance, the yen lacks the potential for appreciation and has, in fact, experienced a fairly long period of depreciation. Moreover, the interest rate of the Bank of Japan has remained at zero for many years, signifying that investing in the yen does not yield substantial profits. Therefore, we want to explore that the factors drive countless speculators to invest in yen and in turn make the Japanese economy remains robust despite its inability to maintain high-speed growth.

Keywords: Japanese Fiscal Issues, Abenomics, Economic Growth

1 Introduction

Fiscal policy involves economic activities primarily by the national or local governments. Governments collect a portion of national income for public needs, aiming for optimal resource allocation, fair distribution, and economic stability and development. According to Japanese fiscal law, government expenditure should rely on government income other than debt or loans. That is, the law prohibits Japan from issuing sovereign bonds. However, the fiscal law also stipulates that the funds required for investments, contributions, and loans for public projects can be raised through issuing bonds or borrowing within an amount approved by the Diet. Thus, Japan finances its public projects mainly by issuing a substantial number of these construction bonds.

2 The Fiscal Issues in Japan

In terms of the structure of Japan's fiscal revenue, tax revenue forms a significant portion, similar to China. Japanese taxes are categorized into direct taxes and indirect taxes. Direct taxes—comprising corporation tax, income tax, and inheritance tax—are mandatory for every individual, while indirect taxes, including consumption tax, are not levied unless a direct relationship is established [2]. Additionally, Japan's fiscal revenue

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includes stamp duties, government bonds, profits and revenue from state-owned enterprises, and government assets. The ratio between national and local taxes in Japan is significant. Therefore, like China, Japan also belongs to a centrally controlled fiscal system. However, the wisdom of Japanese fiscal policy lies in its efficient use; if state-owned enterprises want to use taxpayers' money, they need to present a report in the Diet.

From the perspective of Japan's fiscal expenditure structure, the outlays include government operational expenses, local fiscal allotments, defense spending (military expenditure), national preservation costs, industrial economic spending, cultural and educational spending, and social security-related expenditure, among others. Government operational expenses cover the salaries of Diet members, judiciary, police, fire service, diplomacy, etc. Local fiscal allotments refer to central funds allocated to relatively impoverished regions to support local economic construction. Furthermore, defense spending amounts to five trillion yen, accounting for 1% of Japan's total GDP, indicative of Japan's substantial military strength. Education and social security also consume a large chunk of fiscal expenditure. The comprehensive education system and welfare regime in Japanese society necessitate significant fiscal spending in these public service sectors [1].

Despite being a highly developed capitalist society, Japan's fiscal condition is far from optimistic. One could describe the financial state of the Japanese government as living beyond its means and perpetually accruing debt. Firstly, the primary source of Japan's tax revenue is the consumption tax, not income tax. The consumption tax, roughly equivalent to China's value-added tax, serves as a significant revenue source because income tax can only be levied on the income that Japanese citizens earn in a particular year. However, it is impossible to levy income tax on the gradually accumulating wealth of the people, thereby necessitating the collection of consumption tax to cover this massive loophole [8][9]. Within Japan's fiscal expenditure, social security and debt repayment have drained a large portion of the government's resources. From the perspective of debt repayment, Japan has almost zero or negative interest rates, yet repayments account for 11% of fiscal expenditure. This fact signifies that the amount of national debt owed by the Japanese government is astoundingly high. Moreover, in less economically developed regions of Japan where fiscal income is insufficient, public service construction must still be carried out—for instance, in the Hokkaido region. Consequently, the Japanese government has adopted a policy of levying taxes in developed areas and providing subsidies to relatively underdeveloped areas, exacerbating its fiscal imbalance. However, the Japanese government does not seem overly concerned about this. Instead, it continues its daily issuance of bonds to maintain fiscal operations. Several reasons contribute to this, a crucial one being that the Japanese government issues bonds not to foreigners or other governments but to its own citizens. This approach allows the government to increase the money supply by printing money, leading to inflation, which can solve a portion of the problem. For instance, the core of Abenomics is inflation. This can reduce the volume of national debt, thereby alleviating the fiscal pressure on the Japanese government. Additionally, the long-term approach adopted by the Japanese government is essentially a means of distributing wealth among the populace after national economic development. In a situation where the entire money market is experiencing low interest rates and the economy is sluggish, only national bonds can obtain stable interest rates, thereby stimulating Japanese citizens to purchase national [4][5].

Yet, the Japanese government still aspires to resolve the fiscal quandary. The principal concern may not necessarily be a potential debt crisis, but the fact that national debt has become the fundamental reason for the stagnation of the national economy. To begin with, banks' interest rates are nearly zero, while the interest rate on national debt is 1%. After receiving deposits from the public, banks, in a depressed economic climate, conduct risk assessment. Given the cautious and conservative nature of the Japanese people, if risks are present, banks would favor purchasing national debt over lending money to businesses, thus guaranteeing steady returns. Consequently, capital is not effectively channeled into the real economy, making the latter even more sluggish. Banks, therefore, are even less willing to lend to businesses, creating a vicious cycle of disconcerting proportions. The Japanese government's concern about fiscal issues, perhaps, fundamentally stems from its desire to stimulate the financial system, thereby generating employment and boosting the economy.

From the 1990s onwards, Japan has seen a swift increase in the issuance of national debt, with various reasons at play. The growth of public investment projects since the 1990s; the increase in social security-related expenditures due to an aging population; the worsening local fiscal situation, leading to an increase in the central government's allocation to local governments; economic downturns and tax reduction policies resulting in diminished tax revenues, are all significant contributing factors. In addition to the issuance of national debt, the accumulated total amount of long-term debt, including local government and the Japanese government's national debt interest, reached 94 million units (approximately 196% of Japan's GDP that year).

Although Japan may not fear a fiscal crisis, its colossal fiscal deficit still presents numerous pressing issues that need resolution. First, the enormous debt has constrained policy flexibility; second, the expanded scale of government-occupied funds could crowd out the financing capabilities of the private sector, thereby reducing economic vitality and efficiency; third, it could exacerbate generational inequities. Due to Japan's policy of wealth accumulation among its populace, the generation that contributed to Japan's economic development retired with significant pension funds. Now, while the younger and middle-aged generations may not earn much, they still have to pay social security contributions to the elderly, resulting in intergenerational inequity. Fourth, a decline in fiscal trust leads to a fall in national debt prices, long-term interest rates rise, causing negative impacts on the economy. For instance, if private borrowing rates increase, it would be akin to central bank rate hikes, leading to even more capital hesitating to enter the real economy, which would further negatively impact the economy [[10].

The Japanese government has been continually seeking ways to alleviate fiscal pressure. For instance, first, achieving a basic balance in the current fiscal year's accounts; second, increasing revenues and decreasing expenditures, including increasing the proportion of the consumption tax (from 5% to 8%) and issuing fewer bonds, as well as reducing social welfare (such as decreasing pensions and local taxes); third, implementing targeted policies, like addressing a host of social security issues brought about by an aging society with a declining birth rate.

3 Abenomics

Since taking office as Prime Minister, Shinzo Abe has implemented what is known as "Abenomics." Abenomics incorporates three critical aspects: First, substantially increasing the money supply and encouraging bank loans to businesses, thus striving to boost the real economy; second, increasing the Japanese government's fiscal expenditure; third, inducing businesses to increase investment in Japan through structural reforms [3]. However, despite implementing such robust measures, Abenomics has yielded only negligible effects on the real economy. Firstly, Japan's GDP did not grow; secondly, employment opportunities for Japanese citizens did not increase, and wages did not rise significantly. In contrast, Japan's stock market, the Nikkei Index, witnessed substantial growth. Yet, most of those keen on investing in the Japanese stock market are foreign investors, so the rising stock index does not necessarily indicate real earnings for small and medium investors. The core of Abenomics lies in creating expectations of inflation, using the prospect of rising prices to stimulate consumer spending, thus achieving the goal of boosting the economy in the short term [[6]. Yet, Abenomics still faces significant challenges, such as the massive debt of the Japanese government and the aging, declining population of Japan, which leads the general public to hold limited optimism for Japan's economy. Japan is already a highly developed capitalist society. If it wishes to achieve economic growth, it may need to explore new paradigms[7].

4 Discussion

Observations of Japan's fiscal issues and Abenomics have also prompted we to reflect on other matters.

Firstly, it pertains to how governments manage their fiscal issues. Observing Japan, one can discern how it has maneuvered its economic development primarily through extensive borrowing. Yet, would this strategy be suitable for other countries? In various developed countries within Europe, borrowing is also a common phenomenon. Taking Greece as an example, when it initially joined the European Union, it did not meet the Union's rules. Nevertheless, it managed to veil its fiscal issues through several economic subterfuges. Only upon the outbreak of the European debt crisis was it revealed that the country's finances were severely perforated. The sovereign bonds Greece issued to some developed European countries were in a state of default. If a country is on the brink of a fiscal crisis, it is doubtful that any foreign governments or individuals would be willing to lend to such a country's government. Subsequently, the country might have to issue sovereign bonds with higher interest rates to attract investors, which, in layman's terms, would significantly elevate its borrowing cost, trapping the government in a vicious cycle. Nevertheless, it can be observed that the Japanese government dares to borrow year after year to stimulate economic development. Apart from the reasons elaborated above regarding different entities buying the bonds, an important rationale is that the Japanese government holds a large quantity of unsold state-owned assets, such as one-third of Japan's land. Therefore, the fiscal problems of the Japanese government should be viewed from multiple perspectives. There exists a commonality between Japan and Greece: if a government's debt far exceeds its capacity to repay, struggling to repay the debt may not be the best choice. A potential turnaround might be issuing more bonds to attract domestic or foreign governments or individuals. On this front, Japan and Greece have taken similar approaches to a certain extent. Fiscal deficits do not necessarily imply a financial crisis. Conversely, China, an emerging economy, has amassed a vast amount of foreign exchange reserves by making money from developed countries like the United States and Japan, which in turn reflects its overcapacity. On one hand, the amount of China's foreign exchange reserves is astonishing, but one should not be misled by the surface figures.

Secondly, it is about how governments reduce wealth disparity to achieve common prosperity for all. The burgeoning debt of the Japanese government also has a significant cause: Japan purchases agricultural products at high prices from farmers and then sells them at lower prices in the market through government intervention. The difference in price is borne by the government. As a result, government finances become increasingly strained. However, it is undeniable that, despite the lack of economic development for twenty years, Japanese society remains orderly. The incredibly small wealth disparity has played a significant role. In contrast, China's economic development speed has been astonishing since the 1990s. Nevertheless, it must be recognized that such growth has come at a considerable societal cost. The first being the widening wealth gap, with China's Gini coefficient reaching 0.46, a rather alarming figure. When the economy develops, all social problems can be temporarily concealed. But particularly now, in an era when China's economic growth has slowed down, social conflicts could be exacerbated. Perhaps China cannot adopt the same model as the Japanese government to reduce the wealth gap, but it should take various measures to narrow this disparity, such as protecting local agricultural products and providing national subsidies to farmers.

Thirdly, it concerns the model of national economic development. Abenomics has not greatly stimulated Japan's economic development. A critical point is that Japan's aging population and declining birth rates are becoming increasingly evident, leading to growing disillusionment about future development. This is because the economy is largely determined by public expectations for the future, not the present. The rapid development of the Chinese economy since the 1990s largely depends on its demographic dividend and low-end manufacturing. However, as the labor costs in China's market continue to rise year after year, more developed countries are setting up factories in countries like Vietnam and Cambodia, where labor costs are lower. China's demographic dividend is being consumed. This is a wake-up call. Perhaps China needs to seek a new development model, and a crucial aspect of this would be innovation. State-owned enterprises need to undertake reforms, no longer relying on their monopolistic status in the domestic market.

Fourthly, Japan's stringent control over state-owned enterprises. In Japan, the annual budget of state-owned enterprises is required to be reported to the parliament, which greatly limits the power of state-owned enterprises. This ensures that every penny of taxpayer money is effectively used. Therefore, although Japan also has a centralized fiscal system, it is much more efficient than China. By contrast, the situation in China is concerning. First of all, many of China's state-owned enterprises have entered the world's top 500, but most of them rely on domestic monopoly, continuous state subsidies to acquire their status. Only a very small portion truly possess advanced management techniques and business models internally. Thus, the situation would be more worrying should they lose their market advantage in the future. Secondly, due to lack of competition and control, some of China's state-owned enterprises exhibit issues of extravagant spending and corruption. It is unthinkable in Japan that a state-owned enterprise could spend billions every year on buying Maotai liquor to entertain foreign guests.

Fifthly, the issue of wealth stored in the country versus wealth stored in the people. Although the Japanese government is heavily in debt, Japanese households are affluent due to long-term high welfare. In China, the vast majority of wealth is concentrated in the hands of a small number of individuals, and the country's foreign exchange reserves are staggering, but the per capita GDP still has a significant gap compared to developed countries. However, we need to dialectically and rationally view the issue of wealth stored in the country versus wealth stored in the people. The high government debt in Japan can, in turn, hinder economic development. Japan's economy has not experienced real growth for 20 years. It would also be unthinkable if China did not have a certain amount of foreign exchange reserves. However, the reality is, the two countries represent two nearly extreme cases. Japan urgently needs to stimulate domestic consumption and boost the real economy, while China also has to consider how long it can maintain its overcapacity and extensive economic development. Ideally, a balance should be struck between storing wealth in the people and storing wealth in the country.

5 Conclusion

The financial issues in Japan actually reflect various aspects of Japanese society, such as economic development models, education, political systems, and social issues related to declining birthrates and aging. These provide valuable references for other countries. How a country's government can balance a variety of social issues while pursuing economic development is indeed thought-provoking, with finance being just one aspect of the problem. Whether a strategy like Abenomics, which relies on the expectation of inflation to stimulate economic growth, is advisable is another issue. It is hoped that economic development can be more substantially reflected in the real economy, as opposed to industries that yield no tangible output, such as the stock market.

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