Supplementary Budgets and Fiscal Reconstruction

In December last year the Japanese government's draft budget for fiscal 2018 was adopted by the cabinet. It added the pursuit of fiscal consolidation to the two existing pillars of the economic revitalization plan, namely the human resources development revolution and productivity revolution, claiming to achieve both offensive and defensive goals. Simultaneously, and much less conspicuously, the cabinet also approved the draft ¥1.6 trillion fiscal 2017 supplementary budget.

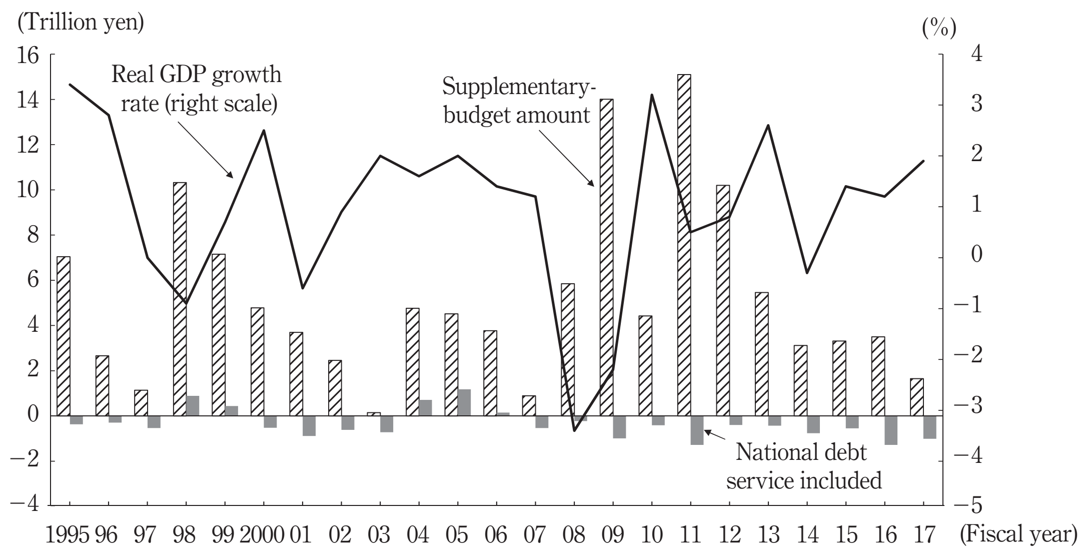
Supplementary budgets are provided for in Article 29 of the Public Finance Act, which empowers the cabinet to prepare supplementary budgets for the purpose of compensating for shortfalls to cover expenses and for payment of, or assumption of debt for, particularly necessary expenses incurred for reasons that arise after the drawing-up of a budget. This means that a supplementary budget is an additional budgetary provision in any fiscal year for addressing unforeseen expenses that arise after the principal budget is implemented, for example as a result of damage caused by major earthquakes or other natural disasters, or sudden slumps in the economy. Examples of large-scale supplementary budgets compiled in the past are the ¥14 trillion budget in fiscal 2009 in the immediate aftermath of the financial crisis caused by the collapse of Lehman Brothers, and the ¥15 trillion budget in 2011 to address the impact of the Great East Japan Earthquake, both of which were closely in line with the true intended purpose of a supplementary budget. Based on these examples alone it would be natural to suppose that supplementary budgets are drawn up in only a very limited number of years, but in fact they have been produced every year in a ceaseless stream since the Public Finance Act came into force in 1947.

The figure shows the trends in the amounts of supplementary budgets and real GDP growth rates in a time series in the past 20 years or so. From this it can be confirmed that the scale of the supplementary-budget amounts expanded at times when the economy's growth rate dipped for whatever reason, as if they were compensating for such declines. In contrast, it can be seen that when the "three arrows" of Abenomics came into operation and the economy was launched into its recovery phase, the scale of the supplementary budgets has diminished since fiscal 2014.

The problem here is the content of the budgets. As can also be seen from the figure, one component of supplementary-budget expenditure, namely national debt service, has been negative in a large number of years. The negative amount of national debt service indicates that when government-bond interest payments are likely to be less than anticipated in the initial budget, the surplus has been used as a source of funds for supplementary budgets. Since difficulties can arise if there are shortages of funds for interest payments during the course of a fiscal year, initial budgets understandably include somewhat inflated estimates of those costs, but there has been a negative figure for national debt service in almost every year with a few exceptions. This is presumably because the assumed interest rates at the time the amounts of government-bond interest payments are estimated are set at higher levels than the actual rates, with the result that it is easy for surpluses to arise. In reality, the interest rates assumed for interest payments recently have been 2% almost consistently, so the gap between them and actual interest rates has kept widening as the latter have been trending downward. The assumed interest rate has been lowered gradually since fiscal 2013 in tandem with the actual circumstances, but was nevertheless assumed at 1.1% in the initial budget for fiscal 2017, and given the current situation in which interest-rate levels for long-term government bonds have been lingering at around 0%, it appears that the divergence from actual rates is widening further. Against this background, it seems undeniable that the government, with the aim of achieving its policy goals, deliberately intends to incorporate surpluses in national debt service into a relatively inconspicuous supplementary budget as a source of funds for items that it deemed difficult to include in initial budgets.

As can be seen from the above, the proper purpose of supplementary budgets is to address unforeseen economic and social situations, and thus in phases of economic expansion such as the one at present they should not be drawn up automatically, simply because financial resources are available to do so. Amid the severe public finance situation, the proper approach would be to use surplus from national debt service for debt repayment and then, after subsequent consideration, discuss fiscal measures such as additional issuance of government bonds only if absolutely necessary expenses arise. It might not be an exaggeration to say that the inconspicuous drawing-up of a supplementary budget for a non-crisis period such as at present poses questions about the administration's true level of commitment to fiscal reconstruction.

Trends in amounts of supplementary budgets and real GDP growth rates



Note : The fiscal 2017 supplementary-budget amount and national debt service are government proposals; the GDP growth rate for the same fiscal year is a government forecast.
Sources : Ministry of Finance, Cabinet office