2

Fiscal Policy Works When It Is Tried

If the current Japanese stagnation is indeed the result of insufficient aggregate demand, what should be the policy response? Fiscal stimulus would appear to be called for, especially in a period following extended overinvestment that has rendered monetary policy extremely weak. Yet the statement is often made that fiscal policy has already been tried and failed in Japan. Claims are made of variously 65 to 75 trillion yen spent in total stimulus efforts since 1991, even before the currently announced package.[1] Both the Japanese experience of the late 1970s of public spending as a ''locomotive'' to little-lasting domestic benefit, and the worldwide praise for government austerity in the 1990s, have predisposed many observers to dismissing deficit spending as ineffective, if not wasteful. Could there really have been this much stimulus effort having so little effect?

The reality of Japanese fiscal policy in the 1990s is less mysterious and, ultimately, more disappointing. The actual amount injected into the economy by the Japanese government—through either public spending or tax reductions—was 23 trillion yen, about a third of the total amount announced. This limited quantity of total fiscal stimulus was disbursed in insufficiently sized and inefficiently administered doses, with the exception of the 1995 stimulus package. That package did result in solid growth in 1996, demonstrating that fiscal policy does work when it is tried. As on earlier occasions in the 1990s, however, the positive response to fiscal

1. For example, a 66 trillion yen number is given in *Bloomberg News*, 23 January 1998, while a 72 trillion yen number is given in ''Hashimoto's Response,'' *Wall Street Journal*, 25 March 1998.

stimulus was undercut by fiscal *contraction* in 1996 and 1997. On net, the Japanese fiscal stance in the 1990s was barely expansionary, and it is the *net* injection of stimulus into the economy that determines the minimum result.[2] In fact, the repeated reversals of fiscal direction and revelations of gaps between announced and implemented policies make even this near-zero net injection an overstatement.

I begin this chapter by establishing certain institutional patterns of the Japanese fiscal system that predispose economic policy to being less countercyclical than that of most other industrialized nations. Even controlling for these factors, discretionary fiscal policy in 1992-97 was barely countercyclical on average, rather than working to make up for these institutional patterns. I then chart the course of total Japanese government revenues and expenditures since the bubble burst, demonstrating that the actual discretionary fiscal response was limited, despite the apparently rising government-debt levels. The one large and effective stimulus package, from 1995, is analyzed in detail, as are the 1996 and 1997 budget measures that reversed its beneficial effects. In summary, Japanese fiscal policy in the 1990s should be seen as a failure of mistaken fiscal austerity and not of fiscal policy per se. The Japanese government got what it paid for in the 1990s—one good year of growth and little else.

Starting from a Cyclical Disadvantage

The Great Depression offered many important lessons for macroeconomic policy. One of the clearest and least controversial is that there is a role for government revenues and expenditures to automatically move in the opposite direction of the business cycle—taxes should fall as the economy slows, and public spending (through unemployment benefits and other social assistance) should rise. This ''leaning against the wind'' to stabilize economic fluctuations should take place irrespective of any discretionary fiscal policy added to it in times of more severe downturn. The fact that such stabilizers are automatic, however, does not mean that they are equally effective or ambitious in all countries. Before assessing the impact of Japan's announced additional stimulus packages, the overall baseline must be established for Japan.

Total Japanese government spending does not reveal obviously countercyclical tendencies. As noted in the previous chapter, except when it rose by 0.5 percent of GDP in the relatively strong growth year of 1986, government consumption rose by between 0.1 and 0.3 percent every year

2. This is a statement based on analysis of the actual amounts spent by the Japanese government and does not rest on any assumptions about ''fiscal multipliers'' (i.e., the likely ripple effect on the economy of a given stimulus). The ultimate effectiveness of fiscal policy once undertaken, and its long-run costs and benefits, are discussed in the chapter 3.

from 1984 to 1996 (see table 1.2), irrespective of the macroeconomic environment. In 1997, despite the slowing of Japanese growth to an unprecedented negative level, government consumption actually added nothing to growth. Public investment, if anything, moved somewhat procyclically in the last decades, adding over half a percent to GDP growth during the boom in 1987 and 1991, and shrinking in 1994, 1996, and 1997. Of course, these growth numbers include *both* the discretionary and automatic stabilization responses. Since it is impossible to imagine a scenario where the automatic stabilizers would ever go in the *wrong* direction—tax revenues rising as the economy slows or social spending declining as unemployment rises—absent a policy change, this time path of public investment implies that Japanese discretionary fiscal policy was sufficiently procyclical (i.e., in the direction of the downturn) to more than outweigh the appropriate built-in stabilization effects in those years.

The response of the government balance (i.e., the amount of deficit spending) to year-to-year fluctuations in GDP may give a better perspective on the limited countercyclical role of Japanese fiscal policy. Table 2.1 presents a comparative analysis of six of the G-7 governments' changes in fiscal policy with the cycle at the central and local levels.[3] For each country, the average share of government revenue in GDP is reported, as is the estimated coefficient of cyclical stabilization (β_2). This estimate comes from an ordinary least squares regression of changes in annual government (central, subnational, and combined) balances on that year's revenues, the previous year's government balance, a time trend, a constant, and the year-over-year real GDP growth rate, where β_2 is the coefficient on GDP growth.

Several matters are apparent among the six countries considered. First, the Japanese central government's response to cyclical swings in GDP growth is significantly less than that in Germany or the United States (less than 60 percent as much), and the total government response is less than half of that in Canada or the United States. This pattern is true even controlling for the time trend of rising US government deficits in the 1980s and early 1990s and even including the supposedly large Japanese fiscal-stimulus measures of 1992, 1993, and 1995.

Second, in fiscal terms, Japan looks more like the federal states in Canada, Germany, and the United States and less like the centralized British or French states, with subnational governments taking in about a third of total government revenue. Local-government stimulus must take on some of the burden for countercyclical responsiveness in Japan

3. Bayoumi and Eichengreen (1995) perform a similar analysis using data through 1990 and a different econometric technique. I am grateful to Tam Bayoumi for discussion of their methods. The other member of the G-7, Italy, is not included because such regressions were not stable over the sample period.

Table 2.1 Government cyclical stabilization, 1970-95

	Central government (including social security fund)			Subnational government			Central/subnational government revenue	Combined government		
	REV/GDP[a]	β_2	t-stat for β_2	REV/GDP[a]	β_2	t-stat for β_2		REV/GDP[a]	β_2	t-stat for β_2
Canada	0.196	0.227**	3.48	0.298	0.106	1.86	0.66	0.388	0.386**	3.846
Germany[b]	0.330	0.504	0.35	0.172	0.191**	3.40	1.92	0.441	0.129	0.315
United States	0.212	0.527**	5.79	0.133	0.060*	2.64	1.59	0.310	0.571**	6.469
France	0.543	0.004	0.28	0.084	0.002	1.15	6.45	0.591	0.003	0.706
Japan	0.243	0.296**	4.32	0.123	0.062	1.74	1.98	0.283	0.201*	2.227
United Kingdom[c]	0.300	0.213	1.70	0.109	0.033	1.44	2.74	0.396	0.241*	2.612

Note: Δ BAL/GDP(t) $= \alpha + \beta_1(\text{REV/GDP(t)}) + \beta_2(\ln(\text{Y(t)}) - \ln(\text{Y(t}-1))) + \gamma(\text{BAL/GDP(t}-1)) + \sigma(\text{t}) + \varepsilon$.

*(**)indicates significance of coefficients at the 5(1) percent level of confidence. Central and local government figures, which are fiscal-year basis, do not sum to general government figures, which are calendar-year basis.

a. REV/GDP column shows mean of REV/GDP for each country over the entire time period.

b. A dummy variable for Germany is included because after 1991 the government budget is based on a unified government. Dummy variable $= 1$ if year $\geqq$ 1991, 0 otherwise. It is significant at the 5 percent level of confidence in the local government equation, but is not significant in the central or general government equation.

c. 1995 United Kingdom data are not available; the sample includes data from 1970 to 1994.

Sources: OECD, *National Account, Volume II,* detailed table, various issues. IMF, *International Financial Statistics Yearbook,* 1997.

to be effective.[4]

Third, countercyclical responsiveness is not a function of the share of government in the economy. Japan and the United States have the lowest government-revenue-to-GDP ratios of the six economies (i.e., the smallest government sectors), yet they are on nearly opposite ends of the ranking for cyclical stabilization. Meanwhile, France—with the largest, most-centralized government sector—has the smallest countercyclical response.

There are some institutional reasons that Japanese automatic stabilization might be less than in some other countries, such as in the United States. In particular, the Japanese labor market is designed to rely on the adjustment of workers and employers to shifts in aggregate demand, rather than having the government share some of the burden. By most estimates, official measured unemployment only captures half the actual number of idle laborers—the other half are often retained on business payrolls, at sometimes 30 percent cuts in salary, even when demand for these firms' products declines (Ito 1992, chapter 8, 1994; Miyazaki 1997). There are microeconomic efficiency arguments for why this can be a rational policy for the Japanese firm, such as the cost of retraining workers when new ones are needed, or the effects on general loyalty and morale (see, for example, Aoki 1989, 1990). At a macroeconomic level, however, this means that while businesses' balance sheets are eroding, they are carrying more labor per unit of production. Had these workers actually been made redundant, the firms' costs would have fallen and the burden of supporting these workers would have been spread over the whole society. In the present system, those idle workers continue to pay withholding taxes to the government and take benefits from their employers rather than from the government. This means that the Japanese government's taxes decline less, and social transfers increase less, in response to the business cycle, than in an economy where the burden of unemployment is shared.

In addition, the government-provided social safety net in Japan is far smaller than that provided in the other G-7 economies. As Ostrom (1997) points out, the Japanese unemployment program is less generous than that of the United States, let alone those in Europe; before-tax benefits as a share of previous earnings are only 9.9 percent, the benefits last only six months, and only 40 percent of the unemployed receive benefits (see OECD 1997b; Layard, Nickell, and Jackman 1994). Social welfare spending is also at the bottom of the OECD as a percentage of GDP. While actual poverty is very rare in the wealthy Japanese society, and there is a great deal of self-insurance through private savings and family networks, this, too, serves to diminish the automatic response of fiscal stabilizers to the business cycle. When unemployment actually increases, as it currently is,

4. As discussed later in this chapter, part of the gap in fiscal stimulus in the 1990s arose because Japanese local governments refused to spend on public works anywhere near as much as the national government requested (see Ishii and Wada 1998).

the average rise in public spending is small, while the fall in consumption for those parts of the private sector affected by the downturn is large, effectively deepening the downturn.

In general, the institutional reliance on private self-insurance (such as private business supporting the hidden unemployed) in Japan can account for part of the demonstrated lower government responsiveness to the business cycle. If a significant portion of the society draws down its own resources simultaneously, and that is the part of the society already hit by the downturn, then we would expect a sharper change in national income than when the government spreads out the pain over all of society and smoothes out the expenses over many years.[5] In fact, this lack of a safety net, which encourages self-insurance, may make consumption (saving) more procyclical (countercyclical) than it otherwise would be, causing it to drop (rise) greatly in downturns. Yet even limited automatic stabilization is still countercyclical, and the assessment of limited Japanese stabilization presented here takes into account *all* of the discretionary fiscal policy in the 1990s as well—including *contraction* of total public-sector consumption and investment in 1996 (-0.1 percent of GDP) and 1997 (-0.5 percent). So, despite starting from a prior design that limits countercyclical response, discretionary fiscal policy was sufficiently austere to give the lie to claims of strong fiscal stabilization efforts in Japan in the 1990s.

The Size of the Budget and the Deficit

Another way of establishing the fact that Japanese fiscal policy in the 1990s was, on net, only mildly countercyclical is to recognize that most of the government deficits accumulating during the past seven years were the result of the downturn and not of any discretionary response to it. In other words, while large budget deficits were reported in the 1990s, structural deficits that measure what the revenue would be given full employment were much less. The cumulative amount of additional public debt taken on was not excessive either by Japanese historical or by international standards. There is no question that over a span of decades, less public debt is to be preferred to more, but there is also little question that the path of Japanese debt accumulation in the 1990s is consistent with repeated reversals of fiscal stimulus rather than with a sustained break from austerity.

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5. It is an empirical question whether the gains in, for example, labor-market efficiency from forcing workers to plan ahead and look after themselves ultimately outweigh the losses from larger macroeconomic responses to widely felt negative shocks. The 1996 *OECD Jobs Study* would emphasize the benefits of the former, but the repetition of some aspects of 1930s history in 1990s Japan in the absence of stabilization may turn out to be a counterargument.

Table 2.2 lists the size of recent Japanese government budgets, the number of bonds issued, and the year-to-year change, for 1991 through 1997. A 1965 law requires that public bonds in Japan be split between those issued for purposes of ''public investment'' (such as infrastructure construction) and those that feed into general revenues (special public bonds). The regular government budget is followed every year by a ''supplementary budget'' voted on around April, because any amendments offered to the Diet ruling coalition's original budget constitute a no-confidence vote if passed. The sum of these two budgets is the fiscal program for the year. Often, and throughout the 1990s, additional public works spending has been included in the supplementary budget and classified as ''public investment.''

In a time of minimal GDP growth, the central government budget has remained essentially stable since FY1993, with the combined initial and supplementary budgets fluctuating around 77 trillion yen, or 15 percent of GDP. There is no secular upward trend in government expenditure. As would be expected in a downturn, when tax revenues decline, however, bond issuance has risen as a percentage of total expenditure. From 1994 to 1997, significant numbers of revenue-generating special public bonds were issued; many construction bonds were issued as well. As of the end of FY1997, Japanese government bonds held directly by the private sector totaled 254 trillion yen, or 49 percent of GDP. When those bonds held in the ''special account'' are included, that is, largely those in the portfolio of the postal savings system, the outstanding bonds total 344 trillion yen or 67 percent of GDP. These are all seemingly large amounts.[6] Yet, as shown in table 2.2, the total amount of new government bonds issued, rather than just rolled over, was 79.4 trillion yen from 1992 to 1997. If the additional deficit spending in this period arising from discretionary fiscal stimulus had been the 70 trillion yen often claimed, then tax revenues would have fallen only 10 trillion yen below expenditures cumulatively in the period of Japan's most extended postwar recession, while automatic government expenditures would have increased as well. This is a patently absurd claim, even allowing for some revenue increase as a result of the government spending. Simple arithmetic proves that no such amount of net stimulus was undertaken. Assuming, quite reasonably, that the government issued only half of the bonds to compensate for a decline in revenues, fiscal stimulus for 1992-97, net of contractionary revenue-enhancing policies, is capped at 40 trillion yen (plus any amount of taxes generated by the stimulus), or less than 60 percent of the headline claims. As we will see, this number is an overstatement as well.

6. Whether that amount is large or small is discussed in chapter 3 (remember that the Maastricht criteria on government debt for prospective EMU members was 60 percent of GDP, and most members exceeded that amount in the end without market meltdown).

Table 2.2 Recent budget, 1991-97 (billion yen)

	General accounting, initial budget plan								Supplementary budget		
	Total		Public investment		Public bonds issued[b]		Special public bonds				
Fiscal year	Size	Percentage changes over previous year	Size	Percentage changes over previous year	Size	Bond/total[a] (percentage)	Size	Bond/total[a] (percentage)	Total (size)	Public investment (size)	Additionally issued bonds (size)
1991	70,347	6.2	6,666	6.3	5,343	7.6			266	761	1,387
1992	72,218	2.7	8,097	21.5	7,280	10.1			−728	1,844	2,256
1993	72,355	0.2	8,600	6.2	8,130	11.2			5,083	6,576	8,044
1994	73,082	1.0	11,146	29.6	13,643	18.7	3,134	5.2	349	1,625	2,847
1995	70,987	−2.9	9,240	−17.1	12,598	17.7	2,851	4.8	7,047	4,977	9,434
1996	75,105	5.8	9,618	4.1	21,029	28.0	10,118	15.9	2,666	1,599	1,339
1997	77,390	3.0	9,745	1.3	16,707	21.6	7,470	11.4	na	na	na

na = not available.

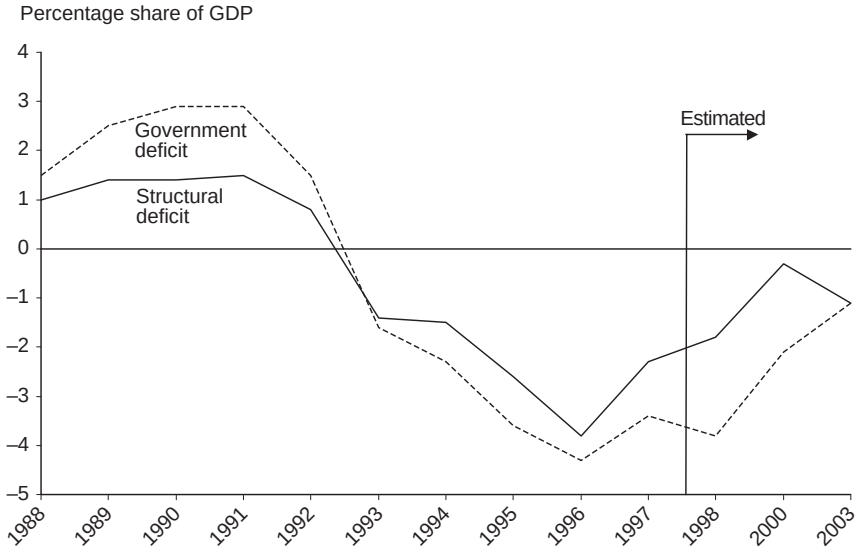
Note: Central government account only, not including local government bonds. In 1997, government bonds outstanding are as follows (accumulative figures): Stock of ordinary bonds (including construction and special bond) is 254 trillion yen, or 49.2 percent of GDP. When stock of bonds issued from special account is included, total is 344 trillion yen, or 66.6 percent of GDP. When stock of local government bonds is included, total is 476 trillion yen, or 92.2 percent of GDP.

a. Bond/total represents the share of that year's expenditure financed by issuing bonds.

b. Public bonds include all newly issued government bonds, including special bonds.

Source: Zusetsu Nihon no Zaisei, 1997, Toyo Keizai Shinposya, Tokyo, Japan: 340.

Figure 2.1 Government and structural deficit[a]



a. This refers to general and central government fiscal balances.

Source: IMF, *World Economic Outlook* 1998.

The way to separate discretionary fiscal stimulus from the additional deficit spending to make up for the revenue shortfall is to recognize that the structural deficit has remained limited in Japan in the 1990s, as one would expect for a government sector that remained stable in size.[7] Japan's potential growth rate is largely unchanged, as argued in the previous chapter, so its long-run capacity to support the same share of government in national income is also unchanged. Figure 2.1 shows that the structural deficit has moved less than appears in the official budget figures, exceeding 3 percent only in 1996. Not coincidentally, that was the one year that followed a large fiscal-stimulus package that was actually implemented. The fact that the structural budget deficit declined in both 1996 and 1997 and was projected to contract again in 1998 (prior to the announcement of the April supplementary budget) indicates that discretionary fiscal policy since the 1995 package has moved in the direction of austerity. The fiscal reversal of 1996-97 was actually opposite and more than equal to the stimulus of 1995 (the structural deficit in 1995 was 2.6

7. ''The structural budget balance is the budgetary position that would be observed if the level of actual output coincided with potential output. Changes in the structural budget balance consequently include effects of temporary fiscal measures, the impact of fluctuations in interest rates and debt service costs, and other non-cyclical fluctuations in the budget balance'' (IMF 1998, 35).

percent of GDP, and in 1997, 2.3 percent). Similarly, whatever discretionary policy there was in 1994 must have been contractionary, as the structural deficit rose only 0.1 percent in 1994 despite the fact that the 1993 stimulus should have given an ongoing increase to the deficit in 1994 because of the momentum of spending (as the 1995 program did to 1996). The total change in the structural deficit since 1992 is 5 percent of GDP, despite claims of 15 percent of GDP spent on stimulus packages. In all, the structural-deficit numbers confirm the start-stop, expand-retrench, fiscal policy indicated by the behavior of the public components of GDP discussed in the previous section.

To get a sense of the magnitudes involved, the highest annual structural deficit in 1990s Japan was 3.8 percent of GDP in 1996. This was comparable to or less than the highs of the United States (3.4 percent), Germany (4.0 percent), France (3.6 percent), the United Kingdom (4.4 percent), and Canada (4.6 percent) for the decade. However, none of these other countries suffered as great a recession, and so they had less justification for deficit spending. Table 2.3 puts recent Japanese fiscal expansion efforts in a longer-term comparative perspective. I identify a list of episodes of large discretionary fiscal impulses from a sample of 13 OECD countries from 1960 to 1992. Following Alesina and Perotti (1995), if a country in a given year has a Blanchard-measure fiscal impulse of greater than 1.5 percent of GDP, where that impulse is defined as the difference between an unemployment-adjusted measure of the primary deficit and the previous year's deficit, that impulse is classified as a major fiscal expansion.[8] In 28 episodes, deficits rose by more than 1.5 percent of GDP in a given year, that is, by more than any year-over-year increase in the Japanese structural deficit in the 1990s.

Obviously, not all of these increases in deficits were salutary. No country would want to use the history of Italian fiscal policy or the widespread stop-go budgetary policies of the 1970s as a model for fiscal policy. But even in the 1990-92 period, when fiscal probity was the order of the day among the many conservative majority parliaments, there were seven such major fiscal expansions. The important perspective is that there is indeed precedent for one-year fiscal stimulus packages on an even larger scale than Japan has undertaken in the 1990s. This leaves aside the Japanese government's net reversals of the more limited packages already undertaken. Claims made by Japanese officials that the scale of Japanese

8. See Blanchard (1993) for details. This measure is obviously analogous in intent to the year-to-year change in a more carefully constructed and country-specific structural deficit series, but it facilitates cross-national comparison. Alesina and Perotti (1995) point out in their broader study that using any of three other measures of changes in the budgetary position of the government to capture its fiscal stance produces an essentially unchanging list of expansionary episodes in their larger sample.

Table 2.3 Major fiscal expansions in OECD countries

Country	Year	Rise in deficit (GDP share)	Rise in expenditure (GDP share)	Cut in revenue (GDP share)	Real GDP growth (percentage)		Source of deficit
					Same year	Year − 1	
Australia	1975	3.4	4.7	−1.3	2.3	2.0	
	1976	0.9	1.2	−0.3	4.1	2.3	
	1991	1.6	1.9	−0.3	−1.5	1.4	Tax Cut and Expenditure
	1992	3.0	1.3	1.7	2.3	−1.5	Tax Cut and Expenditure
Austria	1967	2.7[a]	0.9	0.5	2.8	5.1	
	1975	2.4	3.1	−0.7	−0.4	3.9	
Belgium	1975	2.5	5.2	−2.7	−1.5	4.3	
	1981	4.3	5.2	−0.9	−1.0	4.1[c]	Expenditure
Canada	1975	2.0	1.4	0.5	2.6	4.4	
	1982	3.2	2.6	0.6	−3.2	3.7	Expenditure
	1991	0.5	0.7	−0.2	−1.8	−0.2	Expenditure
France	1975	3.0	3.1	0.0	−0.3	3.1	
	1981	2.2	3.0	−0.7	1.2	1.6	Expenditure
	1992	2.5	0.7	0.3	1.2	0.8	Both
Germany	1974	2.0	2.0	0.1	0.1	4.7	
	1975	3.0	3.1	−0.2	−1.2	0.1	
	1990	1.6	0.2	0.7	5.7	3.7	Unification
Italy	1965	1.7[b]	2.1	−0.4	3.3	2.8	
	1971	1.7[b]	2.3	−0.5	1.9	5.3	
	1972	0.8[b]	0.0	0.9	2.9	1.9	
	1975	5.6	6.2	−0.4	−2.1	4.7	
	1981	0.5	−0.1	0.6	0.5	3.5	Expenditure

continued next page

Table 2.3 Major fiscal expansions in OECD countries *(continued)*

Country	Year	Rise in deficit (GDP share)	Rise in expenditure (GDP share)	Cut in revenue (GDP share)	Real GDP growth (percentage)		Source of deficit
					Same year	Year − 1	
Japan	1975	3.4[a]	1.6	1.9	2.9	−0.6	Tax cut
Netherlands	1975	2.9	4.8	−2.2	−0.1	4.0	
	1987	1.3	1.8	−0.9	1.4	2.8	Tight fiscal policy
Spain	1982	0.5	2.8	−2.1	1.6	−0.2	Tight fiscal policy
Sweden	1974	1.8	1.9	0.0	3.2	4.0	
	1977	1.3	3.9	−2.8	−1.6	1.1	
	1979	2.4	−0.9	3.2	3.8	1.8	
	1991	2.6	0.6	2.0	−1.7[c]	1.4	Expenditure
United Kingdom	1971	2.5	0.3	2.2	2.0	2.3	
	1972	2.1	0.5	1.6	2.4	2.8	
	1990	0.8	2.2	−1.4	0.4	2.2	Expenditure
	1991	1.7	2.3	−0.1	−2.0	0.4	Expenditure
	1992	4.0	2.7	1.0	−0.5	−2.0	Expenditure
United States	1967	0.6[b]	1.8	−1.9	2.6	5.9	
	1975	3.3	2.7	0.5	−0.8	−0.6	

a. Without grants and lending, minus repayments.

b. Without grants.

c. Data are not consistent with earlier data.

Sources: IMF, *International Financial Statistics*, *Government Finance Statistics* (various years); OECD, *Economic Surveys*, *Economic Outlook* (various years).

fiscal expansion in 1995 or proposed for 1998 is extraordinary, or likely to have negative effects if exceeded, are simply unsupportable.[9]

The Reality of Japanese Stimulus Packages

Since Japanese fiscal policy has been barely countercyclical on net in the 1990s, what gives rise to the popular perception that a great deal of money has been spent in stimulus efforts? There is a two-part answer. First, all announced Japanese fiscal programs hugely overstate their stimulative content, usually by a factor of 2 or more. Second, the stimulus package implemented in the second half of 1995 and the early part of 1996 was indeed large, though not unprecedentedly so. In fact, the 1995 package was not only large, but also effective. It led to GDP growth of 3.6 percent in 1996 when most forecasts were for a full point lower, even when made after the package's announcement. As noted in the previous section, however, the combined contractionary policies of 1996 and 1997 completely offset the positive effects of the 1995 package. Since the contractionary policies have been consistently announced with far less fanfare than the expansionary packages, if with any notice at all, it is not surprising that this fact has been overlooked.

The recurring tendency for overstatement of Japanese government fiscal packages is demonstrated in table 2.4. Of the seven stimulus measures announced prior to this year, the one in September 1995 topped the list of actual stimulus at less than 60 percent of the headline amount; the other six injected into the Japanese economy less than half the amount claimed, and three had no direct stimulative content whatsoever. This is because for fiscal stimulus, it is actual deficit spending—either through increased public spending or tax cuts—that adds to demand. This amount is captured in the *mamizu*, or ''clear water,'' the total of new public investment projects in announced stimulus packages. Had tax cuts played a significant role in fiscal packages prior to this year's, they too would have been a source of real stimulus worth counting.[10] The total packages

9. ''This [1998 supplementary budget] is the largest package we have ever implemented. I haven't heard of any package like this in the rest of the world that amounts to an impact of between 2 to 3 percent of GDP. I would argue against any criticism of this package as being too small. It may be too big'' (Eisuke Sakakibara, vice minister of finance, quoted in *Nikkei Weekly*, 27 April 1998. See also ''Japan's Cabinet Backs Revival Plan,'' *The Washington Post*, A13, 25 April 1998). Sakakibara's claim was made based on the 1998 stimulus package of 16 trillion yen, or 3 percent of Japanese GDP (as argued at the end of this chapter, the actual stimulus is likely to be less than 1.5 percent of GDP, and smaller still in effect).

10. The pattern, however, has been to announce the number of tax code revisions included in a given fiscal package, even when the total change in effective taxes has been negligible. The 1998 package does include noticeable tax cuts on the order of 4 trillion yen, or 0.75 percent of GDP. Because these are temporary—their partial reversal in 1999 is already announced—they are likely to have much less than that effect. I provide more detail on this subject later in this chapter.

Table 2.4 Announced stimulus packages in the 1990s

	3/31/92	8/28/92	4/13/93	9/16/93	2/8/94	4/14/95	9/20/95
Economic situation							
Exchange rate, yen/dollar[c]	132.92	123.26	113.40	104.45	108.66	104.15	103.25
Discount rate (percentage)	3.75[a]	3.25	2.5	1.75	1.75	1.75	0.5
Nikkei 500 stock price (yen)	19,799	18,000	20,919	20,502	20,660[b]	16,304[b]	18,198[b]
Total package announced	390	10,700	15,230	6,418	6,020	4,800	12,810
Mamizu	0	4,240	5,082	1,500	0	2,700	8,000
Mamizu share							
of total package	0.0	39.6	33.4	23.4	0.0	56.3	62.5
of GDP[d]	0.0	0.9	1.1	0.3	0.0	0.6	1.6
Public investment incentives	0	2,100	4,210	1,268	5,710	na	0

na = not available.

Note: *Mamizu* is calculated as total public investment minus spending in the following year, purchase of land for future public works, and other asset transfers, and represents the amount that potentially increases GDP. *Private investment incentives* are announced government lending programs, which do not directly increase GDP. They do not include local government-processed expenditures.

a. Discount rate was reduced from 4 to 3.75 on 1 April 1998.

b. This is the price at the end of the day, while others are the monthly average.

c. These are the end of the day rate.

d. This refers to fiscal year-based GDP.

Sources: Nihon Keizai Shimbun, various issues; Masao Nishikawa, ''Keizai Seisaku (Economic Measure)'' *Nihon Keizai Jiten (Japan Economic Dictionary) 1996, Nihon Keizai Shimbun,* Tokyo, Japan; *International Financial Statistics,* various issues; Holt's Stock Market Report, gopher://wuecon.wustl.edu:671/11/holt; Federal Reserve Board Home Page, http://www.bog.frb.fed.us.

announced, however, always include many measures that are not *mamizu,* which have no direct effect on GDP growth.

''Private investment incentives,'' which are loan programs offered by government-affiliated institutions to the private sector, are one important example of such ''pumping up'' of the announced packages. There is a long history of government-directed lending in postwar Japan intended to serve public ends. It is made primarily through the Fiscal Investment and Loan Company (FILP) and the Japan Development Bank and uses Postal Savings funds recycled by the government.[11] Such lending may or may not be productive, but its predominant effect is on the *allocation* of funding among various investment projects, not on the total *level* of investment in the economy. If the postal savings were not channeled into the particular sectors emphasized by these stimulus packages, they would go into government bonds or other safe investments. They would not, however, add any more funds to the economy in the way that bond-financed public investment would. Especially in a period such as the 1990s when monetary ease, which has a far more direct effect on private investment than does government lending, has not been able to overcome the drag on investment demand of excess capacity and damaged balance sheets, it is difficult to imagine there being even small benefits from more aggressive government lending. Yet, as seen in the last line of table 2.4, such lending constitutes a significant portion of the announced packages.

Other items that have little or no effect on GDP growth but are often included in the stimulus package announcements are front-loading of previously committed public works programs, land and other asset purchases, and direct injections of funding into the financial system. Moving forward public spending already planned just shrinks future spending by an equivalent amount; even if forward-looking businesses and consumers do not take this into account when planning, and therefore discount the initial spending, this front-loading ends up being the stop-go stance of Japanese fiscal policy in miniature, with no net gain. Government purchases of assets have no direct effect on GDP because they simply reshuffle who owns what without creating any income or wealth. If I sell my house, and I get something close to fair market value for it, I put in my bank account the same amount that I transfer from my real estate assets when I complete the transaction. Put differently, no one believes that when a government privatizes a firm or service it is engaging in fiscal contraction by selling a public asset, and that is just the same transaction in reverse. Discussion of the merits of injecting public money into the financial system is given in chapter 5, but the essential point is that while the balance sheets of banks and the level of the Nikkei stock index will

11. See Bergsten and Noland (1993, chapter 3) and Noland (1993) for discussion of the FILP and other lending programs.

influence the *response* of the economy to a given policy, their repair is not strongly stimulative in and of itself without growth in the economy more broadly.

The actual size of the Japanese fiscal-stimulus packages in the 1990s should be thought of as their public investment content, which ranged from zero to 1.6 percent of GDP (in September 1995) and anywhere from zero to 56 percent of the announced figures. The total amount spent was 23 trillion yen, or 4.5 percent of a year's GDP. While a not insignificant amount of money, it is not a terribly large amount spread out over six-plus years of recession, with a total cost in wealth forgone of 8 to 10 percent of GDP (as argued in chapter 1).[12] The reasons for the repeated overstatement of these packages' actual simulative effect are difficult to fathom. As mentioned at the start of this chapter, a surprising number of the Japanese public and the foreign press have gained the false impression that total public investment has been very sizable in the 1990s, rather than the 23 trillion yen actually spent from 1992 until this year. Unlike in the case of monetary policy, however, a fiscal-policy surprise adds nothing to its effectiveness. The more sophisticated observers in financial markets and in Japanese and foreign governments know to mark down announcements of fiscal-policy stimulus by around half, depending on the details of the *mamizu* and tax measures.[13] Meanwhile, the OECD has gone so far as to suggest in print that there should be greater transparency in Japanese fiscal accounting (see OECD 1997c, 76).

One sensible albeit conspiratorial-sounding interpretation would be that repeated overrepresentation of fiscal stimulus is the result of an effort by the Ministry of Finance to be seen as acceding to political pressures to do something for the economy in the short run, while discrediting the effectiveness of countercyclical fiscal policy in the long run. As recounted in Sakakibara (1991), Schick (1996), and elsewhere, since the introduction of a ceiling on ministry spending requests for the 1961 budget, the Ministry of Finance's role in Japanese budgeting has been to establish budget totals at the start of the process, leaving the details of spending within those totals up to the Liberal Democratic Party (LDP) politicians and their interest-group constituents. The Ministry of Finance officials have been ideologically committed to opposing ''lax'' fiscal policy due to the future aging of the population and the memory of how long it took to bring

12. Figure 3.6 shows that the structural deficit increased by 5 percent over 1992-1996 (from a 1 percent surplus in 1992 to 4 percent deficit in 1996). Thus, the *net* effect of all tax and spending changes not explicitly counted in this 23 trillion yen of public expenditure was 0.5 percent of GDP. In other words, net discretionary fiscal policy is well summarized by these public-spending packages, minus whatever negative effect small rises and falls in taxes have.

13. See, for example, Feldman's (1998) analysis of this year's announced spending packages.

down the deficits that originated in the late 1970s (see, for example, Schick 1996, 31-48).[14] The Ministry of Finance also maximizes its power (or fulfills its role, depending upon one's interpretation) by casting the fiscal situation in as grim a light as possible. It calls attention to the Japanese government's gross debt and interest payments rather than their net levels, underestimates future tax revenues at the time of setting the regular budget, slows the disbursement of supplementary budget funds (since those budgets are passed with less initial input from the Ministry), counts as part of stimulus packages public works spending already programmed in multiyear investment plans, and, of course, consistently publishes the cumulative announced stimulus packages as if they were the actual amount of fiscal expansion. The ultimate significance of this active disinformation program is that by the time the Ministry of Finance completes its efforts, even the levels of stimulus given in the *mamizu* line of table 2.4 probably *overstate* the actual amount put into the economy.

The Plan That Worked Until Stopped

The Japanese government took two economic measures in 1995: ''Emergency Measures for Yen Appreciation and the Economy'' in April and ''Economic Measures Toward Steady Economic Recovery'' in September. Both were prompted by the sharp appreciation of the yen versus the dollar and the fall of the *Nikkei* stock average below 20,000 for the first time since 1992, with the expected negative effects on economic growth.[15] In both cases, the measures were adopted through supplementary budgets passed by the Diet (and, thus, outside the Ministry of Finance's general spending ceilings). The April measure consisted of a 2.7 trillion yen increase in actual government spending and a 0.1 trillion yen (800 yen, or less than $8 per capita) tax cut. The situation continued to worsen, prompting the Bank of Japan to cut its discount rate from 1.75 percent, where it had been held since mid-1993, to 0.5 percent by the time of the second supplementary budget of 20 September. The monetary effort was sufficient to reverse the yen's spike upward to 80/dollar, but any real economic effects of the rate cut would not be felt for at least a year.[16] A

14. Balassa and Noland (1988, chapter 6) argue that the unwillingness of the Ministry of Finance to countenance serious fiscal expansion was a primary reason for excessive monetary stimulus in the mid-1980s. The economic logic of this austerity stance is discussed in chapter 3.

15. A number of private-sector forecasters, including Dai-Ichi Life, Daiwa, Nippon Research Institute, Sanwa, and Salomon, forecast real GNP growth of 1 percent or less for 1995 at the time of the September package announcement.

16. As discussed in chapters 3 and 4, because the limited-interest elasticity of investment and other spending in the Japanese economy declined further in 1996 and 1997, this monetary loosening had little effect.

fiscal stimulus of such small magnitude would hardly be expected to reverse the momentum of declining expectations, especially since it was oversold as always, with the claimed total stimulus being 4.8 trillion yen.[17]

The September package, however, was a unique event in Japan in the 1990s. It was the only package to exceed both 50 percent of its announced level and 1 percent of GDP (see table 2.4). In fact, with a *mamizu* of 8 trillion yen in actual spending for the second half of FY1995 and into FY1996, it exceeded 1.6 percent of GDP.[18] Unlike the April 1995 package, the September package included a planned 6.9 trillion yen of prefectural and municipal government expenditure (2.3 trillion of which actually was a transfer from the central government and should not be counted twice). Pumping up the announced total, in typical fashion, were 3.23 trillion yen for ''promotion of efficient land use,'' 520 billion yen for ''expansion of loan programs of the housing loan corporation,'' 1.23 trillion yen for ''acquisition of land for public works projects,'' and 1.29 trillion yen in lending ''measures for small- and medium-size firms,'' all of which have no stimulative effect.

As shown in the first two columns of table 2.5, the total additional expenditure in the central government supplementary budget amounted to a little over 7 trillion yen. The increases were primarily in public works spending (4.98 trillion), education and science (0.72 trillion), and a difficult to trace ''miscellaneous'' category (1.10 trillion). Tax revenues declined by 3.05 trillion yen from the initial budget forecast as well, because of declining economic activity, not tax cuts. As summarized by the then head of the Economic Planning Agency, Isamu Miyazaki (1997, 289), ''The effect should be measured after deducting loans by government financial institutions, funds for individual projects by local governments and government spending for the efficient use of land. . . . Even when these are excluded, however, the total magnitude exceeds 8 trillion yen, which is believed to be sufficient to boost nominal GDP by about 2 percent over the next 12 months if these spendings [sic] are implemented properly.''[19]

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17. In fact, the previous announced fiscal package of the Japanese government, in February 1994, purported to inject 6 trillion yen into the economy but actually was 95 percent ''private investment incentives'' (i.e., loans, and a *mamizu* of zero). This was hardly an auspicious precedent for Japanese households to react to a package announcement and on which build confidence.

18. Though, of course, the package was claimed to be ''worth a total of 14.22 trillion yen, the largest measure ever in terms of working expenditures'' (Ministry of Finance, *Monthly Finance Review*, October 1995, 23).

19. The reference to ''if these spendings [sic] are implemented properly'' should be taken to mean if the Diet-legislated spending were fully implemented, rather than stalled or spread over a longer period by Ministry of Finance action. Some commentators have suggested that a contributing factor to the 1995 package's success was the presence of a strong Economic Planning Agency minister in the person of Isamu Miyazaki, who openly kept track of the actual amount spent.

Table 2.5 Japan's budget plans, 1995-97 (millions of yen)

	FY1995 Planned expenditure			FY1996 Planned expenditure			FY1997 Planned expenditure		
	Initial budget	With supplementary budget	Difference	Initial budget	With supplementary budget	Difference	Initial budget	With supplementary budget	Difference
Social security	13,924,412	14,548,037	623,625	14,287,943	15,000,360	712,417	14,550,145	15,460,100	909,955
Education and science	6,076,461	6,801,870	725,409	6,226,955	6,311,342	84,387	6,343,566	6,288,400	−55,166
Debt service	13,221,300	12,856,803	−364,497	16,375,197	16,083,851	−291,346	16,802,329	16,268,100	−534,229
Pensions and others	1,726,552	1,726,206	−346	1,659,022	1,658,681	−341	1,597,259	1,597,000	−259
Tax grants to local governments	13,215,395	302,115	−913,280	13,603,826	944,993	341,167	15,480,975	481,000	25
National defense	4,723,610	4,733,996	10,386	4,845,479	8,489,085	3,643,606	4,947,517	4,953,600	6,083
Public works	9,239,759	14,216,406	4,976,647	9,618,359	11,217,544	1,599,185	9,744,659	10,525,300	780,641
Economic cooperation	1,035,114	1,028,254	−6,860	1,071,486	1,078,999	7,513	1,088,486	1,096,300	7,814
Small businesses	185,691	639,262	453,571	185,523	204,450	18,927	186,517	255,900	69,383
Energy	681,862	711,983	30,121	692,283	696,206	3,923	686,017	680,700	−5,317
Foodstuff control	272,318	272,260	−58	270,484	310,380	39,896	269,194	308,000	38,806
Transfer to the individual investment special account	1,281,226	1,281,226	0	171,541	171,541	0	171,541	171,500	−41
Miscellaneous	5,053,420	6,149,255	1,095,835	5,061,826	685,000	−4,376,826	5,171,799	5,297,300	125,501
Reserves	350,000	200,000	−150,000	350,000	5,358,798	5,008,798	350,000	171,500	−178,500
Emergency stabilization fund				685,000	200,000	−485,000			
Adjustment to previous budget		566,335	566,335					150,000	150,000
Total	**70,987,120**	**78,034,006**	**7,046,886**	**75,104,924**	**77,771,231**	**2,667,257**	**77,390,004**	**78,533,200**	**1,143,196**

(continued next page)

Table 2.5 Japan's budget plans, 1995-97 (millions of yen) *(continued)*

	FY1995 Planned revenue			FY1996 Planned revenue			FY1997 Planned revenue		
	Initial budget	Budget with supplement	Difference	Initial budget	Budget with supplement	Difference	Initial budget	Budget with supplement	Difference
Tax and stamps	53,731,000	50,681,000	−3,050,000	51,345,000	51,736,000	391,000	57,802,000	56,266,000	−1,536,000
Income tax	21,348,000	19,564,000	−1,784,000	19,338,000	18,995,000	−343,000			
Corporate tax	13,695,000	12,714,000	−981,000	13,548,000	13,986,000	438,000			
Administrative fees, charges, nonindividual sales	14,569	14,569	0	14,670	14,670				
Enterprise and property income	18,926	19,282	356	21,737	21,737				
Sales of land and intangible assets	304,044	304,044	0	326,956	326,956				
Miscellaneous[a]	4,318,796	4,373,661	54,865	2,348,201	2,380,365	32,164			
Japanese government bonds	12,598,000	22,032,000	9,434,000	21,029,000	22,368,000	1,339,000	16,707,000	18,458,000	1,751,000
From previous year	1,786	609,450	607,664	19,360	923,503	904,143			
Total	**70,987,120**	**78,034,006**	**7,046,886**	**75,104,924**	**77,771,231**	**2,667,257**	**77,390,004**	**78,533,200**	**1,143,196**

Note: All figures are in millions of yen.

a. Miscellaneous includes revenue from public land, Bank of Japan horse racing association, automobile registration, foreign exchange local government share of public investment, public university tuition, licensing fees, etc.

Source: Ministry of Finance Statistics Monthly 5, no. 529, 1996, Ministry of Finance, Tokyo, Japan.

Table 2.6 Economic forecasts, 1992-98

FY	OECD[a]	IMF[b]	EPA[c]	Consensus[d]	Actual
1992	2.4	2.2	3.5	2.4	1.5
1993	2.3	0.3	3.3	1.4	0.1
1994	0.5	0.7	2.4	0.6	0.6
1995	2.5	1.8	2.8	1.4	0.9
1996	2.0	2.7	2.5	2.4	3.6
1997	1.6	2.2	0.1	1.6	0.9
1998	1.7	1.1	1.9	0.1	na

na = not available.

Notes:

a. OECD forecasts are taken from December of the previous year's issue of *Economic Outlook*.

b. IMF forecasts are taken from the May *World Economic Outlook* of the same year (except 1998, which is taken from December 1997 issue).

c. EPA forecasts are made in December for the following fiscal year (April-March).

d. Consensus forecasts are the average of private-sector April forecasts for the same calendar year.

Source: OECD *Economic Outlook*, various issues; IMF *World Economic Outlook*, various issues; Economic Planning Agency; *Keizai Hakusyo (Economic White Paper);* Consensus Forecasts.

In the end, the September 1995 stimulus package did add significantly to economic growth in 1996.[20] Not only was the actual real GDP growth of 3.6 percent significantly higher than the 0.9 percent recorded in 1995, it was at least 0.9 percent higher than the growth forecasted for 1996 by all of the major international institutions and the financial consensus (see table 2.6). This stimulative effect can largely be attributed to the fiscal package, although the decline in the yen also stemmed the decline in net exports (by −1 percent of GDP in 1995 and by −0.4 percent in 1996). There clearly were no crowding-out effects on nonresidential investment, which rose strongly in 1995 (by 1.2 percent of GDP) and 1996 (1.5 percent), while interest rates continued to drop. Despite the list of measures that were included in the September package announcement as a means of ''overcoming imminent problems'' (which included ''giving vitality to the security market'' and ''coping with the problem of nonperforming assets held by financial institutions'') and ''accelerating structural reform of the economy'' (including ''further promotion of deregulation''), there was actually no meaningful progress made on any of these fronts.[21] There was no other source of positive impetus to the Japanese economy in late 1995 and early 1996 that can be identified *except* discretionary fiscal policy.

20. The package was actually passed by the Diet on 18 October, and then implemented.

21. The quoted categories and subcategories of measures are taken from the ''contents'' list of the package (Ministry of Finance, *Monthly Finance Review*, October 1995, 25).

It must be pointed out, however, that there were tax factors outside the September 1995 package at work during this period. The Ministry of Finance had managed to get a consumption tax of 3 percent introduced in April 1989. This was part of an ongoing effort to switch from direct to indirect taxes so that any given amount of government revenue could be collected with minimum distortionary costs (an effort recommended and, to a lesser degree, shared throughout the OECD in the 1990s). In November 1994, the upper and lower houses of the Diet passed a temporary personal income tax cut of 5.5 trillion yen to be paid for by increasing the consumption tax to 5 percent starting 1 April 1997. Despite the clearly temporary nature of such an explicit one-for-one fall and rise in taxes over such a short time period, it had an immediate effect on aggregate demand. Private consumption (presumably brought forward by consumers) rose by 1.9 percent of GDP in 1995 and 1.7 percent in 1996, versus only 0.9 percent in 1994. As also might be expected, such a clear change in the form of taxation caused a shift in spending pattern as well as timing—the promised tax rise included an exemption that spending on residential construction would be taxed at 3 percent for the duration of the project, so long as the contract was signed by September 1996. Residential investment grew by 0.7 percent of GDP in 1996, the highest rate since 1987, after contracting in 1995. Despite the fact that the Diet debate over the consumption tax in November 1994, as well as during the lower-house election campaign of October 1996 (when the issue was reopened), centered on the Ministry of Finance's loudly enunciated justification for the eventual tax rise in terms of future social security costs, this temporary tax cut had real effects. In fact, the measure was intended to be revenue neutral, with some small long-run benefits by decreasing distortions, but it proved stimulative nonetheless.

In contrast, the 1996 budget and supplementary budget were contractionary. The combined planned expenditure of 77.77 trillion yen was slightly less than the 78.03 trillion yen of 1995, but it was a smaller fraction of a larger economy because the 1995 package did lead to growth. Revenues included essentially the same amount of taxes (51.73 trillion yen) and government bond issuance (22.37 trillion yen) as in 1995.[22] Table 2.5 shows that, hidden in the 1996 budget was a switch of 5.16 trillion yen into ''reserves'' (i.e., money not spent during the fiscal year), mostly from public works (3 trillion yen cut from 1995 to 1996). The planned budget for 1997 continued this pattern, slightly decreasing the same level of nominal expenditures (to 77.39 trillion yen) and cutting public works a further 1.5 trillion yen. On 1 April 1997, the contraction was compounded when the planned consumption tax rise from 3 to 5 percent was implemented.

22. Figures for the proportion of bonds rolled over for years after 1995 are not available at the time of this writing.

By the end of 1997, private consumption had declined by 0.7 percent of GDP and residential investment had dropped by 1.1 percent; combined with the contraction in public investment and flat government consumption, these domestic factors took 2.3 percent off Japanese GDP. Had net exports not grown by a remarkable 1.5 percent of GDP after the yen declined sharply—the largest contribution of net exports to the nation's GDP growth in two decades—the Japanese economy would have experienced not only negative growth of 0.3 percent of GDP, as it did, but an outright decline of historic proportions. This reversal from the solid growth of 1996 can only be attributed to the Japanese government's fiscal policy, including carrying through the consumption tax rise regardless of the consequences, because just as in 1995-96, no other significant factors changed during this period. The Asian financial crisis did not harm the Japanese economy in this period, given that net exports increased, no increases in distortionary regulation or special interest protection were passed by the Diet, and the financial system's fragility was if anything reduced by the year-plus of solid growth (though essentially unchanged). Fiscal policy works to expand the economy as well as contract it, when that is misguidedly tried.

Is Fiscal Stimulus Being Tried Today?

The ''Comprehensive Economic Measures'' stimulus package of 24 April 1998 is seen by many as the latest in a series of fiscal-stimulus efforts. While this statement is partially mistaken—the only real fiscal stimulus was undertaken (successfully) in September 1995—the package of spring 1998 proposed by the Hashimoto government is indeed expansionary. Unsurprisingly, it is far less expansionary than claimed at the time of announcement. The headline number given is 16 trillion yen, of which only 12 trillion yen, at most, are purported to be actual spending and tax measures. As usual, 4.3 trillion yen of the 16 trillion headline number consist of asset reshuffles (2.3 trillion yen for land acquisition and ''creation of land demand for the drastic redevelopment of cities'') and government lending (2 trillion concentrated in small- and medium-sized business lending, largely an automatic rise proportionate to the increase in postal-savings deposits), neither of which increase aggregate demand (Economic Planning Agency of Japan 1998).

Another 1.5 trillion yen of the remaining 12 trillion is a central government ''request [to] local governments to increase their independent public works without financial support from the central government''—a request unlikely to be fully met without a direct transfer of funds from the central government, which would mean a cut in spending elsewhere. As documented in Ishii and Wada (1998), local (i.e., prefectural, city, town, and village) governments spend on average about 65 percent of total govern-

ment revenue, and the national government can only request, not force, these subnational governments to increase their public works spending in line with the announced packages. The local governments have repeatedly exercised this right of abstension, as their debt has mounted; from 1992-1996, ''the local governments spent 3.7 trillion yen less than their initial budget. That is, the local governments not only failed to spend [the 6 trillion yen of solo local public works announced] in the supplementary budgets, but also spent less than their initial plans. This means that the local governments reduced capital spending by about 10 trillion yen'' (Ishii and Wada 1998, 6-7).

There is claimed to be 7.7 trillion yen in total public works spending in the April 1998 package. On the spending side, this leaves 3.6 trillion yen of public works (and 200 billion yen of ''disaster restoration works''), which do not require local government matching or solo action. This expenditure is to be concentrated in ''information and communications and science and technology,'' ''special projects for environment and new energy,'' and ''social welfare, medical treatment, and education'' (''Doubts Raised About Japan's economic Stimulus Program,'' Sandra Sagawara, *Washington Post*, D3, 5 June 1998). This would be a *mamizu* of 0.7 percent of GDP, less than half of the 7.7 trillion announced and, sadly, in line with all prior fiscal-stimulus packages. It is this 3.8 trillion yen of spending that passed the Diet in June 1998. The missing 2.4 trillion to bring the total up to the claimed 7.7 trillion is the expected local government contribution to joint spending projects. While this full amount is unlikely to be spent, even including it brings the total public spending package up to about 1.2 percent of GDP.

The tax side of the ''Comprehensive Economic Measures'' is a bit more complicated to assess, but it also ends up having much less stimulative effect on the Japanese economy than advertised. Between the consumption tax increase of April 1997 and the announcement of the current package a year later, one significant discretionary fiscal-policy act was implemented. In December 1997, an income tax reduction of 2 trillion yen was legislated, half of which was paid in February 1998 as a tax return from federal income tax and half of which will be paid from July to December 1998 as a local tax rebate.[23] This amounted to about 65,000 yen (about $480) for an average household of 2 adults and 2 children. The ''implementing additional and continued special tax cuts'' listed in the April 1998 package counts fully an additional 2 trillion yen temporary tax cut, which ''will reduce tax payments by 29,000 yen per year [per] individual taxpayer and 14,500 yen per dependent . . . from August 1, 1998.''

23. The December 1997 measure also included business and financial tax code changes that, while arguably improving the tax system's efficiency, only amounted to a negligible cut in taxes of 650 billion yen and so can be left aside for purposes of this fiscal-stimulus discussion.

Even this meager stimulus on the tax side is being undercut by its temporary nature. Another tax cut of 2 trillion yen is promised for FY1999, but that means that, *on net*, taxes will *rise* by 2 trillion yen next year because these are fixed lump-sum cuts rather than cuts in tax rates, and there was a total cut of 4 trillion yen in 1998. In other words, Japanese households are being told that they will pay 130,000 yen (typically) less in taxes this year than last year, but will pay 65,000 yen more in taxes next year than this year. Logic would have taxpayers smooth out their income by spreading the benefits of this year's cut over the next year and beyond and, thus, save much of the cut. The de facto temporary cut in consumption taxes in 1995 stimulated activity to a greater degree because it induced a shift in the composition and timing of spending in a way that a temporary income tax cut does not. The Japanese government acknowledges this reality by stating that the multiplier on income tax cuts is 0.46 within one year (Government of Japan 1998b), but this is misleading because it is the temporary nature of the cut that limits the multiplier effect below one.

Thus, the April 1998 stimulus package does not reflect the lessons of 1995, that is, that fiscal policy only works when it is tried. With a public works injection of 3.8 trillion yen from the central government (6.2 trillion yen, if we make the unrealistic assumption that all local governments will pay their full share of joint projects) and a temporary tax cut of 2 trillion yen, this year's package is an insufficient improvement on other fiscal stimulus packages undertaken in Japan in the 1990s: it consists of less than 60 percent of the amount announced in the headline (16 trillion yen), it totals a share of GDP (between 1.1 percent and 1.6 percent, depending on local government participation) below the appropriate size to make a difference to confidence, and it is structured to emphasize wasteful public construction projects and inefficient temporary tax changes. As is set out in chapter 5, a program of fiscal stimulus in which the stated amount equals the actual, in which that amount is sufficient to raise the growth rate above potential (meaning, as argued in chapter 1, above 2.0 to 2.5 percent of GDP) so that there is visible reemployment of excess labor and capacity, and in which the stimulus primarily takes the form of permanent income tax cuts, is a fiscal policy that would work.

The danger of the April 1998 package as passed by the Diet in June is not only that it will fail to restore growth to the Japanese economy in 1998—a matter of some urgency given the mounting downside risks to the Japanese and world economies discussed in chapter 4—but that it will also contribute to the myth that fiscal expansion in Japan has been tried and failed. Possible future claims by the Ministry of Finance and certain members of the LDP leadership that 12 or 16 trillion yen (rather than the true 8 trillion or less) was spent in 1998 to little or no avail could be used to support further fiscal contraction in 1999 or 2000. Similar contractions undertaken both openly and by hidden means in 1994, 1996,

and 1997, with reference to announced but unimplemented spending, had destructive effects. Future government packages must recognize that when the Japanese government paid for fiscal stimulus in 1995, it got economic growth, and that when it mistakenly pursued fiscal austerity in most of the remainder of the 1992-97 period, it got economic contraction.