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JAPAN: A TREASURE TROVE FOR APPROACHES TO DEALING WITH THE EUROPEAN CRISIS

Hajime Takata

The European debt problem and the European government bond crisis have grown to the point of undermining the world economy. Given this, how are European government bonds viewed from a Japanese perspective? It is this author's opinion that European government bonds are not purely national bonds but are instead analogous to local bonds in Japan, and that therein lays the true nature of Europe's problems today.

The author likens European government bonds to “local bonds” because the countries of Europe do not have the right to issue their own currencies. Indeed, from a Japanese perspective, European government bonds resemble “local bonds without local tax grants.” In Japan the creditworthiness of local bonds is supported by a fiscal balance system centered on local tax grants. The support provided by a scheme centered on local tax grants and numerous measures such as joint-issued bonds to shore up creditworthiness underlie the extremely high market valuation that Japan’s local bonds still enjoy today.

If Japan did not have local tax grants, then perhaps only Tokyo and other entities not currently receiving tax grants could rely on enough market confidence to issue local bonds. This is similar to the way that, with European government bonds, Germany and the Netherlands have maintained market trust because of their current-account surpluses, which could be interpreted as the market adopting an extremely objective view on circumstances in valuing European bonds today. In Europe’s case, however, there are not enough support elements to enhance trust in “local bonds without local tax grants” and no legal insolvency procedures in place for specific bond issues, making it only natural that investors ask for high risk premiums when investing.

Japan’s joint-issued bonds were first issued by 27 entities in April 2003 as a new and reliable means of procuring funding for local governments in the wake of investment and loan reform. With the participating entities bearing joint and several liabilities on a monthly basis, the bonds boast a greater certainty of redemption. Apart from this joint and several liabilities, a fund has been established – with each entity depositing part of its debt service funds in a commissioned bank – to enhance liquidity and ensure timely payments. There are arguments in favor of joint-issue bonds today in Europe as well, and it would be worth examining efforts that would boost fund-raising capabilities through joint-issued bonds for which European governments would bear joint and several liabilities within their fiscal schemes.

Revitalization measures for Japan’s local governments were put into place in the 2000s. Under the Act on Assurance of Sound Financial Status of Local Governments, local governments facing deteriorating public finances would be designated "Early Financial Correction Entities" or "Entities under Rehabilitation" and mandated to undertake systematic fiscal rehabilitation. More specifically, entities for which any of four indicators – real deficit ratio, consolidated real deficit ratio, real public debt expense ratio, and future burden ratio – are higher than the standards set for early financial correction will be required to undertake improvement efforts on their own to achieve early financial correction. Entities for which any of the three indicators besides "future burden ratio" is higher that the financial rehabilitation standards will be required to pursue steady financial rehabilitation with the involvement of the national government. Today's problems with the euro can be attributed to an inadequate framework of rehabilitation measures such as those above, and Japan's system would no doubt serve as a good reference in developing rehabilitation measures for Greece and other countries. The problems being faced by Europe due to starting out with a common currency system lacking an intra-regional restructuring scheme have become quite apparent.

Europe has already established the European Financial Stabilization Facility (EFSF), a financial support system that has become the core support for countries facing debt crises as a vehicle for backing the guarantees of national governments in the euro zone. The European Stability Mechanism (ESM) has also been created as a permanent relief mechanism succeeding the EFSF.

Fiscal integration and a fiscal balance system would likely be ideal for Europe, but time will be needed to develop these schemes. Consequently, support institutions centered on a financial loan system would undoubtedly be essential to provide support in this regard. The Japan Finance Organization for Municipalities might serve as a useful example in addressing this issue.

Looking back, the disruption in capital markets that followed the bursting of the bubble economy also impacted local finances. Japan's experiences in dealing with local government bonds for more than a decade offer a "treasure trove for crisis management" in the capital markets. Europe's financial authorities would be well-served by studying Japan's local government bond system.

Hajime Takata is the managing executive officer and chief economist of Mizuho Research Institute Ltd.