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How big is Japan's debt?

Japan recently has been experiencing a severe recession, with stagnant growth since 1992 and unemployment climbing to the record level of 4.4 percent. One traditional tool to combat recessions has been to increase government spending and/or lower taxes in order to increase demand for goods and services. To pay for this fiscal deficit, governments issue bonds to the public.

Just as individuals have limited funds to repay debt, governments have access to limited real resources and may be forced to default if they accumulate too much debt. Therefore, when governments spend to stimulate the economy, policymakers must consider whether the government can service the debt.

How big is Japan's debt? The gross debt is the value of total outstanding financial liabilities—bills and bonds. Net debt equals gross debt less financial assets—for instance, shares of stock and bonds—held by the government. The net debt may be more relevant because financial assets can be sold to service the debt.

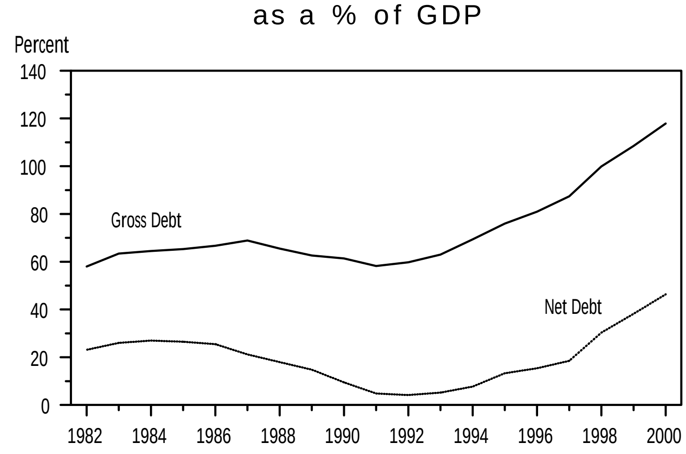
The Organization for Economic Cooperation and Development (OECD) projects the gross debt and net debt of Japan to be 109% and 38% of GDP, respectively, at the end of 1999. Japan thus has the lowest net debt—as a percentage of output—among the G-7. It will soon have the highest gross debt among the G-7, however. The difference between Japan's gross debt and net debt is very large, indicating that the Japanese government holds considerable financial assets. These assets are primarily bonds held for public pension liabilities and holdings accumulated from the government's role in financial intermediation. The Japanese government has long had an important role in matching savers with borrowers through the Postal Savings system and through the investments of the pension system.

The magnitude of the difference between the gross and net debt figures has contributed to disagreement about the ability of the Japanese government to service its debt. While conceptually, one would want to consider only net debt, two factors suggest that this figure undercounts Japan's true obligations. First, the Japanese government has enormous future pension obligations for its aging population. The assets set aside for this commitment cover only a small part of it. Second, the assets related to the government's role in financial intermediation are valued at their acquisition price, which probably overstates their current market value.

Indisputably, the liabilities of the Japanese government are rising rapidly. The OECD projects that the central and local governments in Japan will run a deficit equal to 7.8% of GDP in 1999. By contrast, the largest general (federal, state and local) government deficit of the United States during the 1980s was 4.1% of GDP in 1983. Although the Japanese government retains the resources to cover several more years of stimulative fiscal policy, no government can sustain large deficits indefinitely. Nevertheless, current low yields on long-term Japanese securities suggest that financial markets are not overly concerned about the magnitude of future deficits.

—Christopher J. Neely

Japanese Government Debt
as a % of GDP



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