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Spending caps and debt limits in the EU and Japan

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Chapter 1: Introduction

Perspective of the analysis of fiscal rules

This briefing paper will explore spending caps and debt limits in the European Union (EU) and Japan. There are two primary criteria in assessing such fiscal restrictions: what are the relevant targets and what is the legal framework in which those limits are implemented? In the European Union, the Maastricht Treaty and the Stability and Growth Pact (SGP) are designed to curb "excessive deficits" in Member States through the use of numerical targets measured relative to GDP. Member States—at least those adopting or hoping to adopt the Euro—are required to reach general government deficits below 3% of GDP and general government debt below 60% of GDP. On the other hand, one of the powerful spending caps in Japan has been the Guideline on Budget Request ("Ceiling"), set each year as an annual target of the budget aggregate against last year's budget. Recently, the government has also set a long-term fiscal target against GDP in addition to the Ceiling. However, these budgetary spending caps and debt limits are defined in the Cabinet Agreement, not by statute or treaty. As this comparison shows, it is necessary to answer the following questions to analyze the roles of spending caps and debt limits in various jurisdictions:

Analytical Perspectives of spending caps and debt limits[1];

(1) Are they hard or soft constraints?
(2) Who sets and enforces them?
(3) Which fiscal aggregates do they regulate?
(4) What should be the accounting basis applied in making and enforcing rules?

[1] Allen Schick, *The Role of Fiscal Rules in Budgeting*, OECD Journal on Budgeting, Aug. 12, 2004, at 17-23 (2003), *available at* http://www.oecd.org/dataoecd/12/24/33658155.pdf

Furthermore, in order to understand the function and effect of spending caps and debt limits, it is important to inquire into not only the target and legal framework but also the political and economic circumstances of the area under review.[2]

Fiscal balance in the EU and in Japan

The Appendices to this section provide an overview of fiscal balance in the EU and in Japan from three perspectives: (1) general government fiscal balance, (2) general government gross financial liabilities and (3) general government primary balances.[3] These data sets are useful because these figures tend to be the target of spending caps and debt limits.

The figures in Appendix 1-1 provide an international comparison of fiscal balance to GDP. Generally speaking, since the 1990s most developed countries other than Japan have partially succeeded in improving their fiscal condition. On the other hand, the Japanese fiscal balance has worsened, suffering the largest fiscal deficit among the major advanced economies as a result of its devotion to economic recovery. Maastricht and the SGP aim primarily at this figure.

The figures in Appendix 1-2 afford a comparison of gross financial liabilities. These statistics show that while most other developed countries are leveling-off or decreasing the amount of debt outstanding, Japanese gross debt has rapidly worsened to reach the highest level among developed countries. This figure is a secondary target under Maastricht and the SGP.

The figures in Appendix 1-3 are the international comparison of primary balances. Primary Balance is the fiscal balance reached after subtracting expenditures, excluding interest payment and debt redemption, from tax and other revenue, excluding borrowing.[4] The statistics show that the original EU member states virtually achieve the primary balance. Further, it shows that the Japanese primary balance has improved since FY 2002. The current long-term fiscal target in Japan is aimed at this figure.

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[2] *See id.* at 27-33.
[3] OECD, Economic Outlook
[4] For an explanation of the primary balance concept, see Chapter 3.

Chapter 2: Fiscal Restrictions in the European Union

In this section, we will examine the attempts by the European Union to place budgetary restrictions on member states. Thus far, the fiscal limitations imposed by the EU are an amalgamation of two sets of protocols: the Maastricht Treaty[5] and the Stability and Growth Pact (SGP). The latter consists of two regulations, 1466/97[6] and 1467/97,[7] and a resolution by the European Council.[8] At least on paper, the European Union places limits on the ability of member states to run yearly budget deficits and to carry debt, both measured relative to GDP. Both measures track consolidated, unified budgetary positions—that is, the fiscal position for all government activities, local or national, mandatory or discretionary, is included in the figures. First, we will examine the historical background and the specifics of these restrictions. This will be followed by an examination of compliance with these requirements from 1997 to the present. This section will then conclude with an examination of some of the reform proposals for the European fiscal caps.

Factual Background on the Maastricht Treaty and the Stability and Growth Pact

I. The Maastricht Treaty

The Maastricht Treaty, completed in 1992, had as its primary objective the creation of a European Monetary Union (EMU), the most salient components of which were the introduction of a common currency, the Euro, and the creation of a European Central Bank (ECB).[9] Pursuant to the creation a common currency and centralized control of monetary policy, the framers of the Maastricht Treaty also deemed it essential to set fiscal constraints on member states, in order to assure that national budget policy did not undermine the common monetary policy of the ECB. As such, Article 104 of the Treaty encapsulated what was known as the Excessive Deficit Procedure (EDP), to be implemented with the assistance

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[5] Treaty on European Union, Dec. 24, 2002, 2002 O.J. (C 325) 1 [hereinafter Maastricht Treaty].
[6] Council Regulation No. 1466/97, 1997 O.J. (L209) 1, *available at* http://europa.eu.int/comm/economy_finance/about/activities/sgp/sgp_en.htm (follow Council Regulation 1466/97 hyperlink).
[7] Council Regulation No. 1467/97, 1997 O.J. (L209) 6, *available at* http://europa.eu.int/comm/economy_finance/about/activities/sgp/sgp_en.htm (follow Council Regulation 1467/97 hyperlink).
[8] Resolution of the European Council on the Stability and Growth Pact, Amsterdam, June 17, 1997, 1997 O.J. (C236) 1, *available at* http://europa.eu.int/comm/economy_finance/about/activities/sgp/sgp_en.htm (follow European Council Resolution hyperlink).
[9] *See* Niels Thygesen, *Why Is Economic and Monetary Union an Important Objective for Europe?*, 14 Intl Rev. of L. and Econ. 133 (1994).

of the multilateral surveillance procedures of Article 99.[10] The EDP demanded that member states "avoid excessive government deficits," while also requiring the European Commission to monitor the deficit- and debt-to-GDP ratios for their conformance with "reference values," to be set by a Protocol annexed to the Treaty.[11] These reference values were famously set at 3% of GDP for "planned or actual" government deficits and 60% of GDP for government debt.[12] As noted above, these restrictions were applied to the consolidated, unified budget—this is also stipulated in the protocol, which notes that the measure of government finances shall apply to the "central government, regional or local government, and social security funds."[13] Also, as the restrictions apply to "planned or actual" deficits, sanctions can be applied to both estimates of future deficits and past realized deficits

Commentators have noted that the targets set in the Protocol seem arbitrary[14], or that they were, at minimum, "not based on a very rigorous macroeconomic analysis."[15] That these reference values were only adopted as a separate Protocol, annexed to the Maastricht Treaty, suggests that they were chosen only after significant deliberation, though the details of these deliberations are vague. However, as a report from a meeting of the Monetary Committee prior to Maastricht reveals, these reference values represented both a qualitative and quantitative compromise figure.[16] Historical data played an important role in setting the value, and the 3% target was a number that, it was thought, would catch a variety of countries with flawed budget policies—"fish of many sizes," as they are termed in the debate.[17] The reasons for this objective are not specified in the debate, but one can speculate that, in an environment where unanimity is essential, a target that would reach only the worst offenders would have

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[10] *See* Jorgen Mortensen, *Economic Policy Coordination in EMU: What Role for the SGP?* (Centre for European Policy Studies, Working Document No. 202, June 2004).
[11] Maastricht Treaty arts. 99, 104, *available at* http://europa.eu.int/eur-lex/en/treaties/selected/livre223.html#anArt6.
[12] Maastricht Treaty, Protocol on the Excessive Deficit Procedure, art. 1, *available at* http://europa.eu.int/eur-lex/en/treaties/selected/livre335.html.
[13] *Id.* at art. 2. Note that the inclusion of local and regional governments in the calculations renders unfunded mandates an inappropriate tool for avoiding excessive deficits in the EU.
[14] *See, e.g.,* Roel Beetsma, *Does EMU Need a Stability Pact, in* THE STABILITY AND GROWTH PACT, at 35 (Anne Brunila, Marco Buti, and Daniele Franco, eds., 2001).
[15] Mortensen, supra note 10, at 16.
[16] *See* Monetary Committee of the European Union, *Report by the Alternates on the Excessive-Deficit Procedure*, (April 12, 1991), *available at* http://europa.eu.int/comm/economy_finance/emu_history/documentation/chapter13/19910412en10reportexesdeficit.PDF.
[17] *See id*. at 3-4.

been a harder sell to the countries with the worst budget problems. By casting the net to reach "fish of many sizes," all nations would face some budgetary discipline, and politicians in the most fiscally strained states could sell reform to the populace as part of a European-wide belt tightening. Of course, the 3% target was also in step with the monetary policy under the new Central Bank, which aimed for yearly inflation below 2%.[18] Because debt burden relative to GDP is eased by inflation (which lowers the numerator by decreasing the value of debt held) and economic growth (the denominator effect), and debt burden is seen as better measure of the impact of fiscal policy on future generations, a 3% deficit target is consistent with maintaining the 60% debt ratio, given an assumption of 3% growth and 2% inflation.[19]

On the qualitative dimension, there was also considerable debate over what form the fiscal targets should take—should debt level or deficit be most critical, and how should either concept be measured? Although debt targets are, as was just noted, a better measure of the future burden of fiscal policy, a firm debt target was out, given the sizeable deficits in several prospective Euro members, notably Italy, Greece, and Belgium.[20] Of course, given the differing fiscal and economic positions of the EU member states, any measure chosen would create different winners. The 3% unified annual deficit figure, as measured against annual GDP—and, as the Treaty evolved, this measure proved most critical—was in competition with several other deficit measures. Targeting primary balances—a deficit measure that subtracts interest payment on debt, as noted above—was considered, in order to ease compliance for high debt Member States, though the relative silence of the literature on this proposal suggests it was not considered feasible. High debt countries were already a concern, and so there was unlikely to a consensus on coming to their aid. Another proposal aimed to target structural, rather than annual deficits, while another sought to apply the "Golden Rule" of structural budget balance, absent investment spending.[21] This "Golden Rule" was to be paired with a very low annual deficit target, perhaps as low as 0.5% of GDP.[22] This measure

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[18] *See,* Marco Buti, *Interactions and Coordination Between Monetary and Fiscal Policies in EMU: What Are the Issues?, in* MONETARY AND FISCAL POLICIES IN EMU: INTERACTIONS AND COORDINATION, at 1 (Marco Buti, ed., 2003).
[19] Appendix 2-1 demonstrates this correlation, while also charting appropriate deficit levels given other rates of annual GDP growth.
[20] *See* Appendix 1-2.
[21] *See Report by the Alternates, supra* note 16, at 2-3.
[22] *Id*.

had several advantages over a target for annual deficit spending, not least of which was that, by allowing deficit spending related to "investments," the measure would allow for the infrastructure spending the Mediterranean countries insisted played a large role in their annual deficits, and which they also insisted was essential for convergence with the more developed northern European economies. The measure would also be useful to Germany, which, in the wake of unification, was spending enormous sums to develop the eastern German economy. Targeting structural deficits—the average deficit throughout the economic cycle, rather than the annual measure—also seemed useful, as the rule would allow the automatic stabilizers (the policies that, absent change, shrink the Treasury in times of economic decline—as tax revenues shrink and payments, for things like unemployment and welfare, rise—and aid it in times of growth) to function freely, rather than risking pro-cyclical (and politically unpopular) fiscal decisions like raising taxes to meet annual targets during a recession. Of course, the significant downside is that such measures are far harder to monitor, as most budget data and planning was on an annual basis, and what constitutes "investment spending" can be notoriously hard to define. The 3% annual target seemed to be valued for its simplicity and clarity, as much as anything.[23] Of course, this target also comports with the discussion of protecting investment spending under the Golden Rule: when the 3% target was negotiated, public investment spending amounted to roughly 3% of GDP in Europe.[24] Further, a 3% target is also compatible with a goal of zero structural deficits—i.e., a balanced budget in the medium term—as the later debate over the Stability and Growth Pact reveals.[25]

II. The Stability and Growth Pact

Although Maastricht had set targets for deficit and debt levels at 3% and 60% of GDP, respectively, the provisions of Articles 99 and 104 had little to say about enforcement. As monetary union came closer to fruition, this laxness began to worry Germany in particular, whose population was reluctant to embrace the Maastricht Treaty, as it came at the cost of

[23] *See* Beetsma, *supra* note 14, at 35.
[24] *Id.* at 46.
[25] *See* Declan Costello, *The SGP: How Did We Get There?, in* THE STABILITY AND GROWTH PACT, at 114-16 (Anne Brunila, Marco Buti, and Daniele Franco, eds., 2001).

sacrificing the Deutschemark.[26] Although other nations were open to changes in theory, the legal basis for such changes was unclear: no one wanted to reopen consideration on the terms of Maastricht, least of all Germany, which feared that renegotiating Maastricht could weaken the fiscal restrictions already on the books.[27] As such, the SGP could only exist within the existing treaty framework, as secondary legislation on the provisions of Articles 99 and 104.[28] Although these articles already contained significant provisions for fiscal discipline—reports by the Commission, fines or non-interest bearing deposits for violators—the prescriptions were vague. Article 104 allows that the reference values can be exceeded in "exceptional and temporary" circumstances, and leaves the conditions for punitive sanctions ill defined, allowing ample room for regulations from the European Council to define compliance standards.[29] Of course, this approach also left the punitive provisions for excessive deficits within the discretion of the European Commission and the Economic and Financial Affairs Council (ECOFIN), as provided by Maastricht, rather than the automatic sanctions initially sought by Germany.[30]

After several rounds of negotiations,[31] the text of the Regulations constituting the Pact emerged, the primary features of which were improved monitoring of the budgetary conditions of Member States and punitive procedures for states with excessive deficits. In addition to reinforcing the Maastricht requirement of annual deficits below 3% of GDP, the Pact also promotes a medium-term fiscal goal of budgets, "close to balance or in surplus," which plays a central role in budgetary assessment and recommendations for change under the SGP.[32] In addition to providing an additional focal point for budgetary assessment, this medium-term goal provides the underlying rationale for converting the 3% reference value

[26] *See* Juergen Stark, *Genesis of a Pact*, *in* THE STABILITY AND GROWTH PACT, at 83-84 (Anne Brunila, Marco Buti, and Daniele Franco, eds., 2001).
[27] *See id.* at 85.
[28] For more on the legal problems, *see generally* Costello, *supra* note 25, at 110-14.
[29] Maastricht Treaty, *supra* note 11, at art. 104, cl. 1.
[30] Stark, *supra* note 26, at 91.
[31] I will elide the series of proposals and counter-proposals that formed the debate on the creation of the SGP, except to illuminate a few specific features of the Pact, below. For more information, *see generally* Costello, *supra* note 25.
[32] *See* Jonas Fischer and Gabriele Giudice, *The Stability and Convergence Programmes*, *in* THE STABILITY AND GROWTH PACT, at 161 (Anne Brunila, Marco Buti, and Daniele Franco, eds., 2001).

from a target under Maastricht to a hard ceiling under the SGP.[33] As noted above, a structural budget that is close to balance will allow automatic stabilizers to function in an economic downturn without a risk of breaching the 3% ceiling. Progress towards the medium-term target was also to be outlined in the Stability and Convergence programs that were to be submitted to the Council and Commission under the monitoring conditions of Regulation 1466/97.[34]

The monitoring conditions of Regulation 1466/97 are an important, though less commonly cited, provision of the Stability and Growth Pact. The regulation lists minimum requirements for the budgetary information that is to be submitted to EU bodies by March 1 of each year (which is intended to be roughly concurrent with the domestic adoption of budget proposals).[35] The information to be included in these Stability (for countries adopting the Euro) and Convergence (for the accession countries and current members not participating in the Euro) Programs includes information on medium-term budgetary targets, adjustments taken to reach them, estimates on the general government debt ratio, a description of future programs and a quantitative assessment of their budgetary impact, as well as any economic assumptions and how changes to those assumptions would impact the deficit and debt position.[36] Information must be provided on the current and preceding year, as well as estimates for at least the following three years.[37] This allows the reports to serve as an "early warning system" for nations planning to exceed deficit limits. Reporting differences between the Stability and Convergence Programs are minimal.[38] In both instances, reports must be provided for the "general government," which includes the central government, state and local governments, and social insurance funds.[39] These Programs are public records,[40] and are reviewed by ECOFIN and the European Commission, with a deadline for review by ECOFIN within two months of submission.[41]

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[33] *See* Costello, *supra* note 25, at 114.
[34] Regulation 1466/97, *supra* note 6, at § 2, art. 3, cl. 2(a), and § 3, art, 7, cl. 2(a).
[35] *See* Fischer and Giudice, *supra* note 32, at 159.
[36] *See id.*
[37] Regulation 1466/97, *supra* note 6, at § 2, art. 3, cl. 3 and § 3, art. 7, cl. 3.
[38] *See* Antonio J. Cabral, *Main Aspects of the Working of the SGP*, *in* THE STABILITY AND GROWTH PACT, at 141 (Anne Brunila, Marco Buti, and Daniele Franco, eds., 2001).
[39] *See* Fischer and Giudice, *supra* note 32, at 160.
[40] Regulation 1466/97, *supra* note 6, at §2, art. 4, cl. 2 and § 3, art. 8, cl 2.
[41] *Id.* at §2, art. 5, cl. 2 and § 3, art. 9, cl 2.

These monitoring conditions are also the primary way in which the SGP affects the accession countries and other EU members remaining outside the Euro. All EU members not participating in the Euro are still required to submit Convergence Programs, including substantial data on deficit and debt levels, to the Commission. As noted above, these Programs are nearly identical to the Stability Programs submitted by Euro members, although the Convergence programs also require submission of monetary policy objectives, including price and exchange rate stability goals.[42] Nations not adopting the Euro are still expected to abide by the Maastricht fiscal targets, and ECOFIN has issued numerous excessive deficit warnings to new member states—in 2004, the Czech Republic, Cyprus, Hungary, Malta, Poland and the Slovak Republic all were found to have excessive deficits.[43] Such warnings, however, and any political stigma they carry, are the limits of the targets' impact outside of the Euro area.

In addition to more detailed reporting provisions, the SGP, through Regulation 1467/97, also provides for more robust enforcement of the quantitative targets of the Maastricht Treaty. Under Article 104, and the annexed Protocol setting the reference value, a deficit over 3% percent was not to be considered excessive provided it was "exceptional and temporary."[44] A significant portion of the debate leading to the adoption of the SGP concerned the definition of what would constitute exceptional circumstances for purposes of enforcing the 3% deficit ceiling; indeed, this was considered the make-or-break clause, since a loose definition could vitiate enforcement of the deficit ceiling.[45] Germany fought for a definition of "exceptional" as an annual decline in GDP of at least 2%, based on their estimate that automatic stabilizers in the average member state would lead to an increased deficit of between 0.5 and 0.6% of GDP for each 1% decline in GDP growth—ergo, provided the medium-term budget targets were met, only at that level of recession should deficits breach the 3% reference value.[46] The European Commission, however, provided an historical analysis showing that only 13 times (out of a possible 540) had one of the EU-15 countries

[42] *See* Cabral, *supra* note 38, at 141.
[43] Jurgen von Hagen, *Fiscal Rules and Fiscal Performance in the European Union and Japan*, 24 MONETARY AND ECONOMIC STUDIES 25, 32 (March 2006), *available at*: http://www.imes.boj.or.jp/english/publication/mes/2006/me24-1-2.pdf.
[44] Maastricht Treaty, *supra* note 11, at art. 104, § 2(a). *See also, generally,* Cabral, *supra* note 38.
[45] *See* Costello, *supra* note 25, at 120. *See also* Stark, *supra* note 26, at 95-104.
[46] *See* Costello, *supra* note 25, at 121.

seen this level of economic decline in the years from 1960 to 1996.[47] By comparison, the United States has only seen an annual decline in GDP beyond 2% once since the Great Depression—in 1946, in the wake of demobilization after World War II.[48] As such, what emerged was a two-tier solution: any decline in GDP beyond 2% would automatically be considered exceptional, and not trigger sanctions, while a decline between 0.75% and 2% could be considered severe, depending on the supporting evidence and the discretion of the Commission and Council.[49] "Temporary" was defined more loosely, rather than by a precise timeline, as Germany sought: a deficit would be considered temporary if Commission forecasts indicated that it would "fall below the reference value following the end of the unusual event or the several economic downturn."[50] The term "unusual event" provided a second safety valve in the face of a natural disaster or other non-recessionary budget shocks, an exception that aided consensus on accepting the stringent standards for "severe economic downturn."[51]

Regulation 1467/97 also provides a timetable and standards for the imposition of sanctions, should a Member State breach deficit targets. The timetable allows sanctions to be imposed within ten months of the submission of data indicating an excessive deficit.[52] The ten-month time frame is a worst-case scenario, however, limited to an instance where a Member State disregards ECOFIN recommendations for correction of an excessive deficit, which must be made within three months of data submission.[53] The Member State has four months after the initial recommendation to take corrective action—if it complies, the sanctions procedure will be put in abeyance; if not, ECOFIN will issue another notice, which must be addressed within one month, or sanctions will begin in another two months.[54] If sanctions are implied, a non-interest bearing deposit of 0.2% of GDP, plus 0.1% per point of

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[47] *Id*.
[48] *See* Samuel H. Williamson and Lawrence Officer, *What Is the Average Annual Growth Rate of Various Historical Economic Series* (Economic History Services, March 2006), *available at* http://www.eh.net/hmit/growth.
[49] *See* Costello, *supra* note 25, at 121-22.
[50] *Id*. at 122 (citing Regulation 1467/97, *supra* note 7, at § 1, art. 2, cl. 1).
[51] *Id*.
[52] *See* Cabral, *supra* note 38, at 145.
[53] *Id.*
[54] *Id.* at 145-47. *See also* Appendix 2-2.

deficit over 3% (not to exceed 0.5% of GDP), is required from the Member State.[55] This deposit will be returned if the situation is corrected within two years; otherwise, the deposit is converted into a fine.[56] If the state continues to refuse to take corrective action, a new deposit can be required each year.[57] Though the public nature of the process was intended to apply political pressure to Member States as well, the deposit requirement was the most salient and feared respect of SGP enforcement.

III. Implementation

In this section, this paper will examine the progress of the SGP from its inception to the present. The failure of ECOFIN in 2003 to take action against France and Germany has overshadowed the earlier years of the Pact, when it was generally viewed as a success. We will look first at these earlier years, before examining what happened in 2003 and the subsequent changes to the SGP in light of those events.

The initial years of the SGP showed almost universal improvement in fiscal positions across the Euro Area, as well as substantial progress towards the medium-term target of budgets "close to balance or in surplus."[58] As can be seen from the figures in Appendix 2-3, from the time the Pact took full effect in 1999, through 2001, none of the states adopting the Euro would breach the 3% deficit ceiling, according to the estimates of the European Commission. In the first full year of the Pact, ECOFIN issued findings encouraging Austria, Germany, Portugal, France and the Netherlands to improve their positions relative to the medium-term goal, and for Italy and Belgium to work to improve their debt ratios;[59] whether or not this can be traced to the exhortations of ECOFIN, all did. Of course, given the general strength of the global economy over this period, the SGP is seldom credited for this improvement, particularly in retrospect. Also, as the figures in Appendix 1-1 reveal, the progress in the early years of the SGP was a continuation of the improving fiscal positions seen in the EU in the mid-1990s, prior to adoption of the Pact. As some scholars have

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[55] *Id.* at 149-50.
[56] *Id.*
[57] *Id.*
[58] *Id.* at 152. *See also* Appendix 2-3.
[59] *See* Fischer and Giudice, *supra* note 32, at 161.

suggested, it may have been fear of being denied entry to the Euro that provided the biggest impetus towards improving deficit positions.[60] Once the Euro was adopted, and especially when notes and coins were introduced in 2002, there may have been less pressure to maintain fiscal norms.

The pressure to exceed the fiscal caps mounted as the fortunes of the EU economies began to deteriorate in 2001, and initial forecasts of budget positions for that year were shown to have underestimated deteriorating deficit positions.[61] Late that year, the European Commission warned Member States not to allow their budget deficits to exceed 3%, as it promised to strictly enforce the Pact.[62] In January 2002, shortly after the Euro was put into circulation, the Commission issued a report including a warning that both Germany and Portugal, with deficits as 2.7% and 2.2% of GDP, respectively, should rein in their budgets or risk future sanctions.[63] The Council, however, declined to issue further, formal warnings to Germany, then in greatest risk of a breach, in exchange for a vague commitment to take "discretionary measures" to return the budget close to balance; Juergen Stark, then-VP of the Bundesbank, criticized this move as undermining the SGP.[64] The Council justified its failure to issue further warnings as a response to the upcoming federal elections in Germany—though a warning was finally issued in 2003, after the elections.[65] As 2002 progressed, it became clear that France and Italy were also in danger of crossing the 3% threshold, and by September of 2002 Portugal had announced a deficit over 4%.[66]

The Commission responded quickly to the Portuguese situation, initiating the first step of the sanctions process by issuing a report on September 24, 2002 that Portugal had breached the 3% ceiling.[67] Six weeks later, ECOFIN took further action, agreeing with the Commission that an excessive deficit did exist in Portugal.[68] A new Portuguese government

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[60] *See, e.g.,* von Hagen, *supra*.note 43, at 31.
[61] Refer to Appendix 2-4, which includes the revised figures for deficit positions in 2001.
[62] *See* Paul Libretta, *The Economic and Monetary Union: A Standards or Rules-Based Institution?*, 29 Brook. J. Int'l L. 409, 420 (2003).
[63] *See id.* at 421.
[64] *See id.* at 421-22.
[65] von Hagen, *supra* note 43, at 32.
[66] Libretta, *supra* note 62, at 422. *See also* Appendix 2-4.
[67] *See* Mortensen, *supra* note 10, at 12.
[68] *Id.*

that had taken office in April 2002 had already begun to respond to the problem by raising the VAT rate and cutting expenditures on public investments, but the ECOFIN report declared these measures insufficient.[69] Following the report, the Portuguese government took further corrective action, and by February 2003 the Commission revised its forecasts, estimating a budget deficit just below the 3% threshold for 2003 and lower still in 2004.[70]

France and Germany were a far greater test for the resolve of the Council and Commission under the SGP—as the two biggest economies in Europe, they account for roughly half of the total GDP of the Euro Area.[71] To begin the sanctions process—which could swiftly lead to significant monetary penalties against the Euro Area's main economic engines—presented significant political hurdles, despite that Germany was the initial proponent of the SGP, and France also a strong early supporter. Nonetheless, in January of 2003, as noted above, ECOFIN announced that an excessive deficit situation existed in Germany. The same step was taken with France in June, with deadlines for corrective measures placed on the German and French governments on May 21, 2003 and October 3, 2003, respectively.[72] As neither government acted in accord with the Council recommendations, the Commission recommended that ECOFIN proceed with sanctions against France (in October) and Germany (in November).[73]

As was noted in the discussion of the SGP above, due to the legal constraints imposed by Maastricht, enforcement of the Pact was still at the discretion of a vote by ECOFIN. The Council voted on the Commission's recommendations on November 25, 2003, but a qualified majority would not agree to sanctions. Under Maastricht, the "qualified majority" requirement entails that decisions by the Council must command a supermajority of roughly two-thirds of Member State votes, based on population.[74] Member States already found to

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[69] *Id.* at 13.
[70] *Id.*
[71] Refer to chart in Appendix 2-5.
[72] Mortensen, *supra* note 10, at 13.
[73] *Id*.
[74] For background on qualified majority voting in the EU, *see generally* Vaughne Miller, *The Extension of Qualified Majority Voting from the Treaty of Rome to the European Constitution* (House of Commons International Affairs and Defense Section, Research Paper 04/54, July 7, 2004), *available at* http://www.parliament.uk/commons/lib/research/rp2004/rp04-054.pdf.

have an excessive deficit are not included in the voting, so Germany and France could not directly influence the proceedings.[75] Nonetheless, despite that an affirmative vote only entailed setting a time period for deficit reductions—not fines—only six Euro members voted in favor of moving forward: Belgium, Greece, Spain, the Netherlands, Austria and Finland.[76] Other countries no doubt hoped for their own dispensation for high deficits (Italy and Portugal), or perhaps simply thought it bad policy to discipline such large economies.[77] Instead, the sanctions process was put in abeyance, with a call for regular reports on progress from both France and Germany.[78] The Commission announced that it would continue to attempt to enforce the SGP, and mounted a failed attempt through the European Court of Justice to force ECOFIN to enforce the Pact.[79] Calls for reform of the SGP increased, and were answered with a new iteration of the Pact in March 2005.

In the wake of the enforcement crisis, the European Council amended Regulations 1466/97 and 1467/97 with Council Regulations 1055/2005[80] and 1056/2005.[81] These new regulations change most of the prominent features of the original Stability and Growth Pact, making enforcement far more flexible, although the 3% target is retained.[82] The medium-term goal of budgets "close to balance or in surplus" has been revised to allow each Member State "a differentiated medium-term objective for its budgetary position," to be revised every four years or in the event of "major structural reform,"—a provision intended to encourage social security reforms—and allowing for a medium-term deficit up to 1% of GDP.[83] The immunity provision for exceptional circumstances justifying a temporary deficit now

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[75] von Hagen, *supra* note 43, at 30. It is unclear whether a nation found to have an excessive deficit was prohibited from voting in all proceedings, or only those affecting its own status. Votes against and abstentions are not distinguished, so the record cannot illuminate the matter. Germany and France each voted to put the procedures against the other in abeyance, however. *See* ECOFIN Meeting No. 14492/1/03 of 25 November 2003, *available at* http://www.eurotreaties.com/stabpactend.pdf.
[76] ECOFIN Meeting No. 14492/1/03, *supra* note 75.
[77] The literature does not provide any other explanation of why two countries in no fiscal difficulty—Ireland and Luxembourg—would have voted against sanctions, though their votes were not decisive.
[78] Mortensen, *supra* note 10, at 13.
[79] *Id*. at 13-14.
[80] Council Regulation No. 1055/2005, 2005 O.J. (L174) 1, *available at* http://europa.eu.int/comm/economy_finance/about/activities/sgp/sgp_en.htm (follow Council Regulation 1055/2005 hyperlink).
[81] Council Regulation No. 1056/2005, 2005 O.J. (L174) 1, *available at* http://europa.eu.int/comm/economy_finance/about/activities/sgp/sgp_en.htm (follow Council Regulation 1056/2005 hyperlink).
[82] As was noted in the discussion regarding the initial SGP, this target cannot be changed without renegotiating the Maastricht Treaty.
[83] Regulation 1055/2005, *supra* note 80, at § 1A, art. 2a.

countenances any decline in GDP growth (rather than only a decline over 0.75%) or a prolonged period of "very low" growth, without quantifying that standard.[84] The new regulations also grant considerable leeway for any budgetary decline resulting from pension reform,[85] and the timetable for sanctions is slowed to sixteen months, instead of ten.[86] These changes represent little more than an across-the-board loosening of the standards of the original Pact, rather than an attempt at thorough reform. The additional provisions allowing for pension reform may be laudable, but they are also indefinite—an additional grounds for allowing flexibility from sanctions, rather than a precise target for reform. The European Commission has expressed dissatisfaction with these alterations, and discussions on new possibilities for fiscal controls continue.[87] The possibilities for reform suggested in the literature on European Fiscal Policy are the subject of the next section.

Existing Critiques

There is no shortage of criticisms of the fiscal limits of Maastricht and the Pact, as well as proposals for its reform; this section will survey a few of these approaches. They include such ideas as an increasing focus on debt, implementation of the "Golden Rule" used in the U.K. and elsewhere, and a shift to accrual accounting. Some more radical suggestions, such as a system of tradable deficit credits, similar to the carbon emissions credits used to curb industrial pollution,[88] will not be considered, as such radical changes would face significant political hurdles, and likely could not be incorporated within the requirements of Maastricht. Before considering these views, however, it is worth noting a few general criticisms that apply to fiscal controls in the European Union. First, critics have noted that, despite the intent of the SGP to tighten fiscal controls, the greatest decreases in deficit and debt levels occurred under the Maastricht criteria prior to the implementation of the SGP; the SGP was only successful for, at most, its first two years.[89] So brief a "success" can as easily

[84] Regulation 1056/2005, *supra* note 81, at art. 2, paragraph 2.
[85] *See, e.g.,* Regulation 1055/2005, *supra* note 78, at art. 5, and Regulation 1056/2005, A *supra* note 79, at art. 2.
[86] Regulation 1056/2005, *supra* note 81, at art. 7.
[87] *See* Opinion of the European Economic and Social Committee on Strengthening Economic Governance, *The Reform of the Stability and Growth Pact*, 2006 O.J. (C88) 68.
[88] *See generally*, Alessandra Casella, *Tradable Deficit Permits*, *in* THE STABILITY AND GROWTH PACT, at 393-413 (Anne Brunila, Marco Buti, and Daniele Franco, eds., 2001).
[89] *See, e.g.*, Marco Buti, *Will the New Stability and Growth Pact Succeed? An Economic and Political Perspective* 6-7 (European Commission Economic Papers, January 2006), *available at* http://europa.eu.int/comm/economy_finance/publications/economic_papers/2006/ecp241en.pdf.

be ascribed to accident as intention. One interpretation of this data is that the political pressures for economic reform were far greater prior to implementation of the Euro than after it was adopted, as it is easier to exclude a country than kick it out. Of course, the deficit positions of countries in the late 1990s improved outside of the Euro area, as well as within it—the deficit position of the United States, for example, follows a similar trend line; no one would argue that the U.S. was driven by the Maastricht criteria.[90] Of course, the data also reveals greater volatility in the U.S. deficit position, perhaps suggesting that the fiscal constraints of Maastricht and the SGP provided at least some restraint—although to the extent such restraint hampered E.U. governments in taking anti-cyclical measures, it may be undesirable. It is also worth noting that the EU countries outside the Euro—Denmark, Sweden, and the U.K.—have seen more fiscal improvement post-Maastricht than Euro adopters, even in recent years.[91] This suggests that, at minimum, the enforcement provisions of the SGP have not been effective, though perhaps the reporting requirements and fiscal targets have had at least some effect.

Given this mixed picture, and at least in part due to an acknowledgement of the political need to respond to economic downturns with higher deficits, there have been suggestions that fiscal restrictions should pay more attention to debt positions. Maastricht, as we have seen, included a debt target of 60% of GDP, but the Stability and Growth Pact largely ignored this figure, concentrating instead on enforcement of the 3% deficit criterion. Critics have noted that this overlooks the wildly divergent debt ratios among Member States;[92] a 4% deficit in Luxembourg, with debt at only 3.8% of GDP, would face the same stiff censure as a 4% deficit in Italy, with a debt ratio of 106%.[93] Additionally, a greater focus on debt abatement in the near future would put Euro Area governments in much better position to face future demographic changes and pension reforms.[94] Significant effort has been expended in modeling ideal debt constraints in the E.U.;[95] indeed, part of the appeal of

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[90] Refer again to the data in Appendix 1-1, and the graphically depiction in Appendix 2-6.
[91] *See* von Hagen, *supra* note 43, at 38. *See also* Appendix 1-1.
[92] *See, e.g.,* David Walton, *Time for Radical Surgery*, FIN. & DEV., June 2004, at 26-27, *available at* http://www.imf.org/external/pubs/ft/fandd/2004/06/pdf/walton.pdf.
[93] Refer to Appendix 2-7.
[94] *See, e.g.,* Massimo Rostagno, Javier Perez-Garcia and Paul Hiebert, *Optimal Debt Under a Deficit Constraint*, *in* THE STABILITY AND GROWTH PACT, at 313 (Anne Brunila, Marco Buti, and Daniele Franco, eds., 2001).
[95] *See, e.g., id.*

solidifying the 3% deficit target and adding a medium-term target of fiscal balance through the SGP was that such a constraint would also gradually reduce government debt levels.[96] A basic reality has made a focus on debt impossible, however: the same wildly divergent debt levels that make a debt focus so appealing economically render it impossible politically, as some current members of the Euro Area, most notably Italy and Greece, could not comply in the near-term.[97]

Another proposal for fiscal restraint attempts to incorporate the differing economic realities of Euro members, particularly their differing levels of national infrastructure, through the adoption of the "Golden Rule," which would exclude investment spending from Maastricht's deficit and debt parameters.[98] This constraint has already been implemented by the United Kingdom.[99] Such a rule in the Euro area—and, even more, for newer EU countries eventually seeking to join the monetary union—would allow Member States to loosen their fiscal stance in order to pursue pro-growth policies that should, in the long run, improve their fiscal position via higher GDP.[100] The Golden Rule was considered during the debate over setting Maastricht's initial fiscal caps, however, as was noted in the above discussion, and was rejected as impractical. Critics, too, have concluded that adoption of the Golden Rule, despite its appeal, is probably inappropriate.[101] Also, as such a reform was considered and rejected prior to Maastricht, as noted earlier in this paper, it may be impossible to promulgate such a reform without reworking the Treaty, a limitation that prevented the first iteration of the Stability and Growth Pact from being more rigorous. However, the definition of deficit within the Treaty Protocol is subject to the standards of the European System of Integrated Economic Accounts,[102] and Article 104 of the Treaty does allow the Commission to consider "investment expenditure" before issuing a report that a Member State is running

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[96] Refer again to Appendix 2-1, indicating the sustainability of a 60% debt level at various levels of deficit and GDP growth.
[97] Refer again to Appendix 2-7.
[98] *See generally*, Fabrizio Balassone and Daniele Franco, *The SGP and the 'Golden Rule,' in* THE STABILITY AND GROWTH PACT, at 371-93 (Anne Brunila, Marco Buti, and Daniele Franco, eds., 2001).
[99] *See* William H. Buiter and Clemens Grafe, *Reforming EMU's Fiscal Policy Rules*, *in* MONETARY AND FISCAL POLICIES IN EMU: INTERACTIONS AND COORDINATION, at 92 (Marco Buti, ed., 2003).
[100] *See* Balassone and Franco, *supra* note 97, at 371-2.
[101] *See, e.g., id.* and Buiter and Grafe, *supra* note 98.
[102] *See* Protocol on the Excessive Deficit Procedure, *supra* note 11, at art. 2. Since 1995, this system has been known, more simply, as the European System of Accounts.

an excessive deficit.[103] Such provisions may provide sufficient leeway for a greater emphasis on deficit spending for investments in any new reforms to European fiscal targets.

Even more feasible within the confines of the Maastricht Treaty may be the adoption of accrual accounting standards, rather than the cash basis standard that is currently the norm in the EU. The European System of Accounts currently allows for submission of data on a cash basis, although much of the data are then adjusted to reflect accrual accounting standards for review by the Commission.[104] Currently only Sweden keeps accounting information on an accrual basis (although budgeting is still on a cash basis), although several other EU countries, including some of the recent accession countries, are attempting a similar switch.[105] Of course, given the pension commitments in the more developed EU economies, many Member States would doubtless shatter the targets of Maastricht were all reporting to switch to an accrual method, and so for the moment these numbers remain in the background of the discussion. As noted, though, even the generally lax new version of the SGP has attempted to address, at least minimally, the pension issue. Some critics have also noted that the current deficit focus, but undercounting pension commitments, and discouraging investment expenditures, vastly underestimates the deficit problems of the developed EU economies while exaggerating the fiscal situation of the accession countries trying to ramp-up their infrastructure.[106] With accrual data note yet generally available, it is hard to make any firm statements on the subject, except to note the possibility for future reform.

Of course, even absent reform, one could borrow that old Marxist chestnut, and claim that we do not know how well fiscal targets function in the EU—after all, they have never been tried. Faced with the first significant challenge to the SGP in 2003, Euro members crumbled rather than voting for enforcement against France and Germany. Less than two years later, a more flexible, user-friendly version of the pact emerged. Given the strength of the Euro—which was, after all, the original *raison d'etre* for the Pact— in recent years,

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[103] *See* Maastricht Treaty, *supra* note 5, at art. 104.
[104] *See* Marco Cangiano and Teresa Ter-Minassian, Strengthening Fiscal Management in the Euro Area 16 (May 23, 2003) (unpublished paper prepared for conference, available at http://www.bportugal.pt/events/conferences/SilvaLopes/Teresa_TerMinassian.pdf)
[105] *See id.*
[106] *See* Buiter and Grafe, *supra* note 98, *at* 118-42.

however, there was little basis for any political outcry over the changes, or for the adoption of new, stricter measures. No fines have ever been imposed for excessive deficits, however, nor has the situation some feared at the outset of the Pact—the dissolution of the Euro—come even close to fruition. If fiscal discipline becomes a greater problem in the future, either fines or removal from the monetary union may yet be tried. The specter of the latter has produced dire predictions in some circles, such as runs on banks (as citizens attempted to avoid forced conversion of Euro deposits into the cheaper replacement currency), uncertain contract liabilities, and heavy penalties from bond markets.[107] If such fears are sensible, it may be impossible to recapture the effects the targets may have had in the late 1990s, prior to Euro adoption. Of course, if El Salvador, Ecuador and others can use dollars absent monetary union, a chastised EU member may similarly be able to hold onto the Euro, thereby alleviating the effects of a currency shift, while still being kicked out of the Pact, with the prospect for full reinstatement only after fiscal balance is regained. Of course, such speculation takes us far afield from the scope of this paper—suffice it to say that it is hard to draw conclusions about the fiscal targets of the EU when their most aggressive means of enforcement have thus far been forestalled. Not that other nations have behaved differently when faced with strident measures imposed by fiscal caps, as the next section of this paper will demonstrate.

[107] *See* Hal S. Scott, *When the Euro Falls Apart*, 1998 INT'L FIN. 207, 207-28 (1998), *available at* http://www.law.harvard.edu/programs/pifs/pdfs/scott_euro.pdf.

Chapter 3: Spending caps and debt limits in Japan

Factual Background on spending caps and debt limits in Japan

I. Introduction

The spending caps and debt limits in Japan have several characteristics that distinguish them from the US or the EU countries. Importantly, the fiscal rules, spending caps and debt limits are determined by the Cabinet, not by the Diet. Further, the fiscal rules are not codified into the acts, but are determined by the legal format of the Cabinet decision or agreement. In order to understand the effect and function of the spending caps and debt limits, it is necessary to have a basic knowledge of the fiscal situation and budget process in Japan. Therefore, I will begin by describing briefly the fiscal situation and budget process in Japan.

Fiscal Situation[108]

Until 1964, expenditure and revenue were balanced. Then, in order to deal with a tax revenue shortage, a construction bond was issued in 1965. In 1974, Japan registered negative growth for the first time in the postwar period, due to the effects of the first oil crisis. Then in 1979 the bond dependency ratio reached the first peak of 34.7%. We have promoted fiscal consolidation since the 1980s. The government set a target of stopping the issuance of special deficit-financing bonds by 1990. Accordingly, the government has used the "Ceiling" and implemented administrative and fiscal reform. With increases in tax revenue from the bubble economy, Japan avoided issuance of a deficit-financing bond in FY1990 for the first time in 16 years. However, since the recession in 1990's, the Japanese fiscal condition has deteriorated again. In 2006, the bond dependency ratio is 37.6%. Total expenditures of the general account budget in FY 2006 are 79.6 trillion yen, while total tax (non-tax) revenues are 49.7 trillion yen. The difference between total expenditures and total tax (non-tax) revenues are 29.9 trillion yen. See Appendix 3-1.

[108] For a non-technical explanation of the recent Japanese fiscal situations in English, see Budget Bureau, the Ministry of Finance, Current Japanese Fiscal Conditions and Issues to be Considered 2005 (Annually published), http://www.mof.go.jp/english/budget/pamphlet/cjfc2005.pdf for 2005 version. See also, Budget Bureau, the Ministry of Finance, Highlights of the Budget for FY 2006 (Annually published), http://www.mof.go.jp/english/budget/e20051224a.pdf for FY 2006 version.

Outstanding long-term debts[109]: The table in Appendix 3-2 depicts long-term outstanding debts of central and local governments: general bonds outstanding, long-term borrowing, and local bonds outstanding; the debt outstanding must be redeemed by tax revenue. In FY2006, long-term debt outstanding is expected to be 775 trillion yen (150.8% of GDP). The table in Appendix 3-3 shows the change of government bond issues since 1983. The gap between general account expenditures and tax revenues has widened in recent years, which has led to an increase in government bond issues.

Budget Process[110]

In Japan, the budget is enacted by passing through the Diet after the government formulates the budget draft. The budget draft is hardly changed because we have a parliamentary cabinet system: the Cabinet is formed by the prime minister, the head of the ruling party. Since FY 2002, the basic budget process in Japan is as follows: after deliberation in the Economic and Fiscal Policy Council, first "Basic Policies for Economic and Fiscal Policy Management and Structural Reform" are decided in June. It is called the "Large-boned policy line" every year. Based on these long-term decisions, the Ministry of Finance (MOF) will establish the Guidelines for Budget Requests ("Ceiling") at the end of July or in the early weeks of August. Then, each ministry and agency submits budget requests to the MOF by the end of August. The MOF formulates the MOF budget proposal in December. Then, after ministerial-level negotiation, the government budget proposal is settled at the end of December. In January, the budget is submitted to the Diet and enacted after deliberation. The basic budget process is outlined in Appendix 3-4. As you may understand, the first half of this process is extremely important for spending control in Japan.

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[109] *Id.*

[110] See Budget Bureau, the Ministry of Finance, Understanding the Japanese budget 2004, http://www.mof.go.jp/english/budget/brief/2004/2004.pdf. For a detailed explanation of the Japanese budget process in English, see Maurice Wright, JAPAN'S FISCAL CRISIS; THE MINISTRY OF FINANCE AND THE POLITICS OF PUBLIC SPENDING, 1975-2000 (Oxford University Press, 2002). This book deals with the Japanese budget process between 1975 and 2000 in depth. However, since the Koizumi cabinet, though the basic budget process has not changed, the Cabinet Office and the Council on Economic and Fiscal Policy are also involved in this process. For a brief explanation of the Japanese budget process since 2000, Tanaka Hideaki, *Fiscal Consolidation and Medium-term Fiscal Planning in Japan*, OECD Journal on Budgeting Vol.3, No.2, 105-137 (2003).

II. Fiscal rules in Japan

1. Statutory spending caps and debt limits

a. The Fiscal Act (Zaisei-hou)

The Fiscal Act, named Zaisei-hou, is one basic code, which regulates everything from the content of budget, to the formation process and the administration of the budget. However, there are no spending caps or debt limits in the Fiscal Act, with the exception of the "no incursion of debt" principle. The Fiscal Act provides that national expenditures should be derived from revenues other than public debts or governmental loans.[111] The Government can issue construction bonds and loans—corresponding to public works, capital expenditures and governmental loans—up to the amount that is authorized by the Diet.[112] If the government issues a "special deficit-financing bond," it is necessary to enact the Special Deficit Financing Bond Act, which is an exception to section 4-1 of the Fiscal Act. Since FY 1975, the Japanese government has—except for the brief period from FY 1990 to FY 1994—continually issued this special debt-financing bond, and it has submitted this special act to the Diet and enacted it with the budget.

b. The Fiscal Structural Reform Act (Zaiseikouzoukaikaku-hou)

In Japanese fiscal history after World War II, spending caps or debt limits were codified only once by statute, rather than in the Cabinet decision or other agreement. The Fiscal Structural Reform Act (Zaiseikouzoukaikaku-hou) was enacted in December 1997, taking into account the severe fiscal situation due to successive economic stimulus packages passed to deal with the collapse of the bubble economy and the prospect of upward pressure on expenditures due to the rapid progress of aging and a declining birth rate in the near future.

The outline of this Act is summarized in the following three principles:[113]

1. A fiscal consolidation target was fixed to reduce the fiscal deficit – the GDP ratio within national and local governments was to reach 3% or less by fiscal 2003.[114]

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[111] The Fiscal Act, §4-1. See Komura Takeshi, YOSAN TO ZAISEIHOU 99-158 (2002).
[112] *Id*.
[113] Ishi Hiromitsu, MAKING FISCAL POLICY IN JAPAN: ECONOMIC EFFECTS AND INSTITUTIONAL SETTINGS 146-154 (2000).
[114] The Fiscal Structural Reform Act, §4-1.

2. The issuance of deficit-covering national bonds was to be eliminated by fiscal 2003. (a debt limit)[115]
3. In order to achieve this target, major government expenditures were capped to restrain its increasing growth and promote its curtailment (spending caps).[116] In addition, the three remaining fiscal years of the twentieth century were designated an "intensive reform period" to further cut expenditures.[117]

However, deterioration of the economic situation due to the currency crisis in the Asian region and the destabilization of the financial system led to suspension of the Fiscal Structural Reform Act in December 1998. Since then, there have been no acts dealing with fiscal reform in Japan and currently no prospects to use statutory measures to keep fiscal discipline in Japan, though the fiscal deficit has been increasing after the enactment and subsequent postponement of this Fiscal Structural Reform Act. Instead of the statutory spending caps and debt limits, the Japanese traditional measures—that is, Cabinet decision and agreement—have been readopted as fiscal spending caps and debt limits against the fiscal deficits since 1998.

2. Cabinet decision and agreement

a. Overview

In Japan, important spending caps and debt limits are defined not in the constitution or codes, but in the Cabinet agreement, initiated by the MOF. Presently, I will summarize the spending caps and debt limits via two categories: Guidelines for Budget Requests (annual restrictions) and Primary Balance (a long-term restriction). Further, in FY 2001 and 2006, debt limits were set by the initiatives of Prime Minister Koizumi. These Cabinet agreements are so strong that they are rarely broken because of the budget process discussed above. The Diet has the authority to amend the budget submitted by the government, but there are only a few occasions to amend it.

b. Guidelines for Budget Requests (Annual Restriction)

[115] *Id*. at §4-2.
[116] *Id*. at §7 - §38.
[117] *Id*. at §1.

The fiscal year in Japan begins on April 1, and the budget formulation process starts during the summer of the previous year. At the initial stage, each Ministry submits its budget request to the MOF by the end of August. About a month before these budget requests, the Cabinet approves the Guidelines for Budget Requests, called the “Ceiling.”[118] The guidelines set out expenditure ceilings for major programs such as public works and social security for the next fiscal year's budget request. These ceilings are usually expressed in terms of an absolute or percentage increase (decrease) vis-à-vis the previous fiscal year's amount. Also, the Ceiling establishes special priority-allocated categories for public works as well as non-public works. Since each Ministry must prepare its budget requests within the limits of these guidelines, each Ministry needs to determine the priorities of the various expenditure items before submitting its requests. Therefore, it could be said that these guidelines are effective in controlling each Ministry's inclination towards making excessive requests and forcing them to be efficient. Thus, the system plays a very important role in curtailing overall government expenditures.

Scope: The Ceiling is applicable only to half of general account expenditures, and not to Local Allocation Taxes and debt payments. The Ceiling is applicable to such mandatory spending as Social Security, Health Insurance and National Defense. The Ceiling is not, however, applicable to either the Special Accounts[119] nor to the Budgets of the Government-affiliated Agencies[120]. Finally, it does not include the Supplemental Budgets.[121]

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[118] See Appendix 3-5 for the trends in Guidelines for budget requests since 1961. See also Appendix 3-6 for the Guidelines for FY2006 budget requests.

[119] Special accounts carry out specific projects, administer and manage specific funds, or administer revenues and expenditures separately from the General Account.

1．Special Accounts for Enterprese・・・25 accounts

(1) SA for Government Enterprises（1）
- ・National Forest Service

(2) SA for Insurance（9）
- ・Earthquake Damages Rei
- ・Welfare Insurance
- ・Seamen's Insurance
- ・National Pension
- ・Labor Insurance
- ・Agricultural Mutual Aid Reinsurance
- ・Forest Insurance
- ・Fishing Boat Reinsurance and Fishermen's Mutural Aid
- ・Trade Reinsurance

(3) SA for Public Work（5）
- ・National Land Improvement
- ・Road Construction and Improvement
- ・Flood Control
- ・Airport Improvement
- ・Harbor Improvement

(4) SA for Administrative Business (8)
- ・Registrations
- ・Designated National Properties Consolidation
- ・National Center for Advanced and Specialized Medical Care
- ・Foodstuff Control
- ・Agricultural Foundation Improvement Measures
- ・Patent Registration
- ・Compensation Reinsurance for Motor Vehicle Damages
- ・Motor Vehicle Inspection and Registration

(5) Sas for Loans（2）
- ・Industrial Inventment
- ・Urban Development Loan

2．Special Accountsfor the Fund Management…2 Accounts
- ・Fiscal Loan Program Funds
- ・Foreign Exchange Funds

3．Others…4 accounts

(1) SAs for the consolidation of Funds（2）
- ・Local Allocation and Local Transfer Tax
- ・Government Bonds Consolidation Fund

(2) Others（2）
- ・Promotion of Power Source Development
- ・Measures for Petroleum and the Advancement of Energy Demand and Supply Structure

[120] Budgets of the Government-Affiliated Agencies means Budgets of six public finance corporations and two banks, which are fully capitalized by the government. These organizations are closely tied to overall government

Baseline: The baseline for the calculation of the aggregate is the previous year's initial budget expenditure.[122] (The totals for both revised and out-turn expenditure normally tend to be higher than that planned as a result of in-year spending financed through more supplementary spending.) By using planned expenditures as the baseline for budget requests, the MOF has obligated spending ministries and agencies to bid afresh for any in-year increase above the previously agreed line. This baseline provides the new baseline for the next year's budget. One of the typical characteristics of Japanese national budgeting is incrementalism, which is deeply related to the Ceiling and the negotiation process between the MOF and the spending ministries.

Legality: The Guidelines on budgetary requests have not had the same formal legal status as codes or regulations. The Guidelines are determined by the Cabinet Agreement, named Kakugi-Ryokai.[123] This Cabinet Agreement has the legal authority to bind all the ministries and governmental agencies inside the Cabinet. However, theoretically, even if it were violated, there would be no responsibility or sanction, other than political responsibility by the Cabinet.

c. Primary Balance (Long-Term Restriction)

Primary balance is defined as the fiscal balance reached after subtracting expenditures, excluding interest payment and debt redemption, from tax and other revenues, excluding borrowings.[124] Primary balance indicates whether the cost of various policies in the year is covered by tax revenue in the year or not. When the primary balance is achieved the ratio of debt outstanding to nominal GDP remains stable, provided that the nominal GDP growth equals the nominal interest rate. This is why it is so important to achieve primary balance, with a view to mid-and-long term fiscal sustainability.

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policies, and their budgets are subject to approval by the Diet. They include National Life Finance Corporation, Housing Loan Corporation, Agriculture, Forestry and Fishery Finance Corporation, Japan Finance Corporation for Small Business, Japan Finance Corporation for Municipal Enterprises, Okinawa Development Finance Corporation, Development Bank of Japan, and Japan Bank of International Corporation.

[121] The Supplemental Budget is the budget which adds additional costs to the Initial Budget or changes the Initial Budget. The Supplemental Budget is formulated in case of economic changes etc. After the Diet decision, the the Supplemental Budget is executed with the Initial Budget as one budget.

[122] *See* Wright, *supra* note 110, at 283.

[123] Cabinet agreements have the three ways in Japan; Kakugi-Kettei (Cabinet Decision), Kakugi-Ryokai (Cabinet Agreement) and Kakubi-Houkoku (Cabinet Report).

[124] *See* MOF, *supra* note 110, at 16.

Primary Deficit

Revenues	Expenditures
Bond Revenues	Interest payments Debt redemption
	Primary Deficit
Tax Revenues etc.	Expenditures

Primary Balance

Revenues	Expenditures
Bond Revenues	Interest payments Debt redemption
Tax Revenues etc.	Expenditures

Primary Surplus

Revenues	Expenditures
Bond Revenues	Interest payments Debt redemption
Primary Surplus	
Tax Revenues etc.	Expenditures

Source: MOF, Japan (2005), Current Japanese Fiscal Conditions and Issues to be Considered 2005, at 16.

The following Cabinet decision shows long-term fiscal policy, which leads indirectly to spending caps and debt limits, although these fiscal targets directed towards the primary balance do not specify them.

Reform and Perspectives – FY2002 Revision (Cabinet Decision in January 2003)

Considering that the population of Japan will begin to shrink in about 2007, and that between 2010 and 2015 the baby boom generation—which has been the core of the labor force—will move into retirement and become pension beneficiaries, it is desirable that the primary balance will be in surplus in the early 2010s.

Structural Reform and Medium-Term Economic and Fiscal Perspectives (Cabinet Decision in January 2005)

・Until FY 2006, the government maintain the size of the government (ratio of general government expenditure to GDP) equal to or below its FY 2002 level.

・By FY2006, with the continuing efforts of both central and local governments to reduce expenditure, and based on assessment of necessary public services and expenditure levels, as well as on the status of economic revitalization and fiscal conditions, the government will judge what tax measures are required.

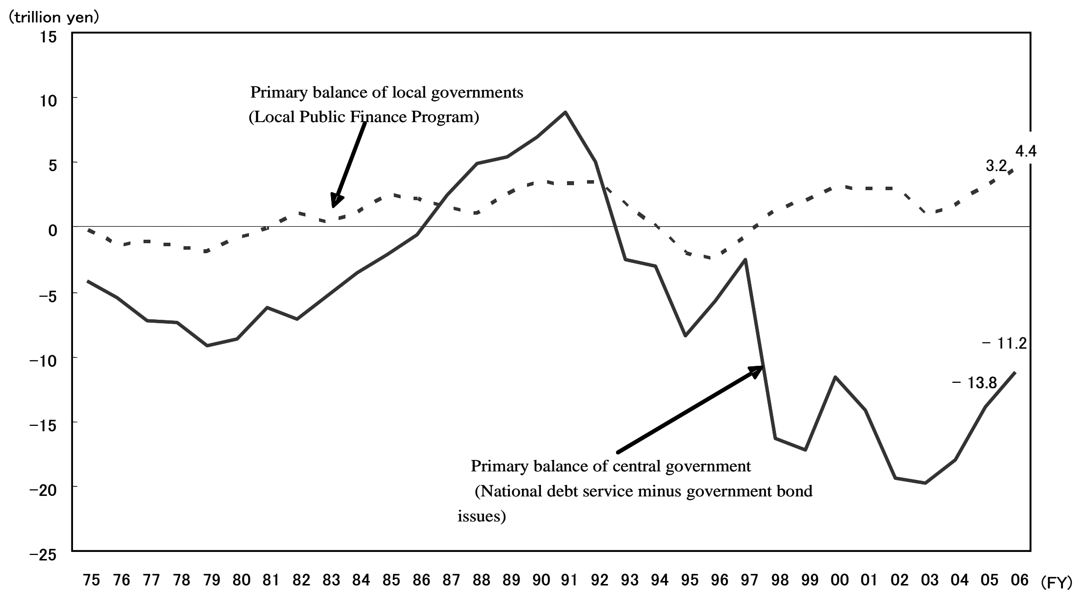
・Beyond FY2007, it will be important to make the same level of effort as before to improve the fiscal balance. The government aims to achieve surplus in the primary balance in the early 2010s through fiscal efforts and the realization of sustainable economic growth led by private-sector demand.

Basic Policies for Economic and Fiscal Managements and Structural Reform 2005 (Cabinet Decision in June 2005)

・Before the middle of 2006, the government will clarify options for the direction of expenditure and revenue reform and the process of the reform.

・By the end of FY2006, the government will reach a conclusion concerning the medium-term measures to improve the primary balance.

Now, the Japanese government aims at achieving primary surplus in the early 2010s. The following table shows the trends in primary balance at the central government and local government levels. At present we have primary deficit, but it has steadily improved in recent years.



(Note) 1. Primary balance of central government: FY1975−2004: settlement, FY2005: rivised, FY2006: budget
2. Primary balance of local governments: FY1975−2005: Local Public Finance Program, FY2006: estimates

Source: MOF, Japan (2005), Current Japanese Fiscal Conditions and Issues to be Considered 2005, at 27.

d. Debt Issue Limitation – 30 trillion yen

If you refer to Appendix 3-3 again, you will note that the debt issue in FY 2001 and 2006 is limited to 30 trillion yen. This debt limit is not regulated by any statute, although the government needs to enact the special deficit-financing bond act. This debt issue limitation is initiated by the directives of Prime Minister Koizumi. This directive has no clear legal basis

demanding that it be met, but this does encourage the government to achieve a certain debt limit. In addition to the Cabinet agreement, this kind of “soft law” sometimes might be useful for debt issue limits under certain conditions (e.g., the parliamentary cabinet system plus the majority in the Diet by the ruling party).

3. Legislative spending caps and debt limits

There are no spending caps or debt limits set by the Diet in Japan. First, whether the Diet has the authority to amend the budget submitted by the Cabinet is controversial under the constitution. This is because the Cabinet has the exclusive authority to submit the budget to the Diet and therefore this authority would be harmed if the Diet is allowed to dramatically increase or decrease the submitted budget.[125] It is the formal opinion of the Japanese government that the Diet has the authority to amend the budget submitted by the Cabinet to the extent that the authority of the Cabinet to submit the budget is not harmed.[126] Historically, the Diet has rarely amended the budget during its deliberations. Therefore, legislative spending caps and debt limits by the Diet are not practical, unlike in the federal budget process of the United States.

Existing Critiques

I. Theoretical critique and reform proposal

Materials on Japanese fiscal polices are legion, given the complexity of the process, but such materials rarely deal with fiscal rules, especially spending caps and debt limits. Of course, some critics recommended the introduction of a pay-as-you-go rule or strong spending caps, similar to those used (on occasion) in the United States. These arguments have ignored the differences in the political economy and budget system, however, and they are not worth discussing, given the scope of this paper. Instead, I will therefore pick up a few of the more practical critiques and reform proposals on Japanese fiscal rules that have been written in English, and discuss the more substantial arguments for and against the Japanese fiscal rules, especially the Ceiling and annual budget process.

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[125] *See* Komura, *supra* note 111, at 255-256.

[126] Finance Committee, House of the Representatives, Feb. 23rd, 1977.

Hideaki Tanaka pointed out three problems from the macroeconomic point of view.[127] First, an annual budget is formulated in a shortsighted manner, often on an ad hoc basis, focusing only on the current budget year. Second, there was excessive reliance on supplemental budgets in the 1990s, mainly because the government adopted Keynesian economic measures to boost the stagnant economy. Third, limited fiscal data to measure the overall stance of fiscal policy are released when the government presents its budget proposal (normally in December). What is used at the time of this initial budget formulation is only the balance of the General Account. In other words, Japan does not normally analyze and discuss the stance of fiscal policy based on the System of National Accounts (SNA) in the budgeting process.

Jurgen von Hagen also recommended several reform proposals, with the emphasis that the Japanese political economy seems more fit for the contracts approach than for the delegation approach of strengthening budgeting institutions, after comparing the Japanese fiscal rules with those in the EU countries.[128] First, budgeting in Japan should become comprehensive, moving away from the limited focus on the general account and covering all government spending in the budget process. Second, the annual budget process should start with an agreement among all coalition partners on fiscal targets for each spending ministry, creating clear responsibilities and accountability. (The party leaderships should not be admitted to the subsequent, more detailed negotiations as they are today, as they could use their political influence to undermine the original agreement.) The targets should be embedded in multi-annual plans closely connected to national accounts and macroeconomic forecasts to ensure consistency over time. They should set limits for the overall budget level, rather than the increment increases in annual budgeting. Third, the position of the executive relative to the Diet should be strengthened by asking the Diet to take a vote on the main fiscal targets early in the budget process, turning these targets into binding constraints for the subsequent parliamentary phase of the budget process. Fourth, supplementary budgets should be ruled out and rules for dealing with revenue and expenditure shocks should be put in place.

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[127] *See* Tanaka, *supra* note 110, at 129-134.
[128] von Hagen, *supra* note 43, at 29-31.

Fifth, the transparency of the budget and the budgeting process should be improved to facilitate monitoring and enforcement of the fiscal contract. Lastly, the position of the MOF in the implementation of the budget should be further strengthened by assuring its control over all parts of government.

II. Evaluation of these critiques

In this section, I will deal with several possible arguments for and against the scope, baseline and legality of Japanese spending caps and debt limits by the Cabinet agreement, with primary focus on the Ceiling.

Scope

- Mandatory spending – General Account

Mandatory spending from the General Account is subject to the Ceiling. As Appendix 3-6 shows, mandatory spending occupies the majority of the General Account. The Ceiling has set an absolute numerical target against mandatory spending after considering the effect of increases due to aging. Some critics might argue that the Ceiling is not effective for reducing mandatory spending. In most cases, it is necessary to amend the authorizing law in order to decrease mandatory spending. Moreover, actual payments of such entitlements as National Pension or Employees' Pension benefits are expensed by way of individual Special Accounts, and it would be necessary to restrict the expenditures from these Special Accounts. Then, as I will show later, if the Initial Budget is short on mandatory spending, then there is a legal compulsion to formulate the Supplemental Budget for mandatory spending, which is not subject to the Ceiling. As such, it is not effective to set fiscal rules only to regulate the General Account. Furthermore, you may doubt if the uniform fiscal rules set in the Ceiling are suitable for mandatory spending. This is partly because the review cycle of mandatory spending is not necessarily the same as the annual budget cycle, which is ordinarily the review period for discretionary spending.[129]

[129] The codes of dealing with fiscal balance have been introduced on the time of the pension reform in 2004. Both the National Pension Act and Employees' Pension Act provide that the Government should take rapid measures to amend the amount of pension benefits, corresponding to the variation in the national living standard, wages or other remarkable circumstances (The National Pension Act §4, The Employees' Pension Act § 2-2), that it should maintain fiscal balance of the pension insurance in the long term so that it should take rapid and necessary measures to prevent its remarkable imbalance of fiscal condition when it is predicted (The National

On the other hand, you could argue as follows: because the budget normally accompanies its related bills in Japan, the Ceiling on mandatory spending would be helpful to compel spending ministries to review mandatory spending and to reform the systems that necessitate mandatory spending. In fact, in that major institutional reform is related to the fiscal cycle, the Ceiling might be a starting point for spending ministries to review their programs. Particularly when a certain budget cycle is the same as the reform cycle for mandatory spending, the Ceiling plays an important role in pressuring spending ministries to reform their mandatory programs to decrease their spending. Moreover, without any ceiling on mandatory spending from the General Account, only a small part of the General Account would be subject to annual spending caps. It may, however, be more practical to review the boundary between mandatory spending and discretionary spending,[130] in order to render a larger percentage of governmental expenditure subject to effective ceilings.

- Special Account

The Japanese government has 31 Special Accounts.[131] The total outlay of the Special Accounts is 411 trillion yen, which is much bigger than that of the General Account. However, a major part of expenditures consists of Special Accounts for fund management such as government bond consolidation funds, local allocation and local transfer tax, and special accounts for pension and insurance. Considered in this way, there is not much spending that would be suitable for spending caps. However, the problem of Special Accounts (i.e., they are unclear) has been pointed out recently. The government is implementing reform for Special Accounts as well as the General Account in FY 2006.[132] In this reform, however, there is no provision for spending caps and debt limits for the Special Accounts at present. The fundamental issue would be similar to the mandatory spending—that is, whether spending caps and debt limits could be applied to a large unit of governmental expenditures that are

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Pension Act §4-2, The Employees' Pension Act §2-3), and that the Government shall calculate the current situation and future 100-year ("fiscal balance period") projection of pension premiums, governmental subsidies, pension costs and other fiscal conditions every 5 years (The National Pension Act §4-3, The Employees' Pension Act §2-4).

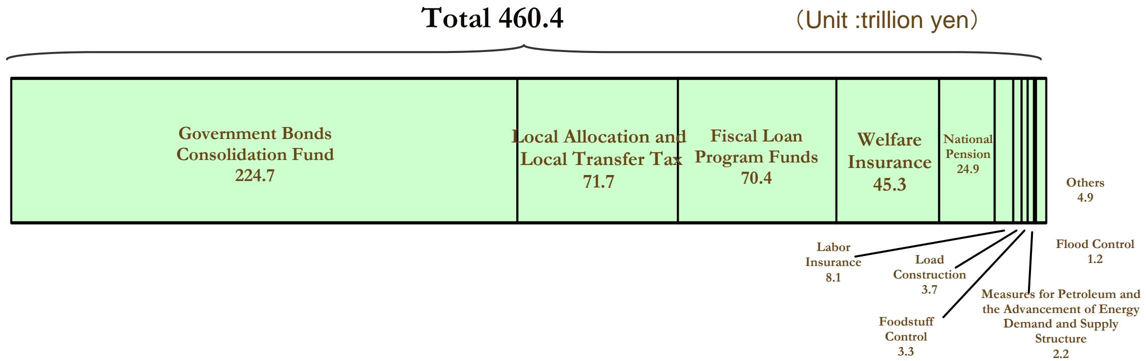
[130] *I.e.*, the budget for the national defense belongs to discretionary spending in the budget of the United States. On the other hand, it belongs to mandatory spending in the budget of Japan.

[131] See supra note 119.

[132] See Financial System Council, Review Special Accounts; Institutional Review and Direction of Reform (Nov. 21, 2005). See also, Budget Bureau, the Ministry of Finance, Explanations of Special Accounts (April, 2006).

mandated to be expensed. Rather, it might be wise to reform mandatory spending program by program.

●Expenditures of Special Accounts (FY 2006 Budget)



Source: MOF, Japan (2005), Current Japanese Fiscal Conditions and Issues to be Considered 2005, at 19.

- **Supplemental Budget**

The Supplementary Budget is excluded from current spending caps and debt limits. The Supplemental Budget is the budget that adds additional costs to the Initial Budget or changes the Initial Budget.[133] The Supplemental Budget is formulated in case of things like economic change. After the Diet decision, the Supplemental Budget is executed with the Initial Budget as one budget.[134]

The Supplementary Budget was originally intended for such emergency expenses as disaster relief.[135] Since the collapse of the economic bubble, the Japanese economy has suffered from a prolonged recession. To deal with this prolonged recession, the Japanese government has taken several economic measures to stimulate its economy during the 1990s. This series of economy packages included increases in public investment and huge tax cuts. Public expenditures above the level of the initial budget are expensed in many supplementary

[133] The Fiscal Act §29.
[134] *See* Komura, *supra* note 111, at 316-323.
[135] Under the Fiscal Act §29-1, the requirement for formulating Supplemental Budget is limited either to the case of the shortage of mandatory spending or to the case of special necessary expenditures that are based on the reasons after formulating Initial Budget.

budgets.[136] Though it is controversial whether these public expenditures were necessary as economic measures, it is clear that the Japanese Ceiling system could not have prevented a significant amount of public expenditures that were authorized in Supplemental Budgets during 1990s. The large scale of supplemental spending in this period is the target of criticism, but it is difficult to determine how these economic measures could be regulated in spending caps or debt limits.

Moreover, since mandatory spending must be appropriated annually in Japan, unlike in the US, if the Initial Budget lacks the necessary amount of mandatory spending, the Supplemental Budget will provide it.[137] However, critics note that if the Supplemental Budget is readily permitted, the Ceiling in the Initial Budget will have a loophole despite its application to mandatory spending. They may be regarded as "Backdoor" expenditures, which are not applicable to the Ceiling. However, you could also argue that it is difficult to calculate with any precision the finances required for mandatory spending at the time of the Initial Budget, as the amount of mandatory spending is dependent on various demographic and economic conditions.

Baseline

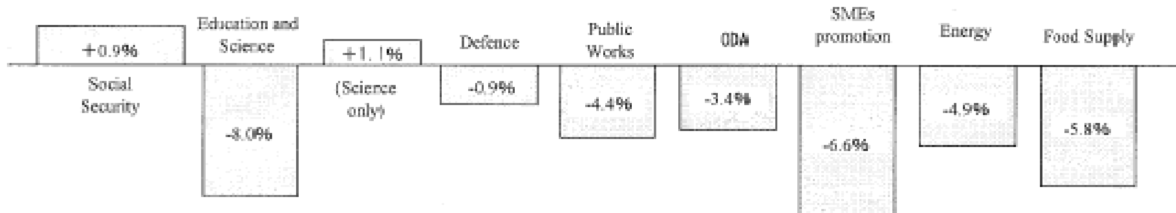
The Ceiling has been criticized as promoting incrementalism, in which the government formulates its budget on the basis of last year's budget. Further, the Ceiling is basically allocated by the spending ministries. Even if one spending ministry has a vital demand for new governmental resources, it will still be bound to the restrictions of the last year's budget. On the other hand, though another spending ministry ceases to need old spending programs, they can continue to use the previous year's allocation of governmental resources. This leads to an incentive problem of governmental agents unwilling to cut their spending programs voluntarily. This might petrify the allocation of governmental resources and prevent the spending ministry from making efficient allocations.

[136] In this context, whether this series of economic measures meet the statutory requirement (specially necessary expenditures which are based on the reasons after formulating Initial Budget) have been controversial. However, it is construed that the government has the authority to decide this requirement reasonably from the perspective of policy decision. *See* Komura, *supra* note 111, at 319-321.

[137] In the case of mandatory spending, its shortage meets the statutory requirement without considering whether it meets the requirement of special necessary expenditures which are based on the reasons after formulating the Initial Budget.

However, the Ceiling might also compel a spending ministry to review its program if it needs new governmental resources. You could to say there is an informal “pay-as-you-go” system inside the spending ministry. Moreover, in practice, it is difficult to compare spending programs across ministries. Yet if you want to change the inter-agency allocation of spending, you need to compare agency programs. However, no one has the expertise to compare the budget of the Ministry of Defense with that of the Ministry of Agriculture, for example, in order to set general priorities. Rather, it would only be practical to review spending programs one by one, not to compare them on the whole. From the standpoint of empirical analysis, you could not necessarily say that the Ceiling has prevented efficient allocation of governmental resources, as the following example of the year-on-year percentage changes in major expenditure categories from FY 2006 to FY 2007.

Year-on-Year (FY2006-07) percentage changes in major expenditure categories



Source: MOF, Japan (2005), Current Japanese Fiscal Conditions and Issues to be Considered 2005, at 17.

Legality

Aside from the minimal influence of the Fiscal Structural Reform Act, the annual ceiling and current long-term fiscal policy are solely determined by the Cabinet Decision or the Cabinet Agreement. Even if the targets in these Cabinet agreements are not met, the Cabinet bears only political responsibility for its violation. There is not any formal penalty for violation (e.g., there is no automatic adjustment). Some critics argue that “strong” fiscal rules, which are codified into law, are necessary to reform the fiscal balance. However, considering the relationship between the Diet and the Cabinet in Japan, as discussed above, the Cabinet Decision and the Cabinet Agreement have played an important role as spending caps and debt limits because the Diet rarely changes the budget the Cabinet has submitted after the Cabinet Decision. In fact, the Cabinet has never violated, but rather has made a studious effort to

follow, the Cabinet Decision and Cabinet Agreement. Further, as the example of the Fiscal Structural Reform Act shows, codified spending caps and debt limits might be not efficient or effective in Japan. Following this line of reasoning, it does not matter what formality is adopted for spending caps and debt limits. Rather, it matters whether the spending caps and debt limits tend to be kept, considering a country's political economy. In addition, two primary characteristics of fiscal rules—the strength of a rule and the effectiveness of that rule—are sometimes in antinomy.

Chapter 4: Conclusion

This paper demonstrates two possible mechanisms for fiscal restraint: firm rules codified in international law, as used in the European Union, and the system of mostly informal restraint, characterized by the "soft law" approach in Japan. Both systems have seen substantial difficulty in periods of economic downturn—Japan during the 1990s, and the Euro Zone from 2001 to the present, particularly in France and Germany. Both systems demonstrate the political difficulties of maintaining fiscal restraints in periods of economic hardship, and the impracticalities of hard rules. Of course, despite these economic difficulties, Japan, Germany and France remain among the world's largest economies. Further, unlike the United States, Japan and the Euro Zone do not face the prospect of large current account deficits in addition to their central government deficits. Neither have these economies faced significant inflationary pressures in recent decades—in fact, Japan has faced the opposite problem, only recently beginning to emerge from a prolonged deflationary episode. In light of these facts, policy makers and economists will continue to struggle with what constitutes an ideal level of government debt and deficit spending, and how to structure fiscal constraints in order to reach such ideals.

Appendix 1 – 1

Annex Table 27. **General government financial balances**

Surplus (+) or deficit (-) as a per cent of nominal GDP

	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Australia	-0.9	-0.6	-1.7	-4.3	-6.4	-5.8	-4.8	-3.9	-2.2	-0.4	0.7	2.1	0.9	-1.1	0.3	0.8	1.0	1.0	0.9	0.9
Austria	-3.4	-3.1	-2.5	-2.9	-2.0	-4.4	-4.8	-5.7	-4.0	-1.8	-2.4	-2.3	-1.6	0.0	-0.6	-1.3	-1.1	-2.0	-2.0	-1.5
Belgium	-7.1	-7.5	-6.7	-7.3	-7.9	-7.2	-4.9	-4.3	-3.7	-1.9	-0.7	-0.4	0.1	0.6	0.1	0.3	0.0	0.0	-0.4	-0.7
Canada	-4.3	-4.6	-5.8	-8.4	-9.1	-8.7	-6.7	-5.3	-2.8	0.2	0.1	1.6	2.9	0.7	-0.1	0.0	0.7	1.3	0.9	0.6
Czech Republic	..	..	..	..	..	..	..	-13.4	-3.1	-2.4	-5.0	-3.6	-3.7	-5.9	-6.8	-12.4	-3.0	-4.0	-3.6	-3.2
Denmark	1.7	0.3	-1.3	-2.9	-2.6	-3.8	-3.3	-2.9	-1.9	-0.5	0.0	1.4	2.3	1.2	0.3	0.0	1.7	2.8	2.4	1.9
Finland	5.2	6.8	5.4	-1.0	-5.5	-7.2	-5.7	-3.8	-2.9	-1.2	1.6	2.2	7.1	5.2	4.2	2.3	1.9	2.1	1.8	1.5
France	-2.3	-1.6	-1.8	-2.3	-3.9	-5.8	-5.4	-5.5	-4.1	-3.0	-2.6	-1.7	-1.5	-1.6	-3.2	-4.2	-3.6	-3.2	-3.2	-3.0
Germany	-2.0	0.1	-2.0	-2.8	-2.5	-3.0	-2.3	-3.2	-3.3	-2.6	-2.2	-1.5	1.3	-2.8	-3.7	-4.0	-3.7	-3.9	-3.6	-2.6
Greece	-11.6	-13.6	-15.7	-11.0	-12.2	-13.4	-9.3	-10.2	-7.4	-6.6	-4.3	-3.5	-4.2	-6.0	-5.0	-5.8	-6.5	-4.5	-3.2	-3.6
Hungary	..	..	..	-3.0	-7.2	-6.6	-11.1	-7.6	-5.9	-7.2	-8.0	-5.6	-3.0	-3.6	-8.4	-6.4	-5.4	-6.1	-5.9	-5.9
Iceland	-2.0	-4.5	-3.3	-2.9	-2.8	-4.5	-4.7	-3.0	-1.6	0.0	0.5	2.4	2.5	0.2	-0.8	-2.1	-0.1	2.0	1.2	-0.5
Ireland	-4.6	-2.6	-2.8	-2.8	-2.9	-2.7	-1.9	-2.1	-0.1	1.5	2.3	2.4	4.4	0.8	-0.4	0.2	1.4	-0.9	-0.6	-0.6
Italy	-11.3	-11.7	-11.8	-11.7	-10.7	-10.3	-9.3	-7.6	-7.1	-2.7	-3.1	-1.8	-0.7	-3.2	-2.9	-3.3	-3.3	-4.3	-4.2	-4.8
Japan	1.1	1.8	2.1	1.8	0.8	-2.4	-3.8	-4.7	-5.1	-3.8	-5.5	-7.2	-7.5	-6.1	-7.9	-7.7	-6.5	-6.5	-6.0	-6.0
Korea	3.2	3.1	3.1	1.7	1.4	2.2	2.9	3.8	3.4	3.3	1.6	2.7	5.4	4.6	5.4	0.4	0.0	-0.2	0.0	0.2
Luxembourg	..	..	4.8	0.9	-0.5	1.6	2.8	2.6	2.2	3.0	3.3	3.5	6.1	6.1	2.1	0.2	-0.6	-2.3	-2.1	-1.9
Netherlands	-4.0	-4.8	-5.1	-2.6	-4.0	-2.7	-3.3	-4.0	-1.7	-1.1	-0.7	0.6	2.1	-0.3	-2.0	-3.2	-2.1	-1.6	-1.8	-1.5
New Zealand	-4.0	-3.7	-4.3	-3.9	-3.3	-1.3	2.5	3.0	2.9	2.0	0.4	-0.4	1.2	2.1	3.9	5.3	5.5	5.3	4.6	4.3
Norway	2.6	1.8	2.2	0.1	-1.9	-1.4	0.3	3.4	6.5	7.7	3.6	6.2	15.6	13.6	9.3	7.6	11.4	15.3	17.0	17.0
Poland	..	..	..	..	..	..	..	-3.8	-4.6	-4.5	-3.9	-3.1	-2.4	-3.7	-3.3	-4.8	-3.9	-3.4	-3.6	-3.3
Portugal	-3.6	-3.0	-6.4	-7.3	-4.6	-7.8	-7.4	-5.3	-4.6	-3.4	-3.0	-2.8	-2.9	-4.3	-2.8	-2.9	-3.0	-6.0	-4.9	-4.6
Slovak Republic	..	..	..	..	..	..	-6.1	-0.9	-7.4	-6.2	-3.8	-7.1	-12.3	-6.6	-7.8	-3.8	-3.2	-4.1	-4.2	-3.5
Spain	-3.1	-2.6	-3.9	-4.6	-3.7	-6.9	-6.5	-6.3	-4.7	-2.9	-3.0	-0.9	-0.9	-0.5	-0.3	0.0	-0.2	0.3	0.3	0.2
Sweden	3.4	3.3	3.4	-0.1	-9.0	-11.4	-9.3	-6.9	-2.8	-1.0	1.9	2.3	5.0	2.6	-0.5	-0.1	1.4	1.2	0.9	1.3
Switzerland	..	..	0.6	-1.1	-2.4	-2.7	-1.9	-1.2	-1.4	-2.4	-1.5	0.0	2.4	0.9	0.1	-1.5	-1.4	-1.6	-1.2	-0.8
United Kingdom	0.5	0.8	-1.6	-3.1	-6.5	-7.9	-6.8	-5.8	-4.2	-2.2	0.1	1.0	3.8	0.7	-1.7	-3.3	-3.2	-3.1	-3.0	-3.2
United States	-3.6	-3.2	-4.2	-4.9	-5.8	-4.9	-3.6	-3.1	-2.2	-0.8	0.4	0.9	1.6	-0.4	-3.8	-5.0	-4.7	-3.7	-4.2	-3.9
Euro area	-4.3	-3.7	-4.5	-4.9	-5.0	-5.7	-5.0	-4.9	-4.2	-2.6	-2.3	-1.3	0.0	-1.9	-2.5	-3.0	-2.7	-2.9	-2.7	-2.5
Total OECD	-2.6	-2.1	-2.9	-3.7	-4.6	-4.9	-4.2	-3.9	-3.1	-1.7	-1.2	-0.8	0.3	-1.3	-3.2	-4.0	-3.6	-3.2	-3.2	-3.1
Memorandum items																				
General government financial balances excluding social security																				
United States	-4.4	-4.2	-5.3	-5.8	-6.6	-5.6	-4.4	-3.9	-3.1	-1.9	-0.8	-0.6	0.1	-2.0	-5.4	-6.3	-6.0	-5.0	-5.6	-5.4
Japan[1]	-2.0	-1.4	-1.4	-0.9	-1.7	-4.6	-5.7	-6.6	-6.8	-5.6	-6.9	-8.3	-8.0	-6.1	-7.7	-7.8	-6.2	-6.1	-5.6	-5.6

Note: Financial balances include one-off revenues from the sale of the mobile telephone licenses. These revenues are substantial in a number of countries including Australia (2000-2001), Austria (2000), Belgium (2001), Denmark (2001), France (2001-2002), Germany (2000), Greece (2001), Ireland (2002), Italy (2000), Netherlands (2000), New Zealand (2001), Portugal (2000), Spain (2000) and the United Kingdom (2000). As data are on a national account basis, the government financial balance may differ from the numbers reported to the European Commission under the Excessive Deficit Procedure for some EU countries. For more details see footnotes to Annex Tables 25 and 26 and *OECD Economic Outlook* Sources and Methods *(http://www.oecd.org/eco/sources-and-methods)*.

1. Prior to 1991, when SNA93 was adopted, these data included private pension funds.

Source: OECD Economic Outlook 78 database.

Appendix 1 – 2

Annex Table 32. **General government gross financial liabilities**

Per cent of nominal GDP

	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Australia	25.9	23.8	22.6	23.8	28.2	31.6	41.4	43.4	40.4	38.7	33.3	27.9	24.3	21.5	20.1	18.9	17.8	15.3	14.7	13.7
Austria	59.1	58.1	57.6	57.6	57.3	62.0	65.1	69.6	69.7	67.3	67.5	69.8	69.5	70.2	71.7	69.4	69.0	69.2	69.7	69.6
Belgium	125.6	122.3	126.2	127.8	136.9	140.7	137.7	135.2	133.5	127.7	122.6	119.1	113.4	111.6	108.1	103.2	98.7	98.5	95.9	93.6
Canada	70.9	72.0	74.5	82.1	89.9	96.9	98.2	100.8	100.3	96.2	93.9	91.2	82.7	82.9	80.5	75.7	72.2	69.3	64.6	60.7
Czech Republic	..	..	..	..	..	..	..	19.3	18.2	17.5	18.9	25.5	26.6	36.9	38.4	46.8	44.6	42.8	42.9	42.8
Denmark	69.5	67.8	68.5	69.4	73.4	87.7	81.4	77.6	73.9	69.8	66.6	60.8	53.7	53.3	54.1	55.5	52.8	49.7	47.1	45.2
Finland	19.0	16.7	16.5	24.9	44.7	57.8	60.3	65.1	66.0	64.3	60.8	55.5	52.9	50.9	50.4	52.0	52.5	53.3	54.9	55.2
France	38.9	38.9	38.6	39.7	43.9	51.0	60.2	62.6	66.3	68.4	69.9	66.5	65.2	63.8	66.6	71.7	74.7	76.7	77.5	78.1
Germany[1]	42.3	40.9	41.5	37.9	41.0	46.3	46.7	55.8	58.9	60.4	62.2	60.8	59.9	59.3	61.6	64.6	67.9	69.9	71.4	72.4
Greece	62.7	65.7	79.6	82.2	87.8	110.1	107.9	108.7	111.3	108.2	105.8	105.2	114.0	114.4	111.6	108.8	109.3	108.1	106.1	104.2
Hungary	..	..	..	..	..	..	..	..	..	67.9	65.5	66.3	60.1	58.0	57.8	58.1	60.7	62.5	64.2	65.8
Iceland	31.1	36.7	36.4	38.6	46.5	53.4	56.0	59.4	56.8	54.1	48.9	44.1	41.5	47.3	43.5	41.4	36.3	32.0	30.0	30.3
Ireland	107.1	97.9	93.2	94.6	91.6	94.2	88.7	81.2	72.8	64.0	53.0	48.1	37.9	35.3	32.0	31.1	29.4	29.9	29.8	29.5
Italy	..	..	..	..	..	..	..	125.5	131.3	133.3	135.0	129.5	124.9	124.5	123.5	121.4	123.0	125.4	126.8	128.6
Japan[2]	74.1	70.8	68.6	64.8	68.6	74.7	79.7	87.0	93.8	100.3	112.1	125.7	134.0	142.3	149.4	154.0	156.3	158.9	160.5	161.5
Korea	9.8	8.9	7.8	6.7	6.4	5.6	5.2	5.5	5.9	7.5	13.1	15.6	16.3	17.4	16.6	18.6	19.6	20.3	22.0	21.0
Luxembourg	..	..	5.4	4.6	5.5	6.8	6.3	6.7	7.2	6.8	6.3	6.0	5.5	6.7	6.8	6.7	6.6	8.6	10.2	11.4
Netherlands	84.4	85.0	84.2	85.3	89.0	93.7	83.9	87.0	86.0	81.0	79.5	71.1	63.7	59.5	60.3	61.9	62.3	63.7	64.7	65.2
New Zealand	..	..	..	..	..	64.8	57.8	51.7	45.2	42.6	42.7	39.9	37.9	35.7	34.0	32.0	29.0	26.0	23.3	19.9
Norway	32.8	32.8	29.3	27.5	32.2	40.5	36.9	40.5	35.9	32.0	31.3	30.9	34.3	33.2	40.1	50.4	51.2	51.7	51.2	50.7
Poland	..	..	..	..	..	..	..	..	..	..	44.4	47.6	43.6	38.3	52.0	52.1	50.2	53.3	57.0	59.9
Portugal	..	..	..	..	..	..	..	69.9	69.2	65.3	61.6	60.2	59.9	62.5	65.1	66.6	69.5	76.5	79.9	82.7
Slovak Republic	..	..	..	..	..	..	..	..	..	..	41.2	52.0	58.9	58.8	51.5	49.7	53.0	56.8	60.5	63.2
Spain	..	..	47.7	49.6	51.9	65.4	64.0	68.8	75.6	74.5	74.4	68.5	65.9	61.6	59.7	54.8	52.0	49.1	46.5	44.3
Sweden	56.1	51.0	46.8	55.5	74.0	79.0	83.5	82.2	84.7	82.9	81.7	71.8	64.4	63.4	60.3	59.8	62.5	61.5	60.9	59.9
United Kingdom	42.8	36.9	33.0	33.6	39.8	49.6	47.8	52.7	52.5	53.2	53.7	48.7	45.7	41.1	41.3	41.9	44.2	46.8	49.1	51.0
United States	64.8	65.1	66.6	71.3	73.7	75.4	74.6	74.2	73.4	70.9	67.7	64.1	58.1	58.0	60.3	63.4	64.0	63.8	64.6	65.3
Euro area	50.3	49.4	49.6	49.0	52.9	59.9	61.7	76.1	80.1	81.2	81.9	78.4	76.1	74.8	75.6	76.6	78.1	79.3	79.7	80.0
Total OECD	57.8	56.8	56.9	58.4	62.0	66.6	67.6	72.8	74.5	74.5	74.5	73.3	70.8	71.1	73.2	75.3	76.3	76.9	77.6	78.1

Note: Gross debt data are not always comparable across countries due to different definitions or treatment of debt components. Notably, they include the funded portion of government employee pension liabilities for some OECD countries, including Australia and the United States. The debt position of these countries is thus overstated relative to countries that have large unfunded liabilities for such pensions which according to ESA95/SNA93 are not counted in the debt figures, but rather as a memorandum item to the debt. General government financial liabilities for Greece, Ireland and Luxembourg follow the definition of debt applied under Maastricht Treaty rather than the ESA95/SNA93 methodology. Maastricht debt for European Union countries is shown in Annex Table 60. For more details see *OECD Economic Outlook* Sources and Methods *(http://www.oecd.org/eco/sources-and-methods).*

1. Includes the debt of the Inherited Debt Fund from 1995 onwards.
2. Includes the debt of the Japan Railway Settlement Corporation and the National Forest Special Account from 1998 onwards.

Source: OECD Economic Outlook 78 database.

Appendix 1 – 3

Annex Table 29. **General government primary balances**

Surplus (+) or deficit (-) as a per cent of nominal GDP

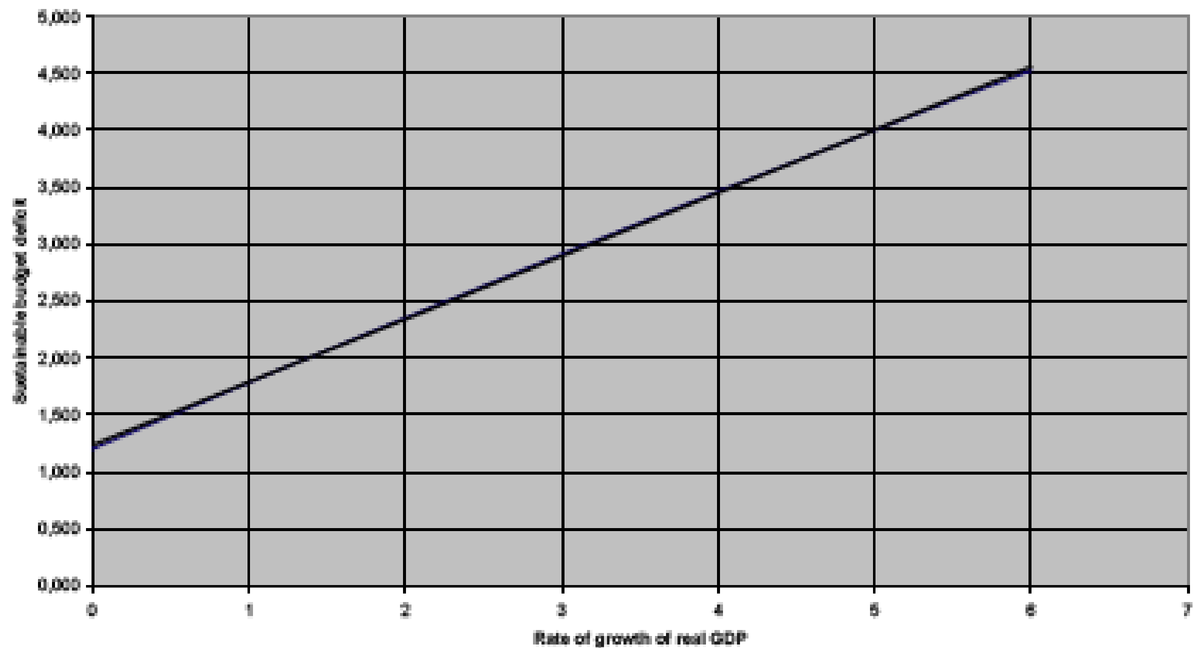
	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Australia	3.0	3.3	1.7	-1.1	-2.7	-2.7	-0.6	0.2	1.2	2.4	3.0	4.3	3.0	0.8	2.0	2.4	2.5	2.5	2.3	2.2
Austria	-0.8	-0.5	0.1	-0.1	0.9	-1.2	-1.8	-2.6	-0.7	1.3	0.6	0.6	1.2	2.7	1.9	1.0	1.2	0.3	0.2	0.7
Belgium	2.5	3.1	4.3	3.2	2.6	3.1	4.0	4.4	4.6	5.6	6.5	6.2	6.6	6.7	5.6	5.4	4.6	4.2	3.4	3.0
Canada	-0.1	0.0	-0.7	-3.1	-3.8	-3.4	-1.5	0.4	2.5	5.0	4.9	5.9	6.0	3.6	2.5	2.0	2.2	2.7	2.3	2.0
Czech Republic	..	..	..	..	..	..	..	-13.3	-2.6	-2.1	-4.6	-3.2	-3.3	-5.7	-6.3	-12.1	-2.6	-3.6	-3.1	-2.6
Denmark	5.9	4.2	2.4	0.9	0.6	-0.4	-0.1	0.2	1.0	2.4	2.5	3.9	4.3	3.0	2.0	1.3	2.4	3.3	2.6	1.9
Finland	4.3	5.5	3.6	-3.0	-7.5	-7.6	-4.7	-3.0	-1.5	0.6	3.3	3.7	8.0	5.8	4.3	2.4	2.1	2.3	1.8	1.4
France	-0.4	0.4	0.4	0.0	-1.5	-3.0	-2.6	-2.5	-1.0	0.0	0.3	0.9	1.1	1.0	-0.6	-1.8	-1.2	-0.7	-0.8	-0.6
Germany	0.4	2.4	0.3	-0.7	0.1	-0.3	0.4	-0.1	-0.3	0.4	0.8	1.3	4.0	-0.2	-1.1	-1.3	-1.1	-1.3	-1.1	-0.1
Greece	-4.4	-6.3	-5.9	-1.7	-1.0	-1.1	4.2	2.0	4.0	2.7	4.2	4.0	3.3	0.7	0.9	-0.3	-1.3	0.5	1.5	0.9
Iceland	-1.3	-3.7	-2.0	-1.7	-1.8	-3.1	-3.4	-1.3	0.0	1.3	2.0	3.8	3.6	1.3	-1.0	-1.4	0.4	2.3	1.5	-0.2
Ireland	1.8	3.5	3.3	2.8	2.2	2.1	2.5	1.9	3.1	4.0	4.6	3.8	5.3	1.0	-0.2	0.4	1.6	-0.7	-0.4	-0.4
Italy	-3.3	-2.7	-1.8	-0.4	1.5	2.3	1.7	3.3	3.8	6.1	4.7	4.4	5.3	2.7	2.4	1.5	1.2	0.0	-0.2	-0.5
Japan	2.9	3.3	3.3	2.9	1.9	-1.2	-2.5	-3.4	-3.7	-2.5	-4.1	-5.8	-6.0	-4.7	-6.5	-6.3	-4.8	-4.8	-4.1	-3.7
Korea	3.0	2.7	2.6	1.2	0.8	1.8	2.4	3.3	2.7	2.4	0.6	1.8	4.4	3.8	4.5	-0.5	-0.9	-1.1	-1.0	-0.8
Luxembourg	..	..	2.7	-1.0	-2.2	0.1	1.6	1.6	1.5	2.3	2.5	2.8	5.3	4.8	1.2	-0.6	-1.4	-3.1	-2.8	-2.6
Netherlands	0.5	-0.7	-1.0	1.7	0.3	1.7	1.0	0.5	2.8	3.2	3.3	4.3	5.1	2.2	0.2	-1.0	-0.1	0.0	0.0	0.3
New Zealand	-0.6	0.0	-0.1	-0.7	-0.5	1.2	3.9	4.4	3.7	2.6	1.1	-0.1	1.6	2.2	3.7	5.1	5.1	4.8	4.0	3.5
Norway	-0.8	-1.6	-1.3	-3.6	-5.3	-4.2	-1.9	1.1	4.3	5.7	1.4	3.9	13.0	10.4	5.7	4.1	7.7	11.6	13.1	13.0
Poland	..	..	..	..	..	..	..	1.5	-0.4	-0.6	-0.3	-0.3	-0.3	-1.2	-0.9	-2.4	-1.6	-1.2	-1.4	-1.1
Portugal	2.8	3.0	1.9	1.2	3.6	-0.3	-1.1	0.8	0.6	0.6	0.3	0.3	0.2	-1.2	0.1	-0.1	-0.3	-3.2	-1.7	-1.3
Slovak Republic	..	..	..	..	..	..	-4.9	-0.1	-6.5	-5.0	-2.4	-5.7	-10.0	-4.2	-4.9	-2.4	-2.5	-3.4	-3.4	-2.8
Spain	-0.4	0.2	-0.9	-1.3	-0.1	-2.3	-1.9	-1.5	0.2	1.5	1.0	2.4	2.1	2.2	2.1	2.1	1.7	1.9	1.8	1.6
Sweden	3.6	3.0	2.7	-0.8	-10.0	-11.8	-8.5	-5.5	-1.2	1.0	3.3	3.7	5.9	3.3	0.6	0.1	1.2	1.1	0.7	1.2
Switzerland	..	..	1.0	-0.7	-1.8	-2.1	-1.3	-0.5	-0.6	-1.6	-0.7	0.9	2.9	1.5	0.9	-0.7	-0.7	-0.9	-0.6	-0.2
United Kingdom	3.5	3.6	1.1	-0.7	-4.1	-5.5	-4.1	-2.7	-1.1	1.0	3.1	3.5	6.2	2.7	0.1	-1.6	-1.4	-1.1	-1.1	-1.3
United States	-0.5	0.1	-0.8	-1.3	-2.2	-1.5	-0.2	0.4	1.2	2.4	3.5	3.6	4.1	1.9	-1.7	-3.1	-2.9	-1.8	-2.1	-1.7
Euro area	-0.5	0.4	-0.1	-0.3	0.1	-0.5	-0.2	-0.1	0.8	1.9	1.9	2.3	3.5	1.4	0.6	-0.1	0.1	-0.2	-0.1	0.1
Total OECD	0.5	1.0	0.3	-0.4	-1.2	-1.5	-0.8	-0.4	0.3	1.5	1.8	1.9	2.7	1.0	-1.1	-2.1	-1.6	-1.3	-1.3	-1.0

Note: The primary balance excludes the impact of net interest payments on the financial balance. For more details see footnotes to Annex Tables 27 and 31 and *OECD Economic Outlook* Sources and Methods *(http://www.oecd.org/eco/sources-and-methods)* .

Source: OECD Economic Outlook 78 database.

Appendix 2-1[138]

Sustainability of government budget deficits (with debt equal to 60% of GDP and 2% inflation)



The relationship between the budget balance and government debt can be expressed by the following budget constraint:

$$d(t) = d(t-1)*(1/(1+g)(1+i)) + b(t)$$

where d(t) = the debt/GDP ratio at the end of period 't', b(t) = the general government budget deficit in period 't', 'g' = the real rate of growth of GDP and 'i' = the rate of inflation (GDP deflator).

By assuming a constant debt/GDP ratio d(t) must be equal to d(t-1) and the equation can be reduced to:

$$b(t) = d(t)*(1-(1/(1+g)*(1+i)))$$

Introducing an assumption concerning the rate of inflation 'i', and the desired level of public debt, the equation can be solved for 'b' and different values of 'g' as expressed in 0.

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[138] Excerpted from Mortensen, *supra* note 10, at 17.

Appendix 2 - 2[139]

Sanctions timetable

January	Year N	Year N + 1
February		
March	Member states submit programs Commission prepares reports	Member states submit programs
April		ECOFIN decides to abrogate or intensify sanctions
May	ECOFIN decides on excessive deficit and issues recommendation	
June		
July		
August		
September	ECOFIN decides on compliance and decides whether to publish recommendations	
October	ECONFIN gives notice	
November		
December	ECOFIN applies sanctions	

[139] Adopted from Cabral, supra at 146.

Appendix 2 - 3[140]

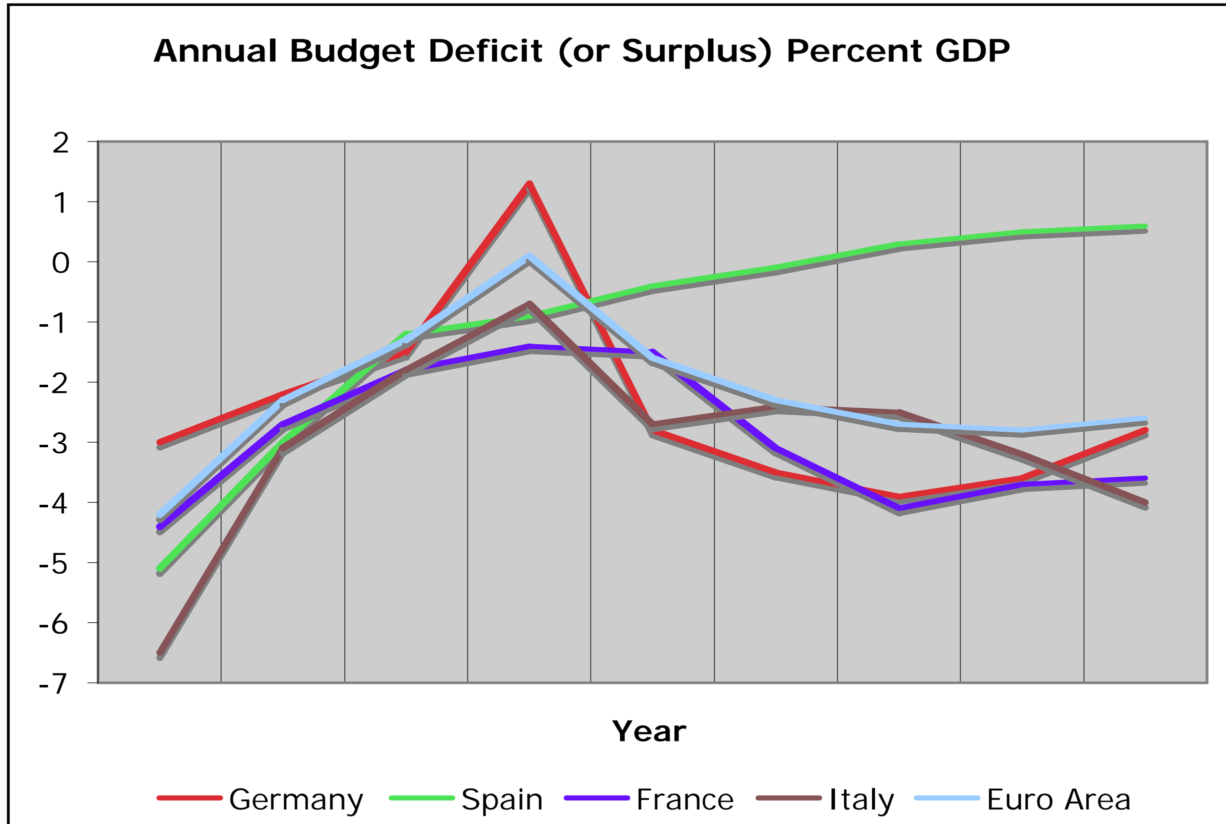
Net lending (+) or net borrowing (-), general government, as a percentage of GDP

	1997	1998	1999	2000	2001*
Belgium	-2.0	-0.9	-0.7	0.0	0.5
Germany	-2.6	-2.1	-1.4	-1.0	-1.7
Greece	-4.6	-3.1	-1.8	-0.9	0.0
Spain	-3.2	-2.6	-1.2	-0.4	0.1
France	-3.0	-2.7	-1.6	-1.3	-1.1
Ireland	0.8	2.1	2.1	4.5	3.9
Italy	-2.7	-2.8	-1.8	-1.5	-1.3
Luxembourg	3.6	3.2	4.4	5.3	4.0
Netherlands	-1.2	-0.7	1.0	1.3	0.8
Austria	-1.9	-2.2	-2.1	-1.5	-0.7
Portugal	-2.6	-2.3	-2.1	-1.7	-1.5
Finland	-1.5	1.3	1.8	6.7	5.3
Euro Area Average	-2.6	-2.1	-1.2	-0.7	-0.8

* European Commission Spring 2001 forecasts

[140] Excerpted from Cabral, supra at 152.

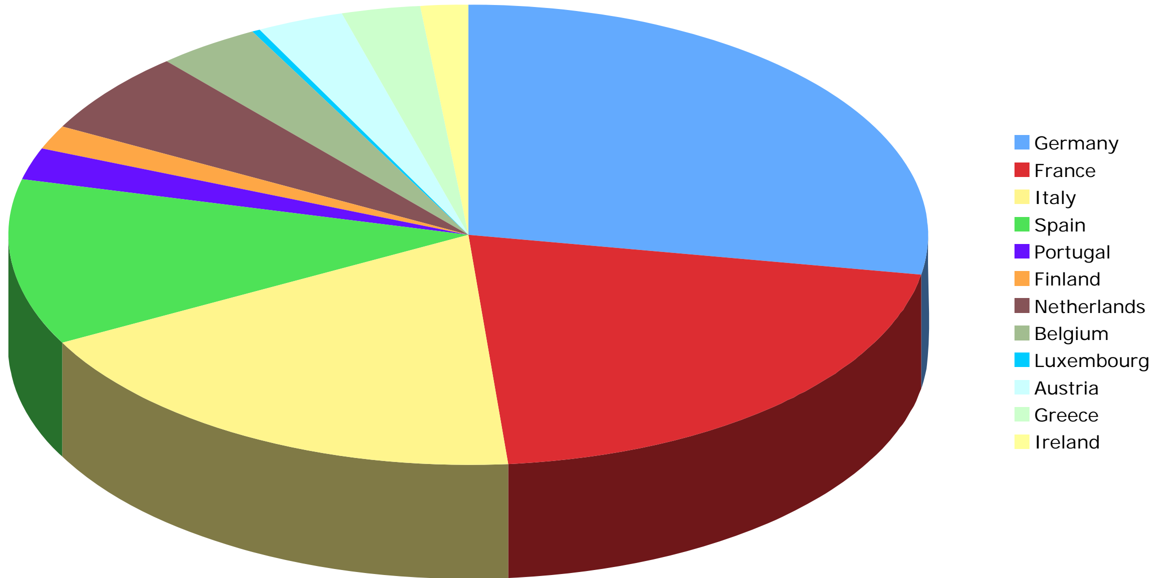
Appendix 2 - 4[141]



	'93-'98	1998	1999	2000	2001	2002	2003	2004	2005
Belgium	-3.8	-0.7	-0.4	0.1	0.5	0	0.2	-0.5	-0.8
Germany	-3	-2.2	-1.5	1.3	-2.8	-3.5	-3.9	-3.6	-2.8
Greece	-7.9	-2.5	-1.8	-2	-1.4	-1.5	-3	-3.2	-2.8
Spain	-5.1	-3	-1.2	-0.9	-0.4	-0.1	0.3	0.5	0.6
France	-4.4	-2.7	-1.8	-1.4	-1.5	-3.1	-4.1	-3.7	-3.6
Ireland	-0.4	2.3	2.3	4.4	1.1	-0.1	0.2	-0.8	-1
Italy	-6.5	-3.1	-1.8	-0.7	-2.7	-2.4	-2.5	-3.2	-4
Luxembourg	2.4	3.2	3.7	6.3	6.3	2.7	-0.1	-2	-2.3
Netherlands	-2.4	-0.8	0.7	2.2	0	-1.6	-3.2	-3.6	-3.3
Austria	-3.8	-2.5	-2.4	-1.6	0.1	-0.4	-1.3	-1.3	-2.1
Portugal	-4.8	-3.2	-2.9	-2.9	-4.4	-2.7	-2.9	-3.5	-3.9
Finland	-3.4	1.6	2.2	7.1	5.2	4.3	2.1	1.8	2
Euro Area	-4.2	-2.3	-1.3	0.1	-1.6	-2.3	-2.7	-2.8	-2.6

[141] Adopted from: Elena Flores, Gabriele Giudice and Alessandro Turrini, *The Framework for Fiscal Policy in EMU: What Future After Five Years of Experience?*, European Commission Economic Papers (March 2005), available at: http://europa.eu.int/comm/economy_finance/publications/economic_papers/2005/ecp223en.pdf

Appendix 2 - 5[142]

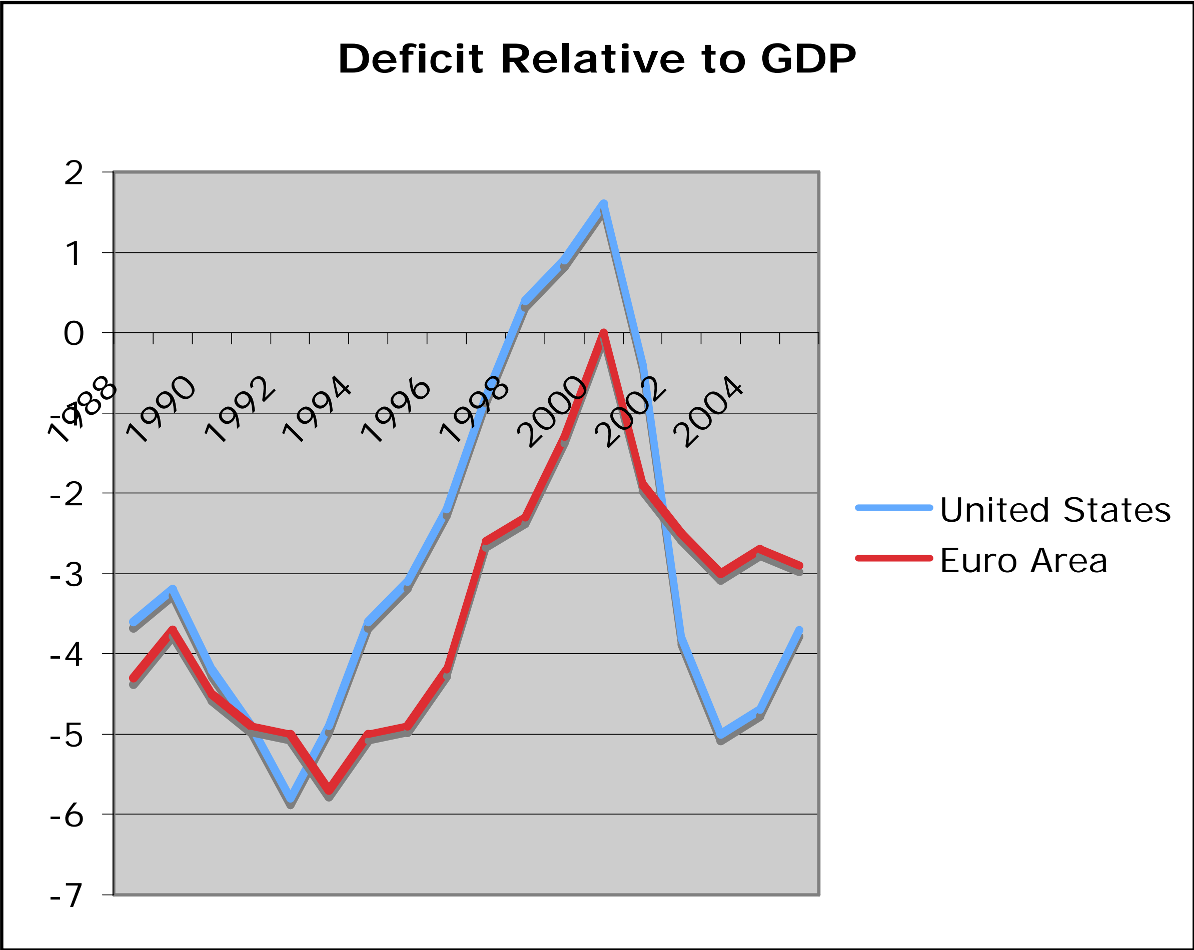


Euro Area GDP in 2005 ($ billion)

	PPP	OER
Germany	2454	2764
France	1822	2068
Italy	1651	1694
Spain	1017	1021
Portugal	196	169
Finland	160	188
Netherlands	502	587
Belgium	331	353
Luxembourg	29	32
Austria	270	295
Greece	243	211
Ireland	137	189
Eurozone	8812	9571

[142] Data from CIA World Fact Book, available at: http://www.cia.gov/cia/publications/factbook

Appendix 2 – 6



Data from Appendix 1-1.

Appendix 2 – 7[143]

Table 2: General government gross debt (as % of GDP)									
	Average 1993-98	1998	1999	2000	2001	2002	2003	2004	2005
BE	130.4	119.6	114.8	109.1	108.1	105.8	100.5	97.4	94.3
DE	55.8	60.9	61.2	60.2	59.4	60.8	64.2	65.6	66.1
EL (1)	108.7	105.8	105.2	106.2	106.9	104.7	103.0	102.8	101.7
ES	63.8	64.6	63.1	61.2	57.5	54.6	50.8	48.0	45.1
FR	54.0	59.5	58.5	57.2	56.8	58.6	63.0	64.6	65.6
IE	76.3	53.8	48.6	38.4	36.1	32.3	32.0	32.4	32.6
IT	121.4	116.7	115.5	111.2	110.6	108.0	106.2	106.0	106.0
LU	6.7	6.3	6.0	5.5	5.5	5.7	4.9	4.5	3.8
NL	74.1	66.8	63.1	55.9	52.9	52.6	54.8	56.3	58.6
AT	65.5	63.7	67.5	67.0	67.1	66.6	65.0	65.5	65.3
PT	60.4	55.0	54.3	53.3	55.6	58.1	59.4	60.7	62.0
FI	55.1	48.6	47.0	44.6	43.9	42.6	45.3	44.5	44.3
EUR-12 (2)	72.2	74.1	72.8	70.4	69.4	69.2	70.4	70.9	70.9

Note Figures 2000-2003 are based on a revised EDP notification not yet validated by Eurostat; hence, they are to be considered subject to revision. Source: AMECO database.

Source AMECO database

[143] Excerpted from: Elena Flores, Gabriele Giudice and Alessandro Turrini, *The Framework for Fiscal Policy in EMU: What Future After Five Years of Experience?*, European Commission Economic Papers (March 2005), available at: http://europa.eu.int/comm/economy_finance/publications/economic_papers/2005/ecp223en.pdf

Appendix 3 - 1

[illegible] Account Budget (FY2006 Budget)

(unit : billion yen)

	FY2005 (Initial)	FY[illegible] ([illegible]al)	FY2005→FY2006	Note
(Revenues)				
Tax Revenues	44,0[illegible]7.0	[illegible],878.0	1,871.0	The ratio of tax revenues to total reveneus: 57.6% (FY2005: 53.5%) Effect of additional transfer of tax resources: 1,89[illegible].0
Non-tax Revenues	3,[illegible]	[illegible],835.0	49.1	Reduction in 'NTT interest-free loans' redemption: -368.9
(Excluding redemption of NTT interest-free loans)	3,4[illegible]7.0	[illegible],835.0	418.0)	
Government Bond Issues	34,390.0	[illegible],973.0	-4,417.0	Bond dependency ratio: 37.6% (FY2005: 41.8%)
Total	82,1[illegible]	[illegible],686.0	-2,496.9	
(Expenditure)				
National Debt Service	18,442.2	[illegible],761.6	319.4	Including increases in fixed-rate transfer due to a rise in the government bond outstanding (643.9) and reduction in 'NTT interest-free loan' redemption (-368.9).
Local Allocation Tax Grants	16,088.9	[illegible],558.4	-1,530.5	Including reduction in Grants for planned tax resources transfer (629.2).
General Expenditures	47,282.9	[illegible],366.0	-916.9	Including increase due to rise in state contribution of basic pension and expanding child-care allowance (291.0).
Subsidies for redemption of NTT interest-free loans	368.9	—	-368.9	
Total	82,1[illegible]	[illegible],686.0	-2,496.9	

Source: the MOF, Japan (2005), "Highlights of the Budget for FY 2006"

Appendix 3 -2

(Unit : Trillion Yen)

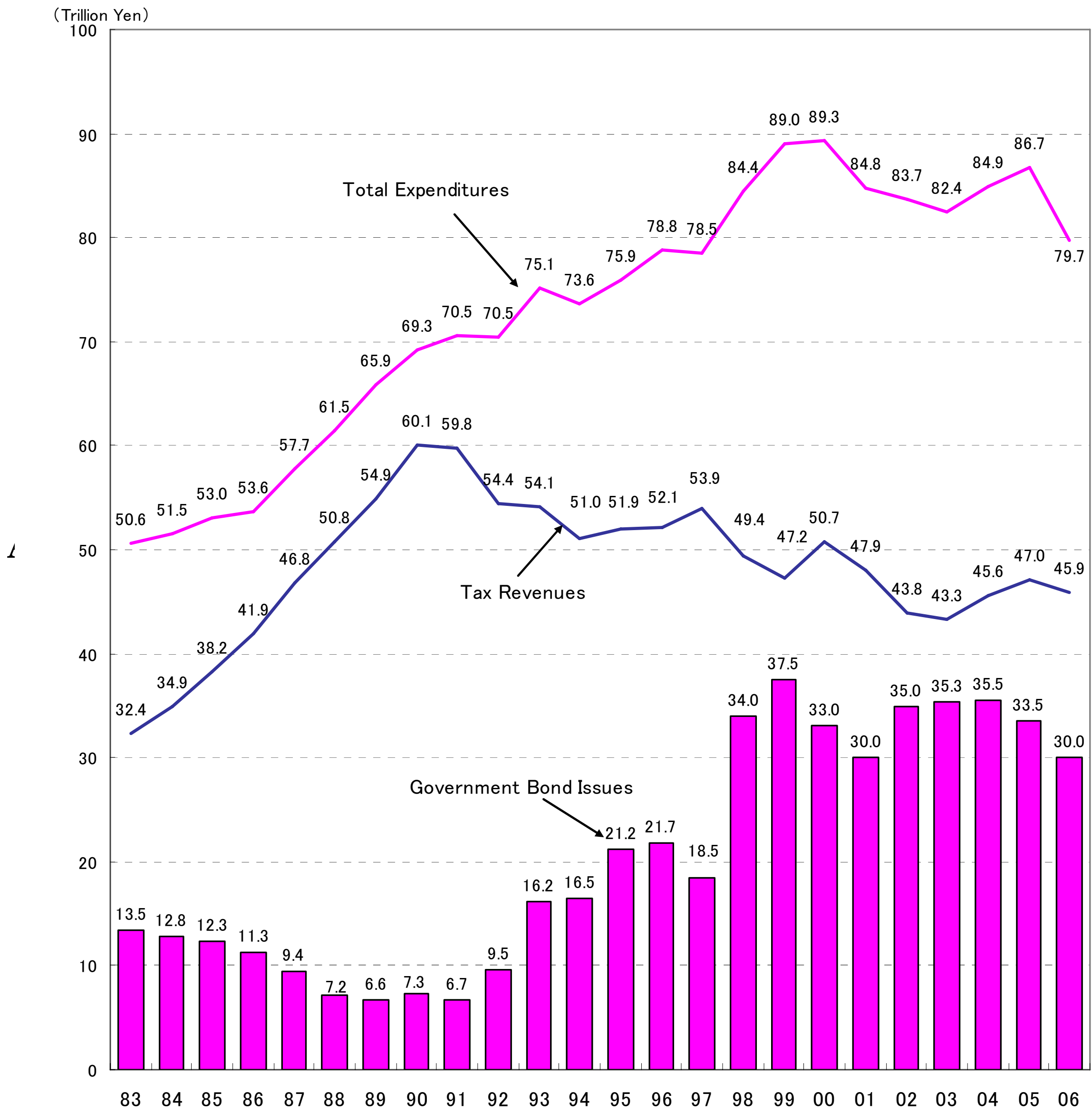
	FY1995 <Settlement>	FY2000 <Settlement>	FY2004 <Settlement>	FY2005 <Revised>	FY2006 <Budget>
Central Gov.	297	491	564	600 (570)	605 (580)
General Bonds	225	368	499	536 (506)	542 (517)
Local Gov.	125	181	201	204	204
Duplication	−12	−26	−33	−34	−34
Total	410	646	733	770 (740)	775 (750)
Percentage of GDP	82. 7%	128. 5%	147. 6%	152. 8% (146. 8%)	150. 8% (145. 9%)

(Note)

1. GDP for FY2005: estimates, FY2006: forecast
2. FY2006 includes redemption by usage of the surplus funds of Special Account for Fiscal Loan Program Funds.
3. Figures in parentheses of FY2005 and FY2006 exclude front loading issuance of refunding bonds.
4. Government bonds outstanding of Special Account for Fiscal Loan Program Funds is 141 trillion yen.

Source: MOF, Japan (2005), "Highlights of the Budget for FY 2006"

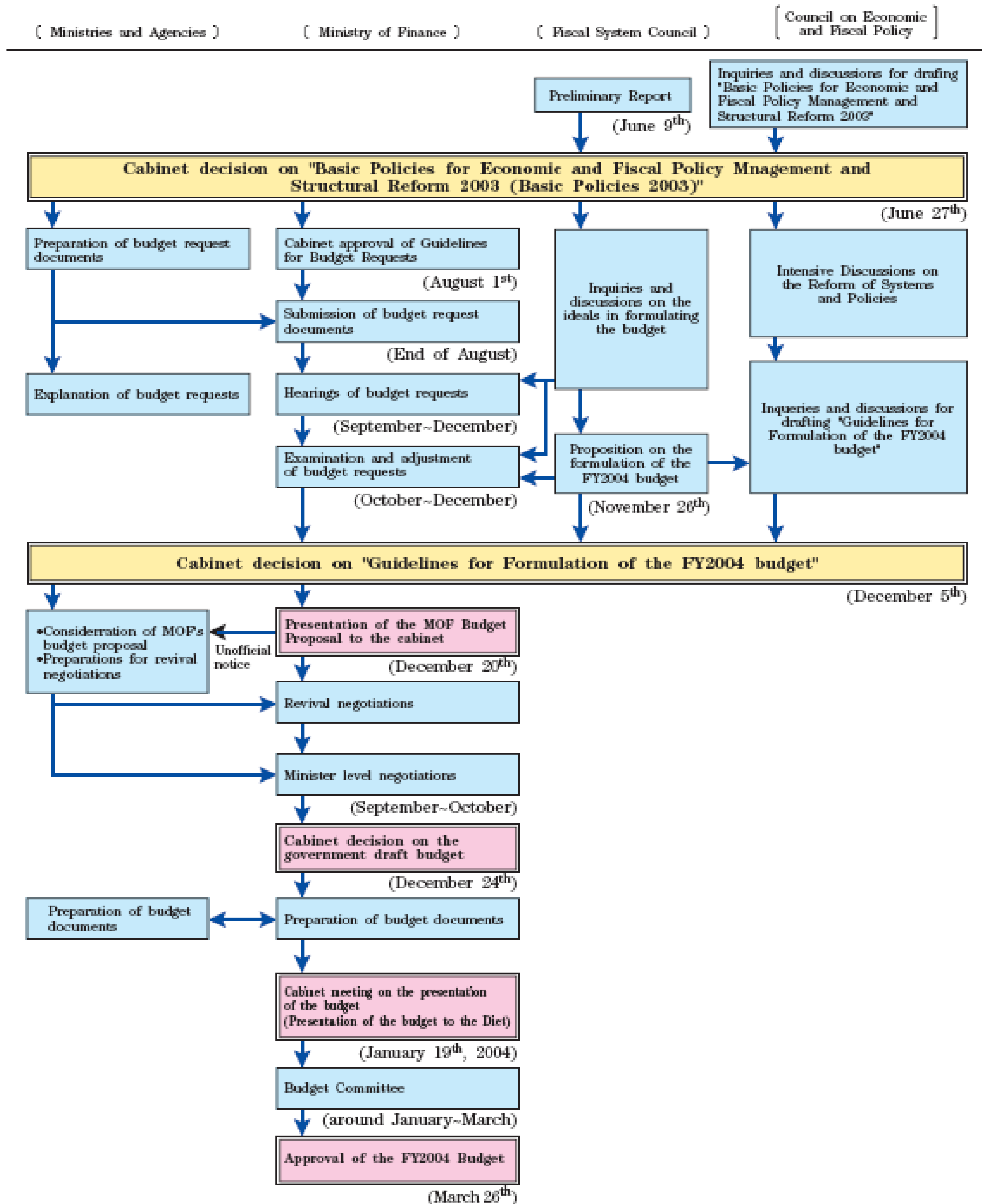
Appendix 3 -3



Source: MOF, Japan (2005), "Current Japanese Fiscal Conditions and Issues to Considered"

Appendix 3-4

The budget process of FY 2004



Source: MOF, Japan (2004), “Understanding the Japanese budget 2004”

Appendix 3 - 5

Fiscal Year	Summary
1961~64	Maximum 50% increase
1965~67	Maximum 30% increase
1968~75	Maximum 25% increase
1976	Maximum 15% increase
1977	General administrative expenses 10% increase Maximum Remainder 15% increase
1978~79	General administrative expenses Current office expenses 0% increase Remainder 5% increase Maximum Remainder 13.5% increase
1980	General administrative expenses 0% increase Maximum Remainder 10% increase
1981	General administrative expenses 0% increase Maximum Remainder 7.5% increase
1982	0% increase
1983	Maximum 5% decrease (Investment expenditure 0% increase)
1984~87	Current expenditures 10% decrease Maximum Investment expenditures 5% decrease
1988~90	Current expenditures 10% decrease Maximum Investment expenditures 0% increase * NTT scheme 1,300 billion yen
1991	Current expenditures 10% decrease Maximum Investment expenditures 0% increase Set aside for livelihood improvement related expenditures 200 billion yen * NTT scheme 1,300 billion yen
1992	Current expenditures 10% decrease Maximum Investment expenditures 0% increase Set aside for livelihood improvement related expenditures 200 billion yen Provisional measures for promotion of public investment 200 billion yen * NTT scheme 1,300 billion yen
1993	Current expenditures 10% decrease Maximum Investment expenditures 0% increase Set aside for livelihood improvement related expenditures 250 billion yen Provisional measures for promotion of public investment 200 billion yen Subsidies provided as alternative resources at the time of repayment of interest-free loan under the NTT scheme

	80 billion yen Provisional measures for improvement of livelihood, academic study and research 110 billion yen * NTT scheme 1,300 billion yen
1994	Current expenditures 10% decrease Maximum Investment expenditures 5% increase Subsidies provided as alternative resources at the time of repayment of interest-free loan under the NTT scheme 290 billion yen * NTT scheme 1,300 billion yen
1995	Current expenditures 10% decrease Maximum Investment expenditures of which 5% increase Basket to promote public investment 300 billion yen * NTT scheme 1,300 billion yen
1996	Current expenditures General administrative expenses 15% decrease Maximum Remainder 10% decrease Investment expenditures 5% increase including Basket to promote public investment 300 billion yen Special treatment for basis of economic development and academic study and research 140 billion yen * NTT scheme 1,300 billion yen
1997	Current expenditures General administrative expenses 15% decrease Maximum Remainder 12.5% decrease Interest-payment subsides 5% decrease Personnel expenses 0.8% decrease Investment expenditures 0% increase including Basket to promote public investment 500 billion yen Provisional measures for economic structural reform 300 billion yen * NTT scheme 1,300 billion yen
1998	General expenditures decrease Social security spending less than 300 billion yen increase Maximum Public investment budget 7% decrease Transfer to the special account for national schools 0% increase Subsidies for private educational institutions 0% increase Defense-related expenditure 0% increase ODA 10% decrease Staple food expenditure 0% increase Science and technology promotion budget

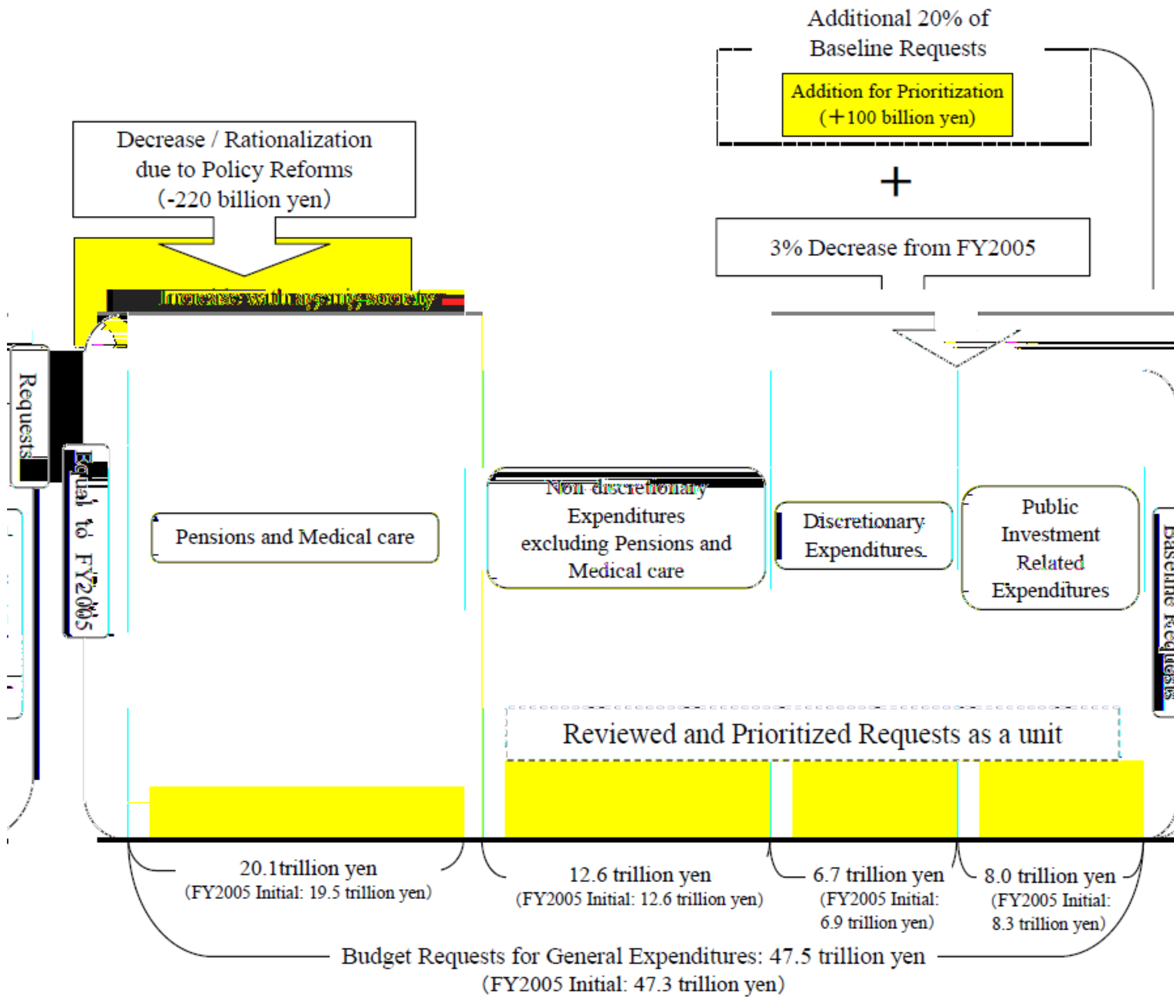
	approximately 5% increase Energy measures budget 0% increase Small and medium-sized businesses budget 0% increase including Provisional measures for economic structural reform 150 billion yen Special treatment for prioritizing public works Improvement of distribution and transportation system 150 billion yen Living environment 250 billion yen
1999	Public works spending 0% increase Maximum including Improvement of distribution and transportation system 150 billion yen Establishing a basis of economic development in the 21st century 100 billion yen Living environment 250 billion yen Science and technology promotion budget 5% increase Social security spending 570 billion yen increase Remainder (except for mandatory increase of personnel expenses) 0% increase Special frame for economic recovery 4,000 billion yen public works spending 2,700 billion yen non-public works spending 1,300 billion yen Special frame for establishing a basis for the 21st century 150 billion yen
2000	Public works spending 0% increase Maximum including Improving distribution efficiency, environment, telecommunication and town development (Special Category for Economic Rebirth) 250 billion yen Improving living environment 300 billion yen Social security spending 500 billion yen increase Remainder (except for mandatory increase of personnel expenses) 0% increase Special category for Economic Rebirth for non-public works (telecommunication, science and technology) 250 billion yen
2001	Public works spending 0% increase Maximum including Special allocation category for the Rebirth of Japan (public works category) 300 billion yen Special allocation category for the Rebirth of

	Japan reserved public works allocation) 100 billion yen Prioritized allocation category for public works related to improving the living environment 300 billion yen Social security spending 750 billion yen Remainder (deduct 1.9% of those items subject to prioritized allocation and add mandatory increase of personnel expenses) 0% increase Special allocation category for the Rebirth of Japan (non-public works) 50 billion yen Special allocation category for the Rebirth of Japan (reserved non-public works allocation) 50 billion yen
2002	Public investment related spending 0% increase Maximum Social security spending (except for facility expenses) 700 billion yen Mandatory spending (including annual increases of personnel expenses) 0% increase Remainder (including 90% of General policy expenditure and Special Request for Structural Reform) 0% increase Total public works expenditure 10% decrease
2003	Public investment related spending 120% of the Baseline for Requests Maximum Non-discretionary spending 0% increase except for 1) personnel expenses 2) pension and medical care 3) special factors Discretionary spending 120% of the Baseline for Requests
2004	Public investment related spending 120% of the Baseline for Requests Maximum Non-discretionary spending 0% increase except for 1) personnel expenses 2) pension and medical care 3) special factors Discretionary spending 120% of the Baseline for Requests

Source: MOF, Japan (2004), "Understanding the Japanese budget 2004"

Appendix 3 - 6

Guidelines for FY2006 General Expenditure Budget Requests



○ The government will maintain and strengthen its commitment to fiscal restructuring to complete various reforms. Further reduction/prioritization of expenditures will be carried out based on Basic Policies 2005.

- Reduction/efficiency in pensions and medical care due to policy reforms.(-220 billion yen)
- Other expenditure items will be reviewed as a unit and thoroughly prioritized.
- Personnel expenses will be strictly controlled and the number of national public servants will be decreased.
- Administrative costs will be thoroughly reviewed.

Increase/decrease in FY2006 Budget Reques

Pensions and Medical care	+ 580 billion y
Special Factors	+ 80 billion y
Public Investment Related Expenditures	- 280 billion y
Discretionary Expenditures	- 220 billion y
Addition for Prioritization	+ 100 billion y
Total	+ 260 billion y

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