

# Summary of the Presentations

## Part I: Budget Process and Data Comparison

The first speaker of the roundtable was Chikahisa Sumi of Ministry of Finance. Mr. Sumi, firstly, described the budget calendar from June to March since a fiscal year in Japan starts in April. In June of the preceding year, the Council on Economic and Fiscal Policy sets working assumptions for budget formulation as well as the preliminary stance of the Budget: whether the Budget shall be expansionary, neutral, or belt-tightening. During the process following up to the Budget formation in late December, governing parties and other interest groups' input are taken into consideration. Thus, the Japanese Budget, as submitted to the Diet (Japanese Parliament) for approval in late January, is not a kick-off of an annual budget round, as it is in US, but an end result of consultations and negotiations between the Administration and the Parliamentary majority.

Japan's budget takes a form of a cash flow statement and not an income statement. Simply, it determines how much can be spent in a fiscal year which eliminates accounting discretion. Japanese budget is based on rather strict year-by-year principle and not on accrual basis. These have made the Japanese Government reluctant, at times, to commit future expenditures in the out years in international negotiations. A second characteristic of Japanese budget is that there is no distinction between mandatory and discretionary items. A final characteristic is restriction of bond issues. During the shortfall of revenue, a supplementary budget needs to be approved to increase bond issues. Since the 90s, Japanese fiscal deficit has mushroomed from 9.5% of expenditures to at one time 42.1% (1999), thereby making debt accumulation a hot topic. When comparing international fiscal condition among G7 nations, Japan stands out as a poor case. The concern is apparently growing since Japan faces not only the cyclical slump but also formidable structural issues arising from rapidly aging society where social security payment is expected to explode. In this context, Prime Minister Koizumi advocated to suppress the bond issues to 30 trillion yen in each of 2001 and 2002.

From the US side, James Hearn, a senior analyst for Government Finance and Management presented his analysis of US budget process and its affect. He illustrates the complex process by showing how the budget affects the process. He notes that the President must sign the revenue and expenditure bill into law, even though the Legislative Branch has the exclusive "power of purse". However since 1921, President is required to submit an annual budget recommendation to the Congress for review which kickoffs the process 17 months prior budget year. Moreover, Hearn indicated that 'over the past year, power in the budget process appears to have ebbed to the President' by threatening to veto the bill which can only be overridden by 2/3 majority of both houses of Congress.

Compare to the Japanese counterpart, US fiscal year starts at October 1. However, for year 2003, the 'Senate never considered, and therefore never passed a budget plan when it was suppose to be don in March and April.' Accordingly, it will operate under the fiscal year 2002-2011 budget levels until a new budget is adopted. The difference between past budget and new budget is the "scoring" conducted by the Congressional Budget Office. Scoring is a baseline projection or the yardstick which illustrates economical and technical changes. Based upon the scoring, legislative proposals are formulated thereby if different baseline is used, different estimates may come up. For example, for 2003, even though the farm bill should have exceeded by \$73.5 billion dollars against latest baseline, by using the 2001 baseline, it only exceeded by 9.3 billion dollars. Moreover, the Budget Committee chairman squeezed an extra 9 billion dollars in subsidies for next 10 years by using an outdated baseline.

In case of emergency, Congress will approve supplemental appropriations. The largest amount of extra funding in recent years has gone to Persian Gulf War (does not reflect payback by allies), Homeland security, disaster activities and agriculture. Secondly, without a budget for 2003, spending caps and pay-as-you-go procedures were skewed.

What are these and how does it affect the budget? In 1990, Congress passed a Budget Enforcement Act (BEA) to “create an annual limit, or cap, on discretionary spending” which accounts for 1/3 of all expenditure. If the amount should exceed the cap, the President’s Office of Management and Budget (OMB) will implement reduction across the board. Additionally, OMB is required to reduce spending across the board for certain mandatory programs. Nonetheless, ‘there has never been a sequestration of mandatory programs’ since the Congress and the President have always agreed to enact a law avoiding reduction.

## Part II: Trade and Agriculture

Professor Merit Janow of Columbia University School of Public and International Affairs dealt with trade and agricultural issues while she attended the Uruguay round which reformed trade in agriculture and textile sectors.

Early indications suggest that agricultural liberalization continues to be a major point of difficulty between the United States, Japan and the European Union, among others. The empirical work in this area is quite clear: studies undertaken by the World Bank and others demonstrate that the benefits to developing countries of agricultural liberalization are likely to exceed manufacturing by a considerable degree. And, according to the USDA and other sources, most of the agricultural distortions are found in developed economies, notably the European Union (at 38 percent); Japan and Korea (at 13 percent); the United States (at 16 percent) and Canada (2 percent). Professor Janow commented on the various forms of distortions and the countries associated most significantly for those supports--e.g., with respect to export subsidies, tariffs and domestic supports. She also commented at some length on agricultural support measures in Japan. For example, export subsidies are not a significant issue in Japan. However, Japan does provide a wide range of supports to domestic production. According to the Trade Policy Review undertaken by the WTO in 2002, for example, the total forms of assistance provided to agriculture in Japan exceed the contribution to GDP of the sector itself. Indeed, as the OECD has noted, total transfers to the agricultural sector were 1.4 percent of GDP in contrast to its share of GDP at 1.1%. She also noted various remaining tariff peaks, food prices and other evidence of the price distortions in this sector.

Professor Janow also briefly considered the role of regional trade agreements and their potential contribution with respect to agricultural reform and liberalization. Regional FTAs involving Japan are now a significant policy development--and a new one. Some are optimistic that these can include some coverage of agriculture and thereby build up a pattern of reform that will support broader multilateral liberalization. This was a view expressed later by Ms. Munakata. Professor Janow indicated some skepticism on this point, noting that in her view the most difficult sectors for nations to liberalize are less likely to be liberalized in small regional arrangements than in a broader framework. She noted that regional trade agreements may serve various political objectives for Japan but it would be quite surprising to see serious agricultural reform result from this process.

Naoko Munakata, a senior fellow at RIETI and visiting scholar at the Sigur Center for Asian Studies at George Washington University, after clarifying the relation between agricultural subsidization and budget, discusses the role of FTAs as a vehicle of reform as well as implications of Asian regional integration of the U.S. Asia policy. On relations between subsidization and budget, she notes that 90% of Producer Support Estimate for Japan came from domestic price support through border measures such as tariffs and non-tariff barriers and domestic regulations on production and distribution. Surging imports overcoming existing tariffs, aging population and weakened consumer confidence are already putting pressure for policy review.

She emphasizes the role a bilateral FTA can play in eliminating border measures on relatively less sensitive items in the agriculture. Japan has chosen countries to negotiate for an FTA with deliberately, one by one, so that liberalization involved in each deal is not too politically sensitive while the overall deal is highly rewarding. She admits that the FTA may not be able to realize liberalization of highly sensitive items since, as to these sensitive items, domestic regulations

need to be reformed first to allow more competition at home and to make domestic producers more competitive before import liberalization.

Japan's motivation to pursue FTAs goes beyond agriculture. Munakata argues that Japan's deeper economic integration with Asia helps Japan dismantle its obsolete "dual structure" and bilateral FTAs can stimulate this process by breaking the weakest few links of political resistance and creating larger momentum with each successful example. At the same time, focused negotiations with a particular country will stimulate policy innovations to make Japan more accessible for foreign companies and business people, which can be extended to MFN basis. Munakata responded to Janow's comments on the downside and limitations of FTAs, arguing, "FTAs allow Japan to go ahead and liberalize what it can. If you are worried about the downside and do nothing, nothing will happen. It is the government's job to design FTAs to minimize their downside and overcome their limitations."

Finally, she discussed the implications of regional developments for the U.S. policy on Asia. Munakata sees that East Asian economic integration is in the U.S. interest in that 1) it helps Japan's economic revitalization, 2) interdependence in East Asia will reduce tension and thus the U.S. security burden, and 3) it pressures Japan to become more trusted and embedded in the region, and in turn, a more valuable ally for the U.S. She argues that the U.S. positive approach toward Asian regional integration will help further strengthen Japan-U.S. relations.

### Part III: Tools of Diplomacy and Overseas Development Aid

The first speaker on this topic was Masahiko Kiya, First Secretary of Economic Section at the Embassy of Japan.

Organizations which deal with ODA in Japan are: Ministry of Foreign Affairs, Ministry of Finance, other ministries (10), Japan International Cooperation Agency (JICA) and Japan Bank for International Cooperation (JBIC). 75% of the ODA is on bilateral and 25% is multilateral basis. Compared to other countries, Japan utilizes loans far greater since it is mostly applied for infrastructure development with emphasis on sustainability. Japan is the largest donor (2000) for 54 countries though preference is given to Asian countries. Nonetheless, Kiya notes that Japan needs to 'improve its institutional flexibility and promoting its message' in its application.

With 10 years of recession, budget allocation for ODA has obviously declined. Yet cutting back on programs may have political implication on domestic and international front, thereby, sensitivity is necessary. However, once the budget is passed, allocation of the money is up to each ministries and institution. Only in certain major policies, are there any explanations forthcoming. Japan's ODA is aimed at 'fulfilling its global responsibility through non-military means' such as peace building.

On the other hand, US has been 'directed by security considerations' in the past on regional or sectoral basis. As the US counterpart, Larry Q. Nowels, a specialist in foreign affairs at the Congressional Research Service was at the roundtable to explain the ODA in the US. Organizations which deal with ODA are numerous and include: Defense Department, State Department, USAID, Treasury Department and others (9). US's ODA serves not only development/humanitarian issues but also other purposes. However, in the US, security is particularly important and often times, ODA is used as a tool of foreign policy. This was particularly evident during the Cold War era. Frequently, however, observers think of ODA as only related to development and poverty reduction goals, which is not always the case with U.S. ODA. FY2002, security/economic, terrorism/non-proliferation, narcotics/law comprised 39.2% of the ODA budget., [though] There is no separate ODA budget as evident in Japan. Though there were hesitation in the U.S. to cancel debts of poor countries initially, it gained momentum for the following reason: 1) humanitarian relief, 2) unlikely to see debt repayment and 3) leverage debt cancellation owed to other creditors as a way of removing obstacles to development in heavily indebted nations. The legislative branch plays a significant role in creating ODA budget since they have the 'power of purse'. However the executive branch initiates the budget and plays a very

significant role throughout the process. Currently, the executive and legislative branches agree on the following ODA priorities: war on terrorism, global health, public/private partnership and results based ODA. However if there are ideological or policy differences between the two branches, Congress might direct or prohibit the President from using or not using ODA money. Controversies between the two branches are: international family planning & abortion and higher resources for ODA. Even if we disregard the bickering between the two branches on how to allocate the funds, ODA budget has been in the past more vulnerable compared to domestic and defense issues. Congress has, often, raided the budget for the ODA. However, most recently Congress has increased funding for ODA above the President's request that suggests stronger support within the legislative branch. Nonetheless, ODA as percentage of GDP will be only 0.13% by 2006.

In monetary terms, growth was evident during the mid-80s. For President Regan, to obtain his defense increase, he needed to agree to increase on ODA as well. However, since the end of the Cold War and budget enforcement, we have seen decline in ODA funding until now. With the Millennium Challenge Account set to begin next year, President Bush has pledged to increase US ODA by \$5 billion over three years. It is exempt from foreign policy influences and assistance will be only provided to countries that performed well in the past using different criteria (good governance, liberalization, corruption ration and etc). Those countries which cannot qualify for the Millennium Challenge Account will still remain eligible for the current \$3 billion in bilateral U.S. ODA.

#### Part IV: Defense Budget and the Expense of the Alliance

To represent the US, Professor Mike Mochizuki, Director of the Sigur Center for Asian Studies at George Washington University presented his case by posing a question 'how does defense spending factor into bilateral contribution? Or how should we define burden sharing and alliances? Historically, during the Carter administration, US demanded that Japan contribute to its defense since many congressmen believed that Japan was a free rider. In 1976, though US spent 5.5-6% on defense (GDP), Japan spent less than 1%. Though no one envisioned Japan to spend 6% of the GDP, using the comprehensive security complex, it was believed that target should be set around 3%. In order to placate the US, Kanemaru instituted what is now called 'omoiyari yosan'. However when President Reagan came into the scene, interpretation of burden sharing shifted from finance to ambitions. During this time, Japan started discussing the notion of 1% ceiling on defense expenditure. In 1987, Japan for the first time Japan breached the 1% ceiling level and for next three years, expenditure broke the 1% GDP level. US is 3.1%. Korea is 3.0%. UK is 2.6%. Thus indeed Japan's 0.99% is considered small in terms of GDP. Nonetheless if we compare by absolute numbers, Japan spends about 44.4 billion yen which is third after US 294 billion and Russia 58 billion. China, France and UK spend less than Japan. However, does US take into account the free access and numerous bases in Japan which provides an opportunity for huge US presence in Pacific theater? This cannot be numerically compensated; nevertheless, it should be a very important factor when calculating burden sharing.

Compared to the US, budget allocation for defense expenditure has been stable, GDP percentage 0.95 – 0.99%. In 1989, defense expenditure for the US was 400 billion yet in 2001, 295 billion (6% of the GDP vs. 3.1%) This is so-called peace dividend phenomenon. Why is Japan stable compared to the US? Though there are three possible answers, Professor Mochizuki believes despite major changes in international system, strategic environment in northeast Asia has not altered. Then what would affect the defense budget? Intelligence satellite system? This is not part of the defense expenditure. Instead it is part of prime minister's office expenditure. BMD program? It is only in research phase and the cost has only been around 50 million dollars. War on terrorism? So far, Japan has avoided the issue though it has contributed 420 million dollars to date. Iraqi war? This is difficult to assess since we cannot anticipate the cost. Estimates range from 50 billion to 750 billion. Moreover, since Japan is in recession with huge dependency on issuing bonds to finance their budget. Japan may rebuke shouldering much financial burden.

Shigeki Akimoto, a research fellow at the National Institute for Defense Studies explains how the budget expenditure for defense is more flexible and efficient with the Concepts of Basic Defense Force than believed. As with any other ministries in Japan, the Defense Agency submits its budget request to the Ministry of Finance. The basis of the budget request is the Mid-Term Defense Program, which is produced every five years. It sets the total limit of defense expenditure and what is expected and planned for that period. However, to respond to unforeseen contingencies in the future and as a condition to creating a more stable security environment, 150 billion yen maybe used, subject to the approval of the National Security Council. The Mid-Term Defense Program is based on the National Defense Program Outline which illustrates how Japan's 'defense capabilities as it ought to be'. Defense policies are based on The Basic Policy for National Defense. Though these programs outlines and defines Japanese strategic position, it provides the latitude to revise and adapt to the environment in concern. To date, the NDPO has been revised 2 times, and the MTDP about ten times.

To demonstrate his analysis, he illustrates the steps taken with ballistic missile defense technology or known as BMD. The government considers cooperation with the US on the BMD enhancing its credibility on the Japan – US Security Arrangement. Since 1999, Japan joined in research for the Navy Theater Wide Defense system. In 1999, 930 million yen was appropriated which was to be debt financed. Additionally, for FY2000 3.7 billion yen, FY 2002 6.9 billion yen was allocated for design and trial manufacture. It is all possible once technological research is completed, Japan may undertake a decision to participate in the development of the BMD. However, to this date, BMD tests have only been successful once.

Finally, he states that the Government proclaims as the basis of Japan's defense policy the development of an efficient defense capability described above and adherence to the Japan-U.S. Security Arrangements. In that sense, unrestrained and unimpassioned policy consultations and information sharing between Japan and U.S. under normal circumstances might play a more decisive role in the policymaking process.