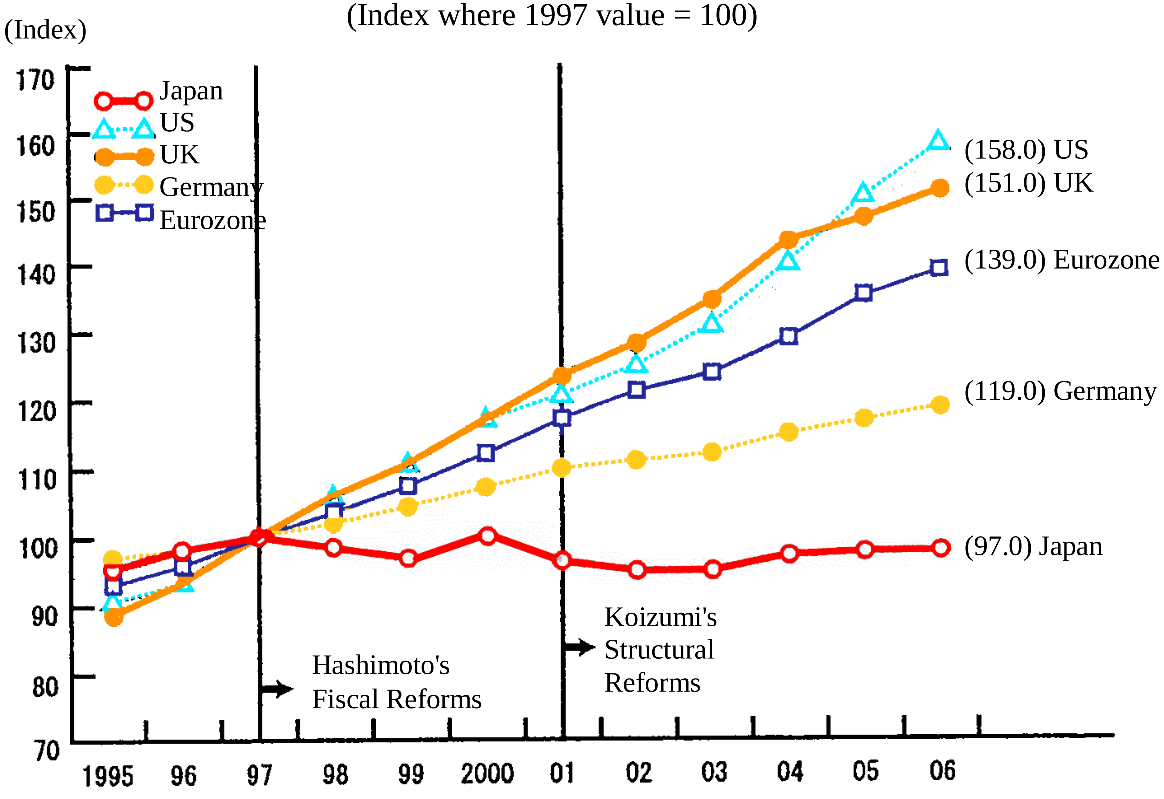
Graph 1: [International Comparison of Nominal GDP]

(Index where 1997 value = 100)



Source; OECD data

International Comparison of Nominal GDP (Gross Domestic Product)

Although Japan's GDP reached ¥521 trillion in 1997, it was no more than a mere ¥505 trillion in FY2006.

Fiscal austerity has held Japan's economic growth in check. Nominal GDP in Japan stopped growing in 1998 when fiscal austerity and tax hikes were implemented in the name of fiscal reform (GDP deflator has been negative since 1998).

The huge tax hike in FY1997 (which increased the burden on the public to the tune of ¥9 trillion due to an increase in the consumption tax from 3% to 5%, an increase in national welfare-related expenditures, and other factors) and scaled back public investment imposed a total burden of ¥13 trillion on the public.

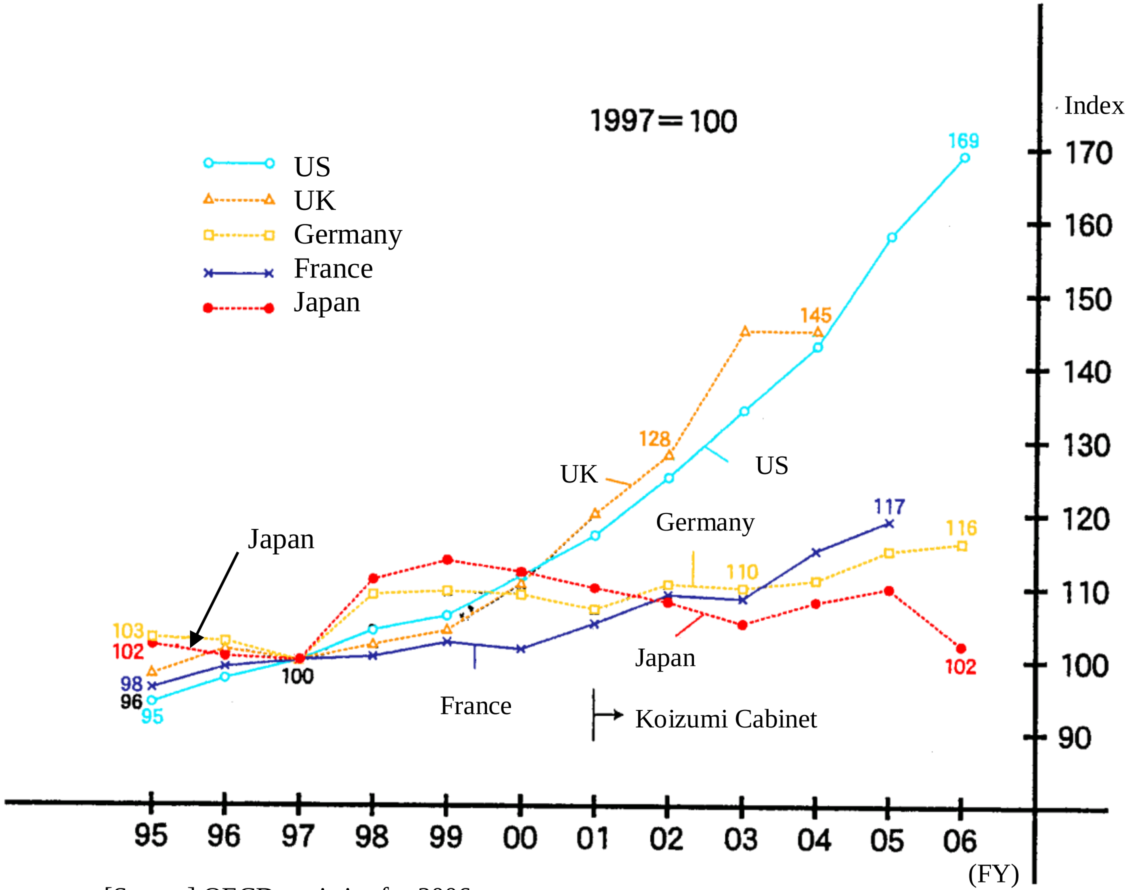
Later, under the Obuchi Cabinet from 1998 to 2000, a positive fiscal policy began to bear fruit and tax revenue also increased.

However, Koizumi's "Structural Reforms" starting in 2001 instituted successive reductions in investment-related expenditures and cut backs in local allocation taxes and subsidies. This caused deflation to further intensify, economic growth to shift into the negative and tax revenue to plunge.

Japan's GDP was ¥521 trillion in 1997. If Japan's GDP had grown on par with Europe and the United States, it would have hit ¥800 trillion in 2007, ¥720 trillion if it were equivalent to GDP growth in the Eurozone, and ¥620 trillion if it were in proportion to that of Germany. Tax revenue would have amounted to ¥70 or ¥80 trillion, and the budget crisis would likely have been resolved in the expanded equilibrium.

Graph 2: Japan's Fiscal Scale is too Small

(Changes in the Annual Fiscal Expenditures of Major Countries)



[Source] OECD statistics for 2006.

[Distinguishing Features]

Japan's annual fiscal expenditures have not increased at all during a period of 10 years. Japan's fiscal scale is too small. (government is too small)

International Comparison of Fiscal Scale

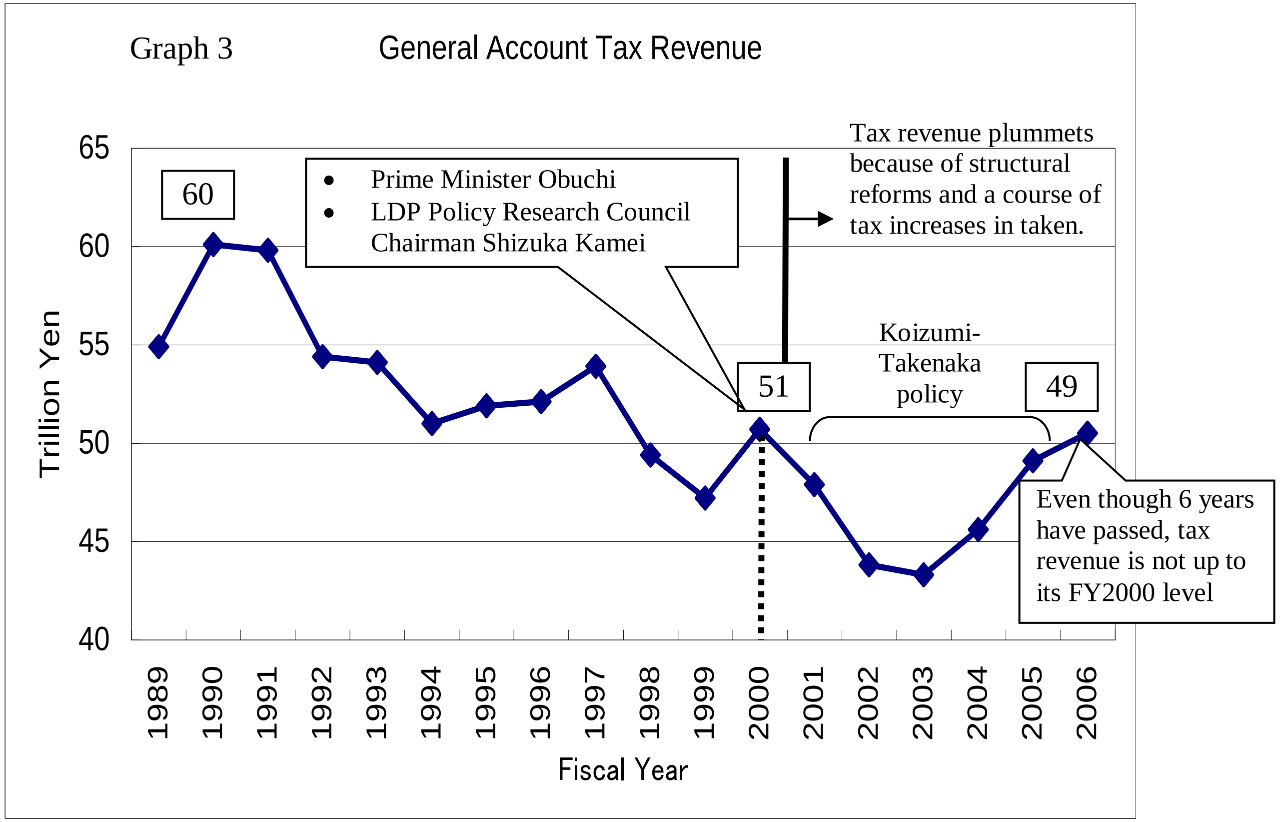
If a comparison is made, using 1997 as a basis of 100, concerning the extent to which major nations have increased their fiscal spending since that year, only Japan has seen extremely small growth in its fiscal spending. Public expenditures are at the same level they were 10 years before.

Over the period from 1998 to 2000, in order to overcome the financial crisis triggered by the failure of Hashimoto's fiscal reforms, public spending was expanded, the economy picked up, and tax revenue increased to ¥51 trillion in FY2000. What crashed this economic upswing was "Koizumi's deflation & structural reforms."

In this way, fiscal austerity, reductions in investment-related expenditures and local allocation taxes propelled deflation and led to a sharp decline in tax revenue.

Under such circumstances, the size of the economy does not expand, so the result is that tax revenue does not grow, nor do salaries rise (year-on-year decrease over 9 years), and medical costs also have to be cut.

If fiscal spending had been exercised on par with Europe and the United States, Japan's FY2006 fiscal expenditures (budget scale) would be ¥120-130 trillion if equivalent to the levels in the United States or the United Kingdom, or ¥92-95 trillion if on par with German or France (Japan's 1997 fiscal expenditures were ¥79 trillion.).



"Structural Reform" Destroyed Japan's Economy
--Each and every economic indicator has deteriorated—

Tax revenue hit ¥60 trillion in 1990
(bubble economy effect).

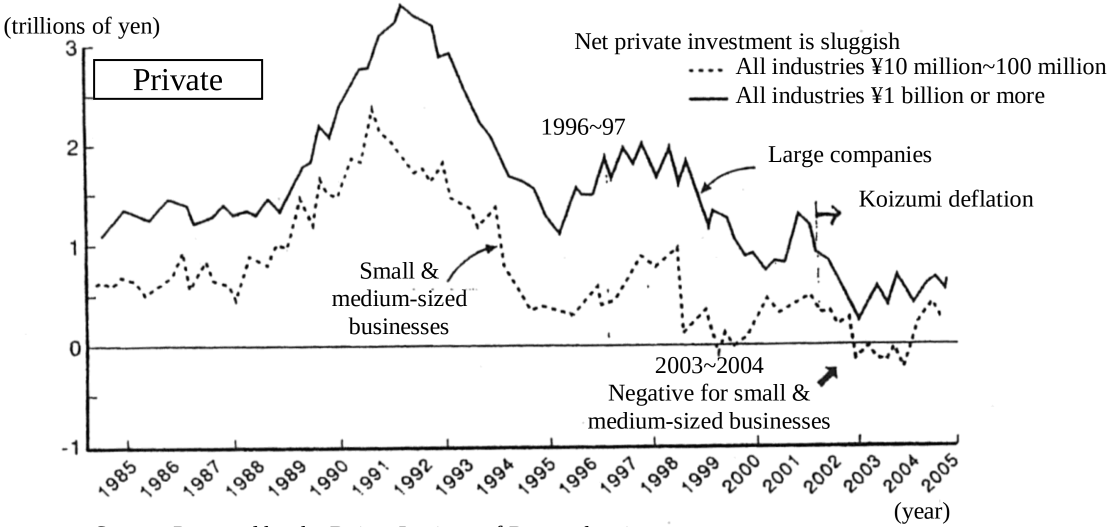
Hashimoto's 1997 fiscal reforms brought about the Heisei financial panic. Later, the positive fiscal policy of the Obuchi Cabinet revived the economy, and tax revenue also increased (¥51 trillion in FY2000).

However, "Structural Reforms" led to a deep slump in which the economy sunk into a panicky economic situation experiencing a drop in tax revenue. In FY2003, tax revenue was a mere ¥42 trillion. Recently, although there has been somewhat of an economic recovery, it was only ¥49 trillion in FY2006.

Tax hikes are the price to be paid for the failure of Structural Reform.

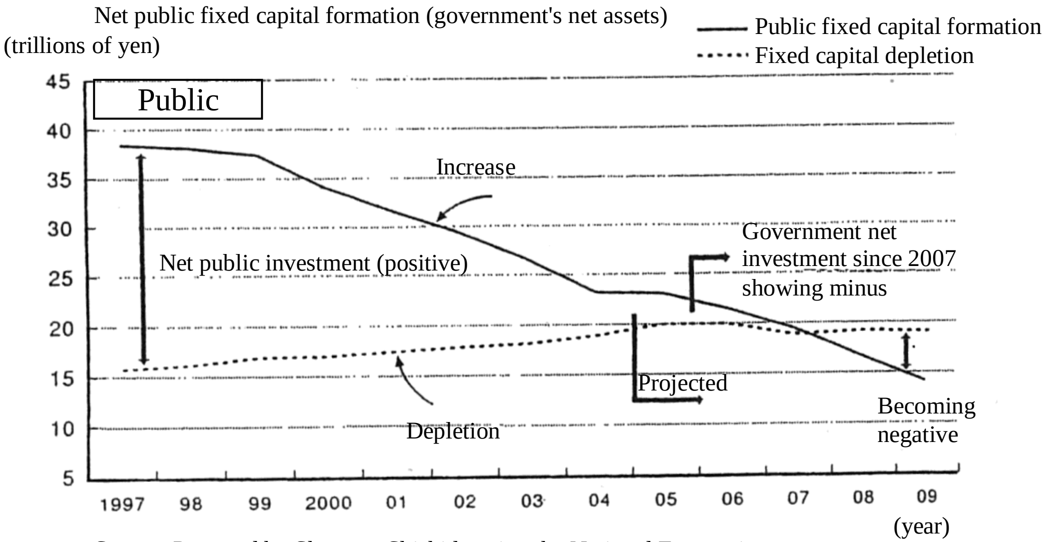
Since June 2007
Local taxes and the huge tax increase are the price to be paid for the failure of "Structural Reform."
Since FY2006, the fixed-rate tax reductions have been discontinued (move to increasing income taxes)

Graph 4-1: Lack of Public and Private Investment in Japan



Source: Prepared by the Daiwa Institute of Research using Financial Statements Statistics of Corporations by Industry issued by the Ministry of Finance

Graph 4-2: Lack of Public and Private Investment in Japan



Source: Prepared by Shuntaro Shishido using the National Economic Accounting Annual Report issued by the Cabinet Office.

Lack of Public and Private Investment in Japan

Private "net investment" is sluggish, while that for small and medium-sized companies is zero and government investment is negative. This is the reason for the long-term slump in GDP.

Koizumi's "Structural Reforms" caused a decline in domestic investment, which led to negative GDP (negative compared to 10 years ago), depriving the public of jobs and income. “Net investment" means “increase in investment minus depletion.” This “plus” raises Nominal GDP.

***Private "net investment" is sluggish**

There is talk about large corporations as if they were experiencing a boom in capital investment. However, the reality is that much of this is replacement investment (investment for updating used or amortized equipment) in a deflationary period, and there is little investment that will create new employment.

Over the period from 2003 to 2004, "net investment" by small and medium-sized companies fell into the negative. It is finally recovering somewhat, but the increase is only slight.

***"Net investment" of public fixed capital formation (public investment) has slid into the negative since 2007, which is the main cause of negative GDP**

Because public investment has significantly decreased since 2001, "net investment," which is the "decrease (depreciation) in investment" subtracted from the "increase in new investment," has also fallen into the negative since 2007. From established experience, when "public investment" is increased, then private investment rises within a year of two. If viewed from this rule grounded in experience, when public investment's "net investment" decreases, then private investment will diminish within one to two years.

The government's policy is to scale back public investment again in FY2008 (-3.5%). Consequently, FY2008 will see accelerated economic stagnation, and there will be absolutely no hope for GDP growth.

Japan does not have a fiscal crisis, but a policy crisis.

Graph 5: No Fiscal Crisis in Japan

(Japan's public finances as viewed according to net debt)

As of June 2007

"¥836 Trillion in Gross Debt" and "¥580 Trillion in Financial Assets" (trillions of yen)

Gross Debt (Ministry of Finance release)		(Correlation)		Financial Assets (Cabinet Office, see note 1 below)	
1 Debts payable	57			Financial assets	580
		Deficit-covering government bonds 224	508		
2 Government bonds (see Note 2)	529	(See Note 2)	277	1 Social security funds	300
3 Investment & loan bonds	142	Construction government bonds 305			
			28	2 Domestic/overseas loans & investments	170
		Directly for loans & investments			
		Dollar-buying with procured Yen →			
4 Short-term government securities	108	→US treasury bonds		3 Foreign capital reserves	110
Total	836			Net debt	256

(ten thousands of yen)

Per citizen	
Gross debt	658
Financial assets	453
	205

(ten thousands of yen)

Financial assets per citizen	**453**
・Pensions & health insurance reserves	236
・Management entrusted to government	217

Source: Prepared using the National Economic Accounting 2007 and Ministry of Finance data.

Note 1: Financial assets are preliminary figures calculated using the figure of ¥538 trillion at the end of 2005, which is given in the Cabinet Office's National Economic Accounting 2007, and adding the estimated subsequent increase.

Note 2: The breakdown for construction bonds and deficit-covering government bonds within the framework of government bonds are estimates.

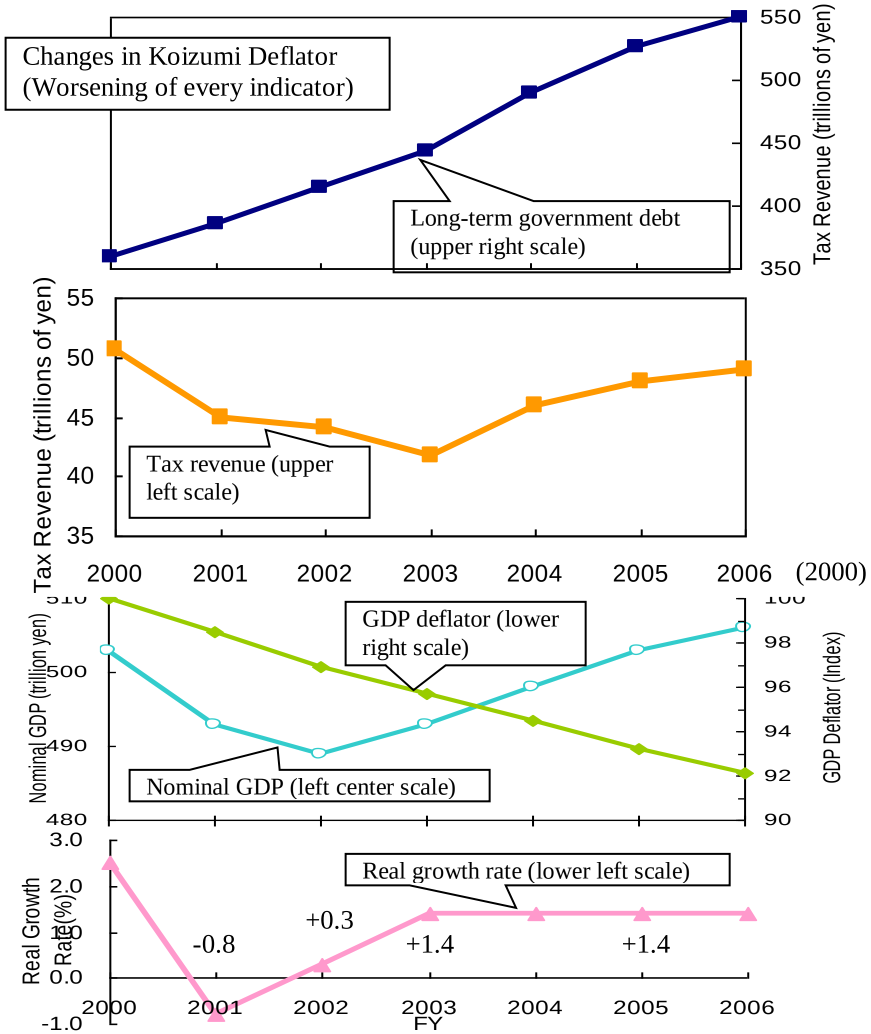
If "Net Debt (the remaining obligations after subtracting financial assets from 'gross debt')" is viewed, Japan does not have a fiscal crisis.

＊The Ministry of Finance's releases only "gross debt (borrowings)" figures, and does not take account of "financial assets (figures released by the Cabinet Office)" that the government holds. The government's "borrowings" (gross debt) are ¥836 trillion, but the government holds an estimated ¥580 trillion in financial assets. So, if we look at "net debt," which is arrived at by subtracting "financial assets" from "borrowings," the government's obligations are only ¥256 trillion. If this is viewed in a comparison using nominal GDP, it is at the level of 50%, which is equivalent to the Eurozone.
This is the basis for other nations' statement that "Japan does not have a fiscal crisis."

＊The Japanese government has sent communications overseas, saying: "If net debt is viewed, there is no fiscal crisis."

When Japan's government bonds were downgraded by companies that rate government debt (Moody's, S&P), the Japanese government send a communication to the rating companies, stating: "The Government of Japan holds the largest amount of foreign currency reserves in the world, the interest on government bonds is low with 95% of bonds being held by Japanese citizens, so a downgrade is not appropriate." The Japanese government itself has acknowledged the fact that "if net debt is viewed, there is no fiscal crisis" (April 2002, letter from Vice Minister Kuroda).

Graph 6: Economic Expansion Since "Izanagi" has been a Big Deception



Source: Cabinet Office, National Economic Accounting 2006
Long-term government debt includes estimated values.

2000-2006 Indices
Nominal GDP growth rate - GDP deflator = Real growth rate
(+0.6%) - (-7.9%) = +8.5% (annual rate +1.4%)
"Izanagi" Boom (November 1965 - July 1970)
Nominal GDP growth rate - GDP deflator = Real growth rate
(17.3% annually) - (5.7% annually) = +11.6% annually
Annual tax reductions Tax revenue increased 2.4 times in 4 years and 9 months

Economic Expansion Since "Izanagi" has been a Big Deception

The real growth rate is the number obtained by subtracting the GDP deflator (aggregate index of commodity prices) from the nominal growth rate. The real growth rate is the nominal growth rate minus the GDP deflator. Japan's GDP deflator has been negative since 1998. A "negative GDP deflator" is subtracted from the real growth rate, so a negative number subtracted from a negative number is a positive number.

If we try this by indexing FY2000 as the basis year of 100, the GDP deflator, which continued for six years until FY2006, is 92.1 in FY2006. In other words, during these six years, deflation advanced by 7.9%.

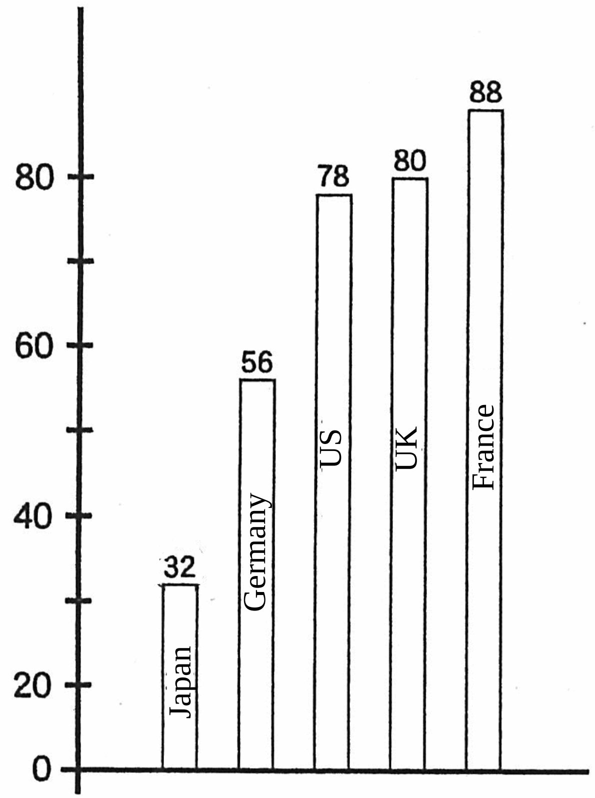
Given this factor, if the real growth rate from FY2000 until FY2006 is calculated, the real growth rate is the 0.6% nominal growth rate minus a negative 7.9% GDP deflator, which adds up to be 8.5%.

From a figure of a 8.5% over six years, the annual average is a 1.4%. In other words, a positive real growth rate in a deflationary period is nothing more than the inverse of deflation. This is precisely what the "big deception" is. That is why tax revenue decreases and a tax increase is being advocated.

*Izanagi Boom
From November 1965 until July 1970, there was positive growth each year over the previous year. The annual average was 11.6% [nominal growth rate (17.3%) - GDP deflator (5.7%)]. During this period (4 years and 9 months), tax revenue increase 2.4 times even though there were annual tax cuts.

Graph 7-1: Number of Personnel in the Public Sector

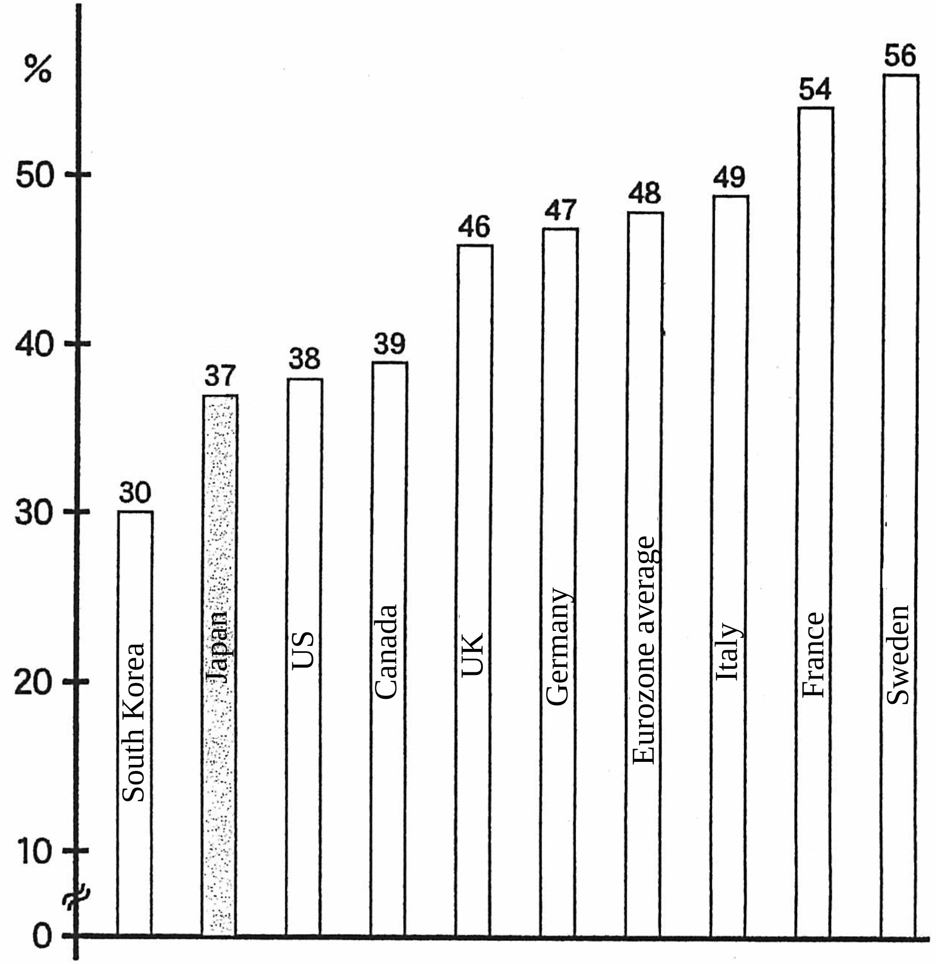
(Number of people per 1,000 citizens)



Source: Ministry of Internal Affairs and Communications (2004-2006)
Japan's number of government employees is the lowest in comparison to the population.

Graph 7-2: Japan's Government is too Small

(Government expenditures as a percentage of nominal GDP)



Source: OECD (2006). "Government expenditures" is the sum total of expenditures by both the central government and regional governments.
Japan already has a government that is too small. Economic scale (nominal GDP) and "too little government expenditure" impede economic growth, and excessively compress welfare budgets.