Legal Framework for Government Debt Management Policy in Japan*

FUJITANI Takeshi

The University of Tokyo, Institute of Social Science

Abstract

This paper examines issues surrounding the design of legal frameworks for government debt management policy. Government debt management policy here refers to the strategy to implement the optimal structure of government debt under a given size of debt stock, and critically a reasonable legal framework is a prerequisite for such debt management policy to function well.

First, the paper reviews the recent developments over the legal frameworks for government debt management policy and points out four legal design issues: (i) allocation of the authority to issue government bonds; (ii) clarification of the relationship between debt management policy and other relevant policies (monetary policy in particular); (iii) the authorities and organization of the debt management organization; and (iv) the transparency and accountability of debt management policy.

Second, drawing on the international and comparative perspectives, this paper uncovers some characteristics of Japan's legal framework for government debt management policy, such as extensive involvement of the Diet (parliament) with the debt issuance and redemption, as well as the (comparatively rare) existence of sinking funds. It is also noted that the design for the legal framework of government debt management policy is closely intertwined with Japan's budgetary law institution.

Keywords: government debt management, diet authorization for borrowing, budget principle of comprehensiveness (gross budgeting), sinking fund reserves
JEL Classification: H61, H63, K39

I. Introduction

The "government debt management" (hereinafter GDM) has no legal definition in Japan, but it is commonly understood as "while trying to mitigate fiscal burden, implements JGB (Japan Government Bonds) issuance, distribution and redemption measures to allow government debts to be smoothly accepted at each stage of the national economy (Ministry of Finance (2021), p. 3)." This common usage precludes the size (amount) of government bond issuance from the scope of "GDM", since it is rather the matter of fiscal policy (i.e., the size

* This article is based on a study first published in the Financial Review No. 146, pp. 58-73, Fujitani Takeshi, 2021, "Legal Framework for Government Debt Management Policy in Japan" written in Japanese.

of budgetary deficit). This paper follows this conceptual demarcation.

In Japan, few legal analyses on the GDM in the above-defined meaning have been made; which is a fact that exists in a sharp contrast with heightened interest in the legal/constitutional constraint on the budgetary deficits, or more generally on the fiscal rules (for the recent jurisprudential development, see Katagiri (2020), Ishimori (2018), and Tanaka (2011)[1]). This may be attributable to the non-coercive and highly technical nature of GDM. Whatever the reason is, it is certain that there is a vacuum of legal examination, which this paper intends to fill.

On the other hand, there are reports by international organizations such as the IMF and the World Bank that emphasize the importance of a legal framework for public debt management (hereinafter PDM). Although these reports are mainly addressed to developing economies that do not necessarily have well-developed legal institutions for public finance, but it is too hasty to turn it down as irrelevant for Japan. In recent years, there have been some developments in the GDM regimes in developed nations such as the United Kingdom, France, and Germany. So, it should be worthwhile examining these developments and shedding a new light on the existing Japanese GDM regime.

Accordingly, the first goal of this paper is to provide an overview of the international development of the "Legal Frameworks for PDM" (Section II). What are the causes for these developments, and are there any "good practices" for the countries to follow? Such an overview will facilitate our second goal, that is, to critically review our existing GDM regime (Section III). Although GDM and PDM are different in the precise scope and definition, this paper uses these concepts interchangeably in the following.

II. The International Development of Legal Analyses of PDM

II-1. Definition of PDM in the International Context

In the international context, the term "PDM" is used in several ways. Some are similar to those as in the Japanese practice above mentioned (IMF (2014), Singh (2016)), while others use the term to include the authorization of public debt issuance and the control of issuance limits (Roy and Williams (2010), Awadzi (2015)). The latter broader definition naturally involves the law; it is often the matter of a fiscal constitution that the government debt issuance must obtain parliamentary authorization and that the government should be accountable to the parliament. In Japan this principle of fiscal democracy is clarified in the Article 85 of the Constitution as well as the relevant legislation (Katagiri (2018)).

Meanwhile, even such a broader definition of PDM excludes the matter of the outstand-

[1] There is a growing body of literature on "fiscal rules." For instance, IMF (2018) argues that the "second generation fiscal rules", which have been in place since the global financial crisis of 2008, have enhanced focuses on (i) flexibility (e.g., clearly defined escape clauses, (ii) simplicity (e.g., rules that provide clear guidelines for fiscal management and target fiscal indicators that can be directly controlled by the fiscal authorities), and (iii) enforceability (e.g., monitoring by an independent fiscal council and a mechanism for sanction). These features distinguish the "second generation" rules from the pre-financial crisis "first-generation" of fiscal rules.

ing amount of public debt (debt level), since it belongs to the domain of macroeconomic fiscal policy (Roy and Williams (2010), para. 26). In short, the common usage of PDM/GDM refers to the policy to strategically determine the composition of the debt stock and to implement that goal via a variety of measures, while the debt level under macroeconomic fiscal policies is given.

II-2. Legal/Institutional Framework for PDM

II-2-1. Outline

It seems that one can point the following four points as the "best practices" commonly endorsed by the legal analyses that discuss the "legal/institutional framework for the PDM":

(i) The constitution or the positive law should clearly state where the authority to issue bonds resides.
(ii) The relationship between PDM and other policies, such as monetary policy, should be clarified in the relevant regime.
(iii) Provide a legal basis for the authority and organization of agencies that conduct government bond issuance and debt management operations.
(iv) Ensuring transparency and accountability of PDM policies.

II-2-2. The Allocation of Power to Authorize Government Bond Issuance

In the literature on the legal framework for PDM, it is generally accepted that the Parliament, which has the power to make decisions on the budget and tax matters, should also have the power to authorize the government to issue bonds for the nation's finances[2]. This might sound obvious, but one should note that greater parliamentary involvement with government bond issuance is not necessarily desirable. For instance, the Parliament should not be involved in the issuance of *individual* bonds, and it is neither recommended that the law should limit the amount of bond issuance (Roy and Williams (2010), para. 19)[3], for it concerns the balance between the mobility and flexibility of PDM policy and democratic control.

---

[2] Although it is unlikely to occur in reality in Japan, one could ask whether government bonds issued without parliamentary authorization are legally valid (i.e., whether they are legally binding on the government and investors). Japanese law has neither explicit rules nor precedent governing this matter; in some countries such unauthorized bonds are invalid (the state must return the funds to the investors, and the investors cannot claim the establishment of a legal relationship regarding such bond), or conversely, some countries have explicit regulations to the effect that the bonds are legally valid even in such cases (Awadzi (2015), paras. 108-112).

[3] A well-known problem with the legal constraint of public debt issuance is its pro-cyclicality. Besides, it might induce the government to circumvent the legal restriction by resorting to the forms that do not constitute "public debt" that is restricted by law (Roy and Williams (2010), para. 40). This kind of practice was observed in Japan, too. When the Japanese government, due to the Prime Minister Koizumi's pledge, must meet the target of the annual ceiling of 30T yen for the newly issued government bond for FY 2001, the government employed exceptional measures such as the transfers from special accounts (Misumi (2012), p. 21). This is not borrowing from outside the government, so it does not meet the definition of "public debt." Nonetheless such measures worsen the government's financial position (the "difference between assets and liabilities" currently published in the "Financial Statement of the Japanese Government") just as much as the increase in the issuance of public debt by the same amount. The question that should be asked here is what kind of meaning Japan's fiscal legislation is trying to give to the figure of "newly issued government bond."

The general consensus in this matter seems to be that the Parliament should just authorize the upper limit of the bond issuance, in a way that is linked to the budget voted on each fiscal year, while clarifying the future fiscal outlook and the sustainability of current government bond management. In this case, the upper limit should be defined in terms of the net increase in the outstanding amount of government bonds during the fiscal year.[4] The reason for this is that setting a ceiling on the total (gross) amount of government bond issuance could unduly constrain the issuance of Treasury securities for cash management purposes within the fiscal year (Roy and Williams (2010), para. 43). As for the authorization for debt redemption, it is suggested that a permanent authorization is sufficient (Roy and Williams (2010), para. 51).

II-2-3. Relationship between PDM and Other Policy Objectives

PDM policy interacts with, and in some cases interferes with, (i) the fiscal policy (jointly conducted by the government and the parliament), and (ii) the monetary policy by the central bank (Togo (2007), p. 9). While the amount of newly issued public debt in a given fiscal year is determined as a consequence of the fiscal policy (the decision on the level of tax revenue and government expenditure), the existing public debt structure conversely affects the fiscal cost through the interest rate. The level of interest rates (as well as exchange rates, especially crucial for a small open economy), which are affected by monetary policy, can constrain certain PDM policy options, such as issuing floating-rate bonds and foreign-currency-denominated government bonds. Conversely, a public debt structure vulnerable to the interest rate fluctuation compromises the central bank's first-best monetary policy choices, such as tightening interest rates and devaluing the currency, due to the concern of its excessive burden on the government finance.

Given such interaction among policies, it is desirable to organize the relationship between PDM and other policy objectives by law, and to clarify the roles and responsibilities of each institution (Roy and Williams (2010), para. 54).

Historically, central banks have played a significant role in PDM in tandem with the fiscal authorities. For example, the U.S. Federal Reserve's bond-buying operations, conducted from 1942 to 1951, to keep the market price of accumulated government bonds above their

[4] This method is common among developed countries. Despite the difference between Germany and France with regard to the budgetary treatment of the bond issuance revenues (Germany counts them as revenue in the budget, while France does not), both countries agree that the net increase in the outstanding amount of public debt (the amount newly issued in a given fiscal year minus the amount redeemed) must be authorized by a budget law. For Germany, the second sentence of Article 18.2 of the Bundeshaushaltsordnung (BHO) and the budget law for the fiscal year 2021 (Gesetz über die Feststellung des Bundeshaushaltsplans für das Haushaltsjahr 2021), §2(2), sentence 1 (stipulating that the amount of the authorization to issue bonds referred to in paragraph (1) shall be increased by the amount of the redemption for the relevant year). For France, LOI n° 2020-1721 du 29 décembre de 2020 finances pour 2021 II.1 [Émission de dette à moyen et long termes, nette des rachats (net issuance of government bonds with a maturity of one year or more, net of redemptions), Variation nette de Variation nette de l'encours des titres d'Etat à court terme (increment of net outstanding short-term government bonds with maturity of one year or less)]. On the other hand, the U.S. federal debt ceiling is set by a law enacted by Congress on an ad hoc basis, which is not necessarily linked to the budget cycle. The U.S. Constitution gives the Congress the power to issue public debt (Article 1, Section 8, Clause 2), but the government can issue (redeem) public debt at its discretion until the ceiling is reached. In this sense, it can be said that the government has the authority to increase the net amount of outstanding public debt, but because it is not linked to the budget cycle, it has repeatedly caused a political turmoil known as the fiscal cliff.

par value was, of course, a direct attempt to make monetary policy serve the Treasury's PDM policy, which was under the pressure of rapidly growing. That policy was also a financial system stabilization policy that prevented a collapse in long-term government bonds held by financial institutions from causing financial system instability (Ikejima (2014)). In the U.K., where the domestic capital market was small, the Bank of England was actively involved in purchasing government bonds that were flooding the market beyond the capacity of private investors to absorb, and "issuing" them into the market when demand from the private sector increased (so-called "tap issue"). The understanding at the time was that the central bank had to act as a dam to stop the "flood" of government bonds flowing into the lackluster capital markets (Goodhart (2012), p. 124).

Later, the situation changed significantly. Since the late 1970s, the mainstream of macroeconomics noticed the limits of discretionary fiscal policy and shifted toward the central bank's independent monetary policy whose primary goal is price stability. Also relevant was the improvement in the market's ability to absorb government bonds due to the accumulation of private capital (in the case of the U.K., it was in large part due to the inflow of foreign capital as a result of the financial "Big Bang" of 1985). Under the new consensus, central banks set its policy interest rate to achieve price stability without considering PDM policy, and conversely, PDM no longer needs to consider its unwanted effect on the quantity of money supplied when pursuing smooth, low-interest bond issuance and refinancing. It was after this new regime was established that the British Debt Management Office became an independent agency; it was merely a confirmation of this new regime, and hardly attracted people's attention (Goodhart (2012), p. 126).

On the other hand, in Germany, the central bank (Bundesbank) continued to play a leading role in PDM policy until the end of the 1990s (Trampusch (2015)). Interestingly, the law made no priority of PDM policy authority among the central bank, the federal debt agency, and the Ministry of Finance, but it was an "informal code of conduct" that allowed the Bundesbank to take the lead. The federal and state governments, for example, refrained from issuing foreign currency bonds that the Bundesbank would not approve, even though it was not prohibited by law (Trampusch (2015), fn. 19). In addition, a conservative and passive PDM policy (i.e, long-term maturity structure, denominated only in the domestic currency) was maintained in accordance with the wishes of the Bundesbank. This regime was changed in the 1990s, by the movement toward European monetary union and the development of financial technology such as derivatives trading. The former meant that German government bonds, which until then enjoyed the advantage of strong national currency (Deutsche Mark), would have to compete with the bonds of other euro member countries. It was argued then that the conventional conservative bond management policy should be changed so as to minimize interest payment costs by using interest rate swaps, for example. Then, a new legal vehicle to accommodate such policy change became necessary, which is suitable to hire financial experts by allowing for a compensation system different from that of civil servants and to clarify duties and responsibilities. It was for this purpose that in 2000, the Federal Republic of Germany Financial Agency (Bundesrepublik Deutschland -

Finanzagentur GmbH) was established as an independent limited company (but wholly owned by the state). One of the motivations was to centralize the decentralized authority for PDM and to ensure the independence of debt management policy from the central bank's monetary policy. However, the Finanzagentur also took over the powers of the Federal Financial Market Stabilization Agency (Bundesanstalt für Finanzmarktstabilisierung, FMSA), which had been responsible for injecting capital into financial institutions through the Financial Stability Fund.[5]

In France, the central bank (Banque de France) had long been engaged in macroeconomic and monetary policy under the direction of the government, and its independence from the government was realized only when countries which joined the Eurozone were required to do so (1993). The independence of central banks, which has gained worldwide support since the 1980s, was based on a distrust of the short-sighted bias of politicians and an emphasis on expert policy judgment to achieve time consistency and long-term benefits. This leads to the idea that PDM should also be independent of the fiscal authorities, which are of political nature. As was in Germany, an independent agency was thought to be advantageous in the recruitment of expert personnel. However, France took a different path: its debt agency (L'Agence France Trésor) is not independent of the Ministry of Finance, rather works closely with the Ministry of Finance to implement debt management policies, which is said to be one of its strengths (Lemoine (2016))[6].

II-2-4. Legal Basis for the Authority and Organization of the Bond Management Agency

One of the issues concerning the legal/institutional framework for PDM is whether to establish an independent debt management office that is exclusively responsible for PDM. Such an office is usually the only entity that issues public debt on behalf of the government (although it may have the central bank as its agent in handling the issuance of bonds), and it has the authority to determine the maturity structure, terms of issuance, and to redeem them. As mentioned in the previous section, historically, bond management policy and its authority have intersected with the central bank (monetary policy) and the Ministry of Finance (fiscal policy). For this reason, various reports on the legal framework for PDM recommend consolidating the PDM authority in a single agency and giving that agency a certain degree of autonomy as a means of clearly distinguishing the goals of PDM policy from those of monetary and fiscal policy.

Keeping this recommendation in mind, one might ask how much parliamentary involvement and thus democratic accountability is necessary for the PDM policies implemented by

[5] https://www.deutsche-finanzagentur.de/de/finanzagentur/ueber-uns/historie/

[6] Lemoine cites the testimony of a high rank official at the AFT that the close relationship of AFT with the Ministry of Finance gives its advantage in IR for foreign investors; independent institutions such as Germany's Finanzagentur are typically not allowed to mention anything beyond the limited scope of their authority (such as the macroeconomic policy outlook of the home country), while AFT can actively promote the attractiveness of home country bonds under its macroeconomic policy outlook on the ground of internal information obtained from the Ministry of Finance.

such an autonomous body. In this respect, Germany's practice is instructive. In Germany, as mentioned in the previous section, the Finanzagentur, a company independent of the government, is responsible for planning and implementing PDM policy. For some time after its establishment, the Finanzagentur was under the control of the Federal Debt Management Office of the Federal Ministry of Finance. Then the 2002 amendment to the law placed the Finanzagentur under the supervision of the Federal Finance Subcommittee (Bundesfinanzierungsgremium), which was established under the Budget Committee (Haushaltsausschuss) of the Bundestag.[7] For example, the Finanzagentur has the authority to enter into swap transactions to optimize the maturity structure as part of its debt management policy, but it is impractical for the agency to seek parliamentary authorization or approval for the details of a given transaction, especially due to the confidentiality. Therefore, the law invented the accountability mechanism in which (i) the Budget Act establishes guidelines for the management of government bonds and sets an annual limit for new swap contracts (Shirota (2017), p. 41), and (ii) while avoiding public disclosure of the details of swap contracts, which are important for confidentiality, the details are disclosed only to a technical committee established under the Budget Committee of the Bundestag. (Trampusch (2015), p. 122).[8]

In addition to issuing, managing, and redeeming government bonds, PDM agencies are generally responsible for issuing and redeeming short-term Financing Bills as part of the treasury's cash management. For example, the UK Debt Management Office (UK DMO), the Agence France Trésor (AFT), and the Fiscal Agency of the Federal Republic of Germany (Finanzagentur) all have the authority to issue short-term bills for cash management purposes and are responsible for treasury management. In jurisdictions that do not distinguish between government bonds whose issuance proceeds constitute "revenue" and financing bills that do not, it seems natural that treasury management and PDM would be closely related. However, it is interesting to note that the contact points for treasury management and PDM are integrated[9] in relation to financial markets even in Germany, where, as in Japan, there is a distinction in budgetary law between the revenue-constituting government bond and the non-revenue-constituting financing bills[10].

---

[7] Federal Debt System Act (Gesetz zur Regelung des Schuldenwesens des Bundes (Bundesschuldenwesengesetz), Article 3.

[8] This method is often used in Germany when the balance between confidentiality and democratic accountability is an issue, as Muranishi (2015) gives an overview of this kind of "'plenary alternative' committee".

[9] "Die Finanzagentur, Kreditaufnahme und Schuldenmanagement für den Bund", p. 16, p. 26. (https://www.deutsche- finanzagentur.de/fileadmin/user_upload/finanzagentur/pdf/Finanzagentur.pdf) Furthermore, the website of the Finanzagentur (https://www. deutsche-finanzagentur.de/de/karriere/unsere-aufgaben/)

[10] In Germany, apart from government bonds (*Kredit*), the proceeds of which constitute revenue (*Einnahmen*) under the Budget Law and are subject to a fixed authorization (see supra note 5), financing is provided by short-term "treasury reinforcement credit" (*Kassenverstärkungskredite*) issued for cash management purposes, the authorization for which is granted with a maximum balance of a certain percentage of total revenue and expenditure (for instance, "20%" in the second sentence of Article 2.9 of the "Budget Law for the Fiscal Year 2021" at supra note 5).

On the other hand, in France, a conceptual distinction is made between the fiscal revenue (*recette*) that appears on the budget (*le budget*) voted on in the budget law (la loi de finance) for each fiscal year and the public revenue sources (*resources publiques*) that are related to the financial balance of the country. Government bond issuance revenues are not added to the former (*recette*) but are voted on as part of "measures to achieve a balance between fiscal costs and resources" (Part 1, Part 2 of the Budget Act).

II-2-5. Ensuring Transparency and Accountability of PDM Policies

The legal/institutional frameworks are less apt to dictate the substantive dimension of the PDM policies. Rather, the concern of the law is how to secure the governance of PDM, which is typically the domain of a high level of professional judgment. In doing so, the emphasis is on ensuring transparency and accountability. In particular, the following elements are considered: (i) setting and announcing the objectives and basic policies of the debt management policy, (ii) announcing the bond issuance and redemption plans, and (iii) disclosing the debt structure on a regular basis. The "objective" of debt management policy is quite straightforward; for example, "managing the government's debt in order to raise the required amount of funding at the lowest possible cost over the medium to long run, consistent with a prudent degree of risk" and "developing and maintaining an efficient market for government securities." (IMF (2014), para. 4), and it has been pointed out that explicitly stating such objectives in the law serves as a basis for government accountability for PDM (Roy and Williams (2010), para. 38; Awadzi (2015), para. 99).

III. Re-examination of Japan's Legal Framework for PDM

Drawing on the international literature review in the previous section as a guideline, in this section we will reexamine Japan's legal framework for PDM policy.[11] What are its idiosyncratic features and possible points for reform? The analyses below are not intended to be exhaustive, but rather a preliminary study to invite a more comprehensive study in the future.

III-1. Involvement of the National Diet in PDM Policy

What has become clear from the discussion in the previous section is that the key to designing a legal framework for PDM is to strike a balance between the mobility and flexibility of PDM policy on the one hand, and the adequate democratic control on the other hand. While parliamentary involvement is often prerequisite in a fiscal democracy, it is not obvious that the greater involvement is the better for achieving such good balance. The literature rather emphasizes the significance of the mobility and discretion of PDM authorities. For example, it may be sufficient that the Parliament just grants a general authorization by a permanent law to empower the government to issue treasury financing bills and refinancing bonds.

From this vantagepoint, one of the characteristics of Japan's PDM regime is its adherence to the democratic control of public finances in the form of ex ante approval by the Diet. It is true that the Article 85 of the Constitution requires the Diet's resolution with regard to the government bond issuance. Nonetheless, there is room to re-examine the meaning of the current practice from the perspective of the effectiveness of fiscal control. In the following, we shall examine (i) the Diet's involvement in the treasury financing bills; (ii) the bond re-

[11] The most useful overview is provided by the Ministry of Finance (2020), Part II.

demption expenditures and the Budget; and (iii) the interest payment costs and the Budget.

III-1-1. Is It Necessary for the Diet to Authorize the Maximum Amount of Treasury Financing Bills?

Under the current law (the Public Finance Act, Article 7(3)), the “maximum amount” of treasury financing bills issued for cash management purposes must also be approved as a part of the Budget by the National Diet. The “maximum amount” referred to hereby means the maximum amount of outstanding Treasury securities at any time within the relevant fiscal year (Komura (2016), p. 136); it should be noted that this “maximum amount” approval is of different nature from the authorization of the maximum amount of issuance of government bonds that constitute the “revenue” in the budget. In accordance with Article 7(2) of the Public Finance Act, treasury financing bills must be redeemed with revenue during the fiscal year, so that the net increase in the public debt stock throughout any given fiscal year (after offsetting the issuance and redemption of these financing bills) is supposed to be zero.[12] Therefore, the aim of this “maximum amount” approval is not, as in the case of government bonds, to “subject the borrowing that will be the basis of fiscal expenditures and taxpayer burdens in the future to the democratic control of Congress”; rather it should be understood as setting the upper limit of the short-term borrowing that Treasury can assume at any given time, so as to check the excessive financial risk-taking by the Treasury.

If this understanding has a point, then the Article 7(3) of the Public Finance Act should be considered as a product of legislative policy choice, not as a constitutional mandate. Since the Article 85 of the Constitution only requires a “resolution of the National Diet,” an alternative method of authorization by a permanent law (and not as a part of annual budget) would not be constitutionally precluded. It may be helpful to note that Article 46(1) of the Special Account Act already adopts such a way of Diet’s authorization; the law authorizes (and the annual budget just confirms) that the government may issue refinancing bonds “up to the amount necessary for the liquidation or redemption of government bonds in each fiscal year.”

Even if constitutionally admissible, is it prudent as a legislative policy? Let us consider a hypothetical scenario (even though it is unlikely to occur in reality in Japan[13]); for example, it would be sensible for the law to prevent a situation in which the government takes on excessive risk by temporarily issuing a too large amount of short-term treasury financing

---

[12] In this meaning, it is equivalent to the mechanism of granting “treasury reinforcement credit” in Germany (supra note 10). In France, on the other hand, there is no distinction between the revenue-constituting government bonds and the treasury financing bills, as both are used to finance the national treasury.

[13] However, under the so-called “twisted Diet” (i.e, the majority party of House of Representative (the Lower House) and that of the Cabinet is not the same as that of the Councilors (the Upper House) in 2012, it became difficult to execute the budget as planned due to the lack of prospects for the passage of the Special Government Bond Authorization Act for that fiscal year, because the Budget is authorized (eventually) by the sole approval of the Lower House, while the Act must be approved (basically) by both Houses. This discord “paralyzed” the implementation of the FY 2012 budget which is deprived of a substantial revenue source. Then as an emergency measure the government considered the option to issue treasury financing bills as a source of revenue, but it abandoned the plan due to a strong suspicion that such a measure would violate Article 7 of the Public Finance Act. If such an extraordinary measure was employed, however, there would not have been legal sanctions, as the positive law provides no legal consequence for such violation.

bills. Of course, it is unrealistic that the fiscal authority (Ministry of Finance) would have the incentive to take such a step voluntarily. One could rather imagine the case where the political leaders coerce the fiscal authority to loosen budget discipline, then the Diet resolution, by making the government's financial position visible to the public, would put a stop to such undue pressure.

In this light, concerning is the current practice of authorizing short-term financing bills issued under the Foreign Exchange Funds Special Account. The Ministry of Finance is authorized by law to issue short-term bills for the cash-management purpose (Articles 15(1) and 82 of the Special Account Act). Such short-term bills must be redeemed with the revenue of the same fiscal year (Article 15(4) of the Special Account Act). However, the law provides an exception for this rule: if the bills cannot be redeemed with the fiscal year's revenue, they are allowed to be issued beyond the fiscal year (to be redeemed with the next fiscal year's revenue) on the condition of a resolution by the Diet (Article 82(2) of the Act). These bills issued beyond the fiscal year must also be redeemed within one year (Article 82(3)), but if this results in a shortfall of revenue of the next fiscal year, then the securities may again be refinanced beyond the fiscal year, and on and on. In practice, a certain balance (currently amounting to the tens of trillions JPY) is continuously rolled over[14], as the Foreign Exchange Fund effectively serves as an investment fund engaging in a carry-trade (Itoh and Yabu (2017)). In short, these beyond-fiscal-year financing bills, along with the continuous rollover, have turned into de facto long-term bonds.

Therefore, based on the aforementioned logic of why Diet's authorization is (ever) necessary for government borrowing, the issuance of "normal" cash-management bills (under Articles 15 & 82(1)) and that of beyond-fiscal-year financing bills (under Article 82(2)) must be constitutionally distinguished. However, in practice both of them are subject to the budget resolution as one (e.g., Article 8 of the General Rules on the Budget of Special Account for FY2021). Given the de facto nature of the Foreign Exchange Fund as foreign currency investment fund, which could be lucrative (as it has been for the last decade) or be risky, its governance should be designed from a different perspective from other authorization; the matter here is not the permissible extent of temporary financial risk (in the case of "normal" short-term cash management bills) nor the burden of future taxpayers (in the case of ordinary (budgetary revenue-constituting) government bonds. Rather it is the matter of how much investment risk the government can take. From this point of view, the current method of Diet's authorization, simply voting on the upper limit of issuance, needs to be re-

[14] This persistent balance occurs due to the continuous holding of foreign currency denominated assets (typically US Treasury Bonds) by the Foreign Exchange Fund (FEF). The FEF was established to enable the government to promptly intervene in the foreign exchange market when the exchange rates fluctuate rapidly. In most cases in post-WWII Japanese history, it meant the rapid appreciation of the Japanese Yen against the U.S. dollar. In such cases, the FEF borrows JPY from the capital market by issuing short-term bills, selling the JPY in the exchange market against the USD, so as to mitigate the rapid appreciation of JPY. The FEF holds the USD on its balance sheet by investing into dollar-denominated securities (typically Treasury Bonds), and maintain that investment position for a longer period, due to the fear that the divestment, i.e., selling dollar-denominated securities and buy back JPY, might again trigger another round of JPY appreciation. The FEF holds its assets (USD-denominated securities) and its liabilities (JPY-denominated bills). Since the latter are the short-term liabilities, they need to be recurrently rolled over.

considered.

III-1-2. Should the Budget Account for the Redemption of Government Bonds?

The redemption of government bonds in Japan is carried out by way of the Special Account for the Government Debt Consolidation Fund. This Special Account is responsible for redeeming the bonds at maturity, or purchasing and retiring them at the interim, and also for paying interests on the existing bonds. The Account is also authorized to issue refinancing bonds to cover the shortfall of the redemption funds for the fiscal year. Then the Budget for the Special Account for the Government Debt Consolidation Fund lists the expenditure item of "Expenditure on Debt Consolidation"; the Budget for the General Account lists the item of "JGB Expenditure" (that is the amount to be transferred from the General Account to the Special Account for Government Debt Consolidation Fund) and the "Revenue from Government Debt Issuance."[15]

As we have already seen, it is rare in developed countries for the redemption of government bonds to be the subject of a budget resolution. In other words, the net increase in the public debt (the gross issuance deducting the redemption amount) is the subject of authorization through a resolution of the Diet. The latter method, adopted in other countries, seems more straightforward and helpful for the fiscal transparency and democratic control, since the net increase of public debt (as a consequence of the given fiscal year's budget) is the information relevant to evaluate the fiscal policy of that year. While the budget principle of comprehensiveness (Article 14 of the Public Finance Act) requires that all the revenues and expenditures items be incorporated into the budget, this does not immediately lead us to conclude that the cost of redeeming government bonds should also be included in "expenditures." What accounts for the budgetary "expenditure" and what accounts for the extra-budget outlays are the matter of legal policy. In fact, the redemption of the short-term financing bills (Article 7 of the Public Finance Act) is not incorporated as the expenditure item of the Budget. Therefore, just like the treasury financing bills, it may be possible to interpret that all cash outflows due to the redemption of government bonds are "expenditures" (Article 2(1) of the Public Finance Act), but that the amount offset against the "proceeds" of government bond issuance in the same fiscal year does not constitute "expenditures." It seems to be a reasonable reform for Japan's budget accounting to join the common practice of other countries. However, we need to take into account the unique situation in the Japanese budget system, where a number of special accounts exist and constitute a complex web of inter-account transfers with the Special Account for the Government Debt Consolidation Fund, the point we shall revisit in the below Section III-2.

III-1-3. Budget Authorization of Expenditure for Interest Payment

Unlike the redemption of government bonds, the expenditure of interest payments is an

[15] The "JGB Expenditure" in the General Account Budget is broken down into the two items, namely "Funds for Redemption" and "Funds for Interest Payments" (shown in the annex document). However, these figures are not a part of the official (legally binding) budget.

obvious fiscal cost, and it is essential that the amount is included in the budget and formerly authorized by the Diet. Nonetheless, the nature of the budget authorization is not the same as that for other expenditure items for the public policy, as the interest payment is a fulfillment of the legal obligation that had been already assumed by the government and authorized by the Diet in the previous fiscal year budget. Then the rationale for accounting such expenditure in the budget is to visualize the interest payment expenses that should be prioritized for funding and to inform the budget policymaker of the prudent allocation of resources in the overall expenditure budget.

For example, France has a more appropriate method of budget authorization of interest payment expenditures: so-called estimated budget appropriations (crédits évaluatifs). The credited amount can be flexibly increased after the fact under certain conditions and procedures (La loi organique relative aux lois de finances (LOLF), article 10). In contrast, the current budget authorization method in Japan makes it difficult to respond to the unexpected fluctuation in interest payments; it can be done only by the supplementary budgets resolution.

It is true that the Japanese budget system might accommodate similar flexibility against the fluctuation of the interest payment expenditure. Because the (legally binding) expenditure budget item is listed just as “Expenditure on the Government Debt Consolidation”, making no distinction in the authorization between that for interest payment and that for redemption (see supra note 15), one may conceive to divert the amount for redemption to cover interest payment expenses (by way of the process of diversion of fund; Article 33(2) of the Public Finance Act); then the shortfall in redemption fund can be compensated by issuing more refinancing bonds (that is within the discretion of the Ministry of Finance). However, this is not the spirit of the law. Such maneuver becomes practically indistinguishable from financing interest payments with refinancing bonds; then it would conflict with a shared understanding of the refinancing bonds (and the absence of explicit authorization by the Diet); that is, “unlike in the case of bonds issued to secure new revenue resources, ... issuing Refunding Bonds does not lead to an increase in the total amount of outstanding debt.” (Ministry of Finance (2021), p. 39). True, the money is fungible. So one might argue that it does not matter as long as the diverted amount does not exceed the amount appropriated in the “Expenditure on the Government Debt Consolidation” item of the budget. However, if the raison d’être of the budget authorization of interest payments is, as mentioned above, to visualize interest payments burden in the entire budget framework, then the significance of the budget authorization of the interest payments should not be disregarded. Given the current public debt structure of Japan, which is dominated by fixed interest bonds, one might argue that the above point has little practical significance; yet it should be noted that the current budgetary system might hinder the future PDM policy option, such as to increase the issuance of floating-rate bonds.

III-1-4. Summary

One might find these points overly technical and of little significance. However, the es-

sential question that underlies them is whether the current way of authorization is the best way to balance democratic accountability and the mobility and effectiveness of PDM policies. In this field, the Diet's involvement in the form of ex ante budget resolution is not necessarily a constitutional mandate, so we should consider the best way to achieve the good governance of PDM policy. We must avoid placing too much emphasis on the Diet's resolution of budget, which tends to be too formalistic, and neglecting more effective methods of fiscal control. We must also avoid having debt management legislation restrict the agile and effective PDM policies without sound reason.

III-2. Is There Still the Case for Sinking Funds?

It goes without saying that the redemption of public debt is an essential component of PDM policy, but whether it can be carried out using a sinking fund mechanism[16] like the one in Japan is another matter. There are very few countries (among the developed countries, at least) that have a working sinking fund (Komura (2016)). The guidelines for PDM issued by international organizations (see Section II above) seldom refer to it. In Japan, too, some commentators call for the abolition of the sinking fund. We shall examine this issue now.

The first advantage of the sinking fund is said to be that it demonstrates the government's commitment to redeem its bonds, by transferring a certain fund from the General Account into the sinking fund, i.e., "Special Account for the Government Debt Consolidation Fund" (Ministry of Finance (2021), p. 76). However, given the fact that Japan's primary balance is persistently in deficit, the transfer from the General Account into the sinking fund gives rise to the additional revenue shortfall, which in turn increases the issuance of new government bonds by the same amount. One might still regard this mechanism as a commitment to secure funds (cash management) for individual redemptions, but not as a commitment to fiscal consolidation. Then what's the point of this complex mechanism? One possible defense is that, given the numerous and complex web of special accounts, the sinking fund is the mechanism to hold each of special accounts "accountable" for the financial costs (redemption and interest payments) attributable to each of them.[17]

The second advantage is that the "Special Account for the Government Debt Consolidation Fund" functions to shelter the flexible PDM policy from the influence of fiscal policy (in which, as discussed in Section III-1 above, prioritized is the ex-ante Diet's control of fiscal matters). The PDM policy, by nature, requires flexibility and agility so as to deal with financial markets. While Japan's budget system adopts a "formally balanced budget", which re-

---

[16] In Japan, the current system has been consistently adopted since the National Debt Consolidation Fund Special Account Act of 1906.

[17] In this light, we can explain why Germany, which has a budget system similar to Japan's (formally balanced budget, i.e., the entire budget revenue amount (including the proceed of bond issuance) is balanced to the entire budget expenditure amount (including the redemption)) and a debt authorization system, does not need a sinking fund. Germany has much fewer special accounts (Komura (2016), p. 140), so it will be easier to maintain the entire budget framework visible. In France as well, although there are various types of special account budgets (comptes spéciaux), the expenditures of special accounts are included in the estimates of required financial resources in the "measures to achieve a balance between fiscal costs and financial resources" in the budget law.

quires that "revenue," including bond proceeds, and "expenditure," including redemption, match in the budget document. Furthermore, under the budgetary principle of comprehensiveness, the gross amount of issuance and redemption of government bonds must be authorized. However, there is a significant disadvantage in binding the gross amount of government bonds issuance, which should be determined flexibly in light of financial market conditions. Given this overly rigid budget system, the Special Account's capacity to flexibly issue refinancing bonds serve as a "buffer" to prevent the formality of budget control from constraining the flexible PDM operation. In other words, the Government Debt Consolidation Fund makes it possible for the government to stably redeem and consolidate its debt without being affected by the fluctuations in the fiscal balance (which is by nature political). If we switch to the Diet's authorization of the net (not gross) issuance of government bonds (just like other countries), this function of Japan's sinking fund would become dormant; it seems to explain the absence of the sinking funds in these countries.

On the other hand, having a sinking fund has a detrimental effect on fiscal transparency. Let us consider the following two scenarios (A) and (B).

Scenario A: The General Account issues ¥30 trillion(T) of government bonds for new revenue purpose, then spends ¥20T in policy expenses, and ¥10T in transfers to the Government Debt Consolidation Fund (for simplicity, hereinafter let us suppose that interest payments are assumed to be zero and the entire amount is paid for redemption). In the Special Account for the Government Debt Consolidation Fund, receiving ¥10T from the General Account, redeems ¥20T of outstanding bonds due in that fiscal year, while filling the shortfall by the additional issuance of ¥10T of refinancing bonds.

Scenario B: The General Account issues ¥20 of new bonds and appropriates the entire ¥20T for policy expenditures. The Special Account for the Government Debt Consolidation Fund issues ¥20T of refinancing bonds and redeems ¥20T of the outstanding bonds due in that fiscal year.

These scenarios (A) and (B) are exactly the same in terms of the fiscal position of the treasury, and financially equivalent from the market perspective. Yet the nominal amounts of the "new government bond" which appears in the General Account Budget look different. And it is this figure that the media covers most actively (see supra note 3), while few pay attention to the amount of refinancing bonds issuance. What is essentially important is to clarify how much of the policy expenditures (both mandatory and discretionary) of the government as a whole (integrating the general and special accounts altogether) is covered by taxes and how much is resorted to the borrowing (i.e., the *net* increase in outstanding public debt), and then subject these budget figures to the scrutiny and authorization by the Diet.[18]

[18] In this meaning, the amount of "excess cost (total financial resources - total operating costs)" exhibited in the "Financial Statement of the Japanese Government" prepared and published annually by the Ministry of Finance may be the best approximation. Of course, it should be pointed out that the limitations of the national financial statements are that they are actual-based and, in particular, the operating costs do not correspond to the budgetary policy expenditures, and that the financial statements are inherently retrospective in nature.

On the ground of foregoing analyses, we might conclude that the "resolution of the Diet" required under Article 85 of the Constitution should be based on the authorization of a *net* increase in the outstanding amount of public debt (after deducting redemption amounts) in the relevant fiscal year, that is, a net amount of newly issued government bonds. One might even speculate that it was indeed the original intent of the Public Finance Act of 1947. The Act sets the principle of a single budget account (Article 13.2 of the Act permits the establishment of special accounts only in limited cases; but in reality, special accounts thrive beyond the control of the Ministry of Finance) and excluding the deficit-filling bonds as revenue source (the proviso to Article 4 of the Act permits solely "construction" bonds); therefore, the Act's original intent was arguably to equalize the bond issuance authorization in the General Account Budget with the net increase in the outstanding public debt. In other words, a potential reform of Japan's budget system will bump into the reality of thriving special accounts and the (perhaps too much idealistic) principle of "no-borrowing" in the Article 4 of the Public Finance Act (the latter is practically hollowed out, but still maintained as a principle). If the scope of reform extends beyond the technical PDM matters to involve the fundamental principle and reality of Japan's budgetary and accounting systems, one might realistically assume such a reform proposal is less likely to obtain enthusiastic support.

III-3. The Interaction between PDM Policy and Monetary Policy

Finally, a thorny question is the relationship between PDM policy and monetary policy. As discussed in Section II-2-3 above, monetary policy and PDM policy have historically had a close relationship. The idea that we should clearly distinguish these two policy domains (which seems to be the keynote of the international reports on the PDM legal framework) is based on the "central bank independence" consensus during the 1990s to 2008. However, the global financial crisis, the European sovereign debt crisis, and the recent Covid-19 pandemic have shaken this consensus. In Japan as well, it is undeniable that the monetary policy of massive quantitative easing serves effectively, if not so intended, as a government bond price maintenance policy.[19] An influential scholar has even argued that we are returning to the situation after World War II, and that if so, we should explicitly re-link monetary policy to PDM policy. As a legal scholar, I am not competent to argue the validity of such arguments of central banking theory. However, the determination of attitudes toward such fundamental issues is relevant to questions such as, for example, "what range of public sector debt should be considered as the subject of 'national PDM policy'?[20].

[19] Indeed, the unprecedented level of quantitative easing, which has made the central bank of Japan (BOJ) a dominant holder of outstanding government bonds, enabled the BOJ to control the long-term interest rate (which used to be believed impossible). See, Iwata-Samikawa (2018).

[20] For the purpose of private law, the central bank and the government are separate entities, and the central bank's liability is distinct from that of the national treasury. On the other hand, in macroeconomics, it is common to consider the balance sheets of both entities as an integrated whole of "consolidated government." One could argue that consolidating the central bank and the national government does not "write off" the outstanding public debt (because the government bonds held by the central bank are substituted with the central bank's liabilities, mostly the central bank money (banknotes and reserves held by private banks). However, some scholars argue that central bank money is not a liability in the ordinary sense (Kumhof et al. (2020)).

IV. Conclusion

In this article, we have made a preliminary analysis of the legal framework for PDM/GDM policy, which so far has received inadequate attention in the legal literature. The legal analysis in this field, by nature, tends to lean toward formal rules rather than the substantive aspect of PDM policy, and this article is no exception. Nevertheless, I hope that this paper has made clear that there are some aspects of the current system that need to be examined and reformed.

References

(Publications in English, French and German)

Awadzi, E. (2015), "Designing Legal Frameworks for Public Debt Management", *IMF Working Paper*, WP/15/147

Baudu, A. (2015), *Droit des finances publiques*, Dalloz

Currie, E. et al (2003), "Institutional Arrangements for Public Debt Management", *World Bank Policy Research Working Paper 3021*

Goodhart, C. (2012), "Monetary Policy and Public Debt", *Financial Stability Review (Banque de France)*, No. 16, pp. 123-130

IMF (2014), *Revised Guidelines for Public Debt Management* (April 1, 2014)

IMF (2018), "Second-Generation Fiscal Rules: Balancing Simplicity, Flexibility, and Enforceability – Technical Background Papers", *IMF Staff Discussion Note*, April 2018

Kott, S. (2019), "Le contrôle juridique de l'endettement public au peril du contrôle politique", in Boudet, J.-F. And C. Lequesne-Roth (eds.), *Les administrations publiques à l'épreuve de leur dette*, Mare & Martin

Kumhof, M. et al. (2020), "Central Bank Money: Liability, Asset, or Equity of the Nation?", *Cornell Law School research paper*, No. 20-46, (August 2020), SSRN-id3730608

Lemoine, B. (2016), "The Strategic State Caught up in Rates: the Creation of a French Public Debt Management Agency", *Revue français de science politique* (English Edition), Vol. 66 No. 3-4, pp. 27-51

Pellet, R. (2018), *Droit financier public, tome I*, PUF

Pünder, H. (2007), "Staatsverschuldung" in Isensee, J and P. Kirchhof (eds.), *Handbuch des Staatsrechts der Bundesrepublik Deutschland Bd.V*, 3 Aufl., C.F. Müller

Reis, R. (2019), "Can the Central Bank Alleviate Fiscal Burdens?" in Mayers, G. et al (eds.), *The Oxford Handbook of the Economics of Central Banking*, Oxford UP

Roy, A. and M. Williams (2010), *Government Debt Management: A Guidance Note on the Legal Framework*, Commonwealth Secretariat, October 2010

Gaber. S. and I. Gruevski (2013), "Public Debt Management, Perspectives of Innovations", *Economics & Business*, Vol. 13 No. 2, pp. 12-18

Singh C. (2016), (ed.), *Public Debt Management: Separation of Debt from Monetary Management in India*, Springer

Togo, E. (2007), “Coordinating Public Debt Management with Fiscal and Monetary Policies: An Analytical Framework”, *World Bank, Policy Research Working Paper* 4369

Trampusch, C. (2015), “The Financialization of Sovereign Debt: An Institutional Analysis of the Reforms in German Public Debt Management,” *German Politics*, Vol. 24 No. 2, pp. 119-136

(Publications in Japanese)

Ikejima, M. (2014), *Modern History of the United States Government Bond Management,* Kansai University Press

Ishimori, H. (2018), *A Study on Fiscal Discipline: German Constitutional Debt-Brake Clause,* Yushindo-Kobunsha

Itoh, T. and T. Yabu (2017), “Foreign Exchange Interventions and Foreign Reserves: Long-term Estimates of Intervention Profits”, *JCER Economic Journal,* Vol. 74, pp. 98-127

Iwata, K. and I. Samikawa (2018), *Dilemmas on the Normalization of Monetary Policy*, Nikkei Press

Katagiri, N. (2018), “Debt Issuance and the Constitution Article 85” in T. Mori et al (eds.), *The Current State and Perspective of Comparative Constitution Study*, Seibundo

Katagiri, N. (2020), “The Law and Fiscal Sustainability in the Shrinking Society”, *Public Law Review*, No. 82, pp. 99-108

Komura, T. (2016), *Budget and the Public Finance Act, 5th ed.*, Shinnihon-hoki

Ministry of Finance (2021), Debt Management Report 2021

Shirota, J. (2017), “German Government Bond Market and the Monetary Policy of ECB”, *The JSRI Journal of Financial and Securities Markets*, No. 98, pp. 39-57

Tanaka, H. (2011), *Fiscal Discipline and Budget System: Why Japan Fails in Fiscal Consolidation*, Nihon-hyoronsha

Fujitani, T. (2021), “Legal Framework for Government Debt Management Policy in Japan”, *Financial Review*, No. 146, pp. 58-73,

Misumi, M. (2012), “’A Paradox of Fiscal Discipline’ Observed in the History of Budgeting”, *Prism of Economics (Research Bureau of the House of Councilors of the National Diet)*, No. 101

Muranishi, R. (2015), “The Globalization in the Public Finance and ‘Parlamentsvorbehalt’” in Y. Asano et al (eds.), *Globalization and The Reformation of Public Law-Private Law Relationship*, Kobundo Publisher