# C O N T E N T

Chapter 1

# Japanese Government Bonds On Brink of Default

# 1.
# Views of Overseas Investors on Japanese Government Bonds (JGB)

## "The default of JGBs is getting a grip on reality" by Dow Jones & Company

> A hedge-fund manager of our acquaintance waxes apocalyptic when painting Japan's economic future. "Within 50 years or so," he contends, "high-tech aircraft will be taking Chinese and American tourists on fly-overs to view the dilapidated remains of what was once the world's second-largest economy."

This is the opening of the article *Is the Sun Setting on Japan* published on the front page of Dow Jones News Corporation's American investment periodical *Barron's* on September 28, 2009.

For those who know the reality of today's Japanese economy, there is nothing new in this article. Given that information on Japan is hard to obtain, it is assumed that many overseas investors only started taking note of the critical situation after this provocative article.

Whilst the article may not be a pleasant read for Japanese readers, we shall examine this further:

> A Japanese GB default (a default caused by a failure

in the issuance conditions) is not only possible, but increasingly likely. [···] By then, all that survives will be blighted megalopolises like Tokyo, populated mostly by the elderly, and decaying, weed-choked highways, bridges and bullet train right-of-ways, spectral reminders of a once-vibrant society that lost its way.

The article is illustrated with a cartoon which shows a caricature of an old man wearing a kimono struggling uphill with a heavy load on his shoulders, reflecting the image of an ageing Japanese society burdened by huge government debts.

Japan's financial deficit is compared to a ticking bomb. Japan's debt-to-GDP (Gross Domestic Product) ratio in 2010 was at a globally critical level of 225.1%, far higher than the 76.7% average of the G-20 nations. (Fig. 1-1)

The article also addresses the issue of Japan's ageing population. The over-65 cohort is predicted to jump 30% by 2025 and 40% by 2050. On the other hand, the working population is predicted to fall rapidly, leaving a small workforce to support an ever-increasing ageing population. The article highlights Japan's rapidly loosening hold on corporate competitiveness.

The article states: *Japan will be unable to repay its huge debt as it is draining its ability to generate wealth.* I am afraid this is all too true. In this book, I will address the issues one by one.

What particularly struck both authors was the observation that overseas investors are losing confidence in Japan; *Barron's,* is a trusted source for many investors in the U.S. and the UK, and this may be the reason why sales of JGBs and Japanese equities softened after the article was published, in Oct. 2009.

It is likely that investors were negatively affected by the article and lost interest in investing in Japan. Wealthy American, British and Middle Eastern private and institutional investors may have instructed their managers to sell their Japanese equities.

Who was behind the publication of this article and why did they choose this time to publish it? Whatever their reasons, it can be interpreted as a Dear John letter to Japan from Wall Street. The publication of the article reveals how

**Fig. 1-1 Japanese Government's Debts–to-GDP Ratio** (%)

(IMF projection)

| | 2006 | 2010 | 2014 |
|---|---|---|---|
| **Japan** | 195.3 | 225.1 | 222.3 |
| **Italy** | 106.9 | 112.4 | 118.0 |
| **Germany** | 66.0 | 80.1 | 77.2 |
| **the U.S.** | 61.9 | 90.2 | 99.5 |
| **Brazil** | 63.7 | 62.9 | 54.1 |
| **China** | 16.5 | 23.4 | 18.6 |
| **G-20 Average** | 62.7 | 76.7 | 76.8 |

* Derived on the basis of UN and IMF statistics by Tashiro

* The above statistics are based on IMF projections made when the Barron's article was published in September 2009. IMF projections for 2014 made in October 2010 predict a significantly higher value of 246.2%.

**The Japanese government's debt is at a globally critical level. The brunt of this is in the form of JGBs.**

many overseas investors see JGBs as a ticking bomb waiting to explode and, accordingly, are beginning to shift from buying Japanese equities and government bonds to 'selling off' Japan. Articles like this are a good indication of the views of the majority on a particular issue.

Overseas investors are losing their confidence in Japan. It is as though they fear that Japan is suffering from a fatal disease which will erode her economy. The majority of Japanese, however, are unaware of this mistrust.

## A British Investment Company: "Invest in Asia but not in Japan"

Japanese companies are eager for foreign investment, however if overseas investors lack confidence in Japan, they are unlikely to invest.

When Japan's economic power was strong, foreign investment was healthy, and overseas investors required little encouragement. However, Japan is no longer an attractive investment prospect as emerging economies such as BRICS continue to grow by leaps and bounds. Few reputable investors are interested in declining economies. It is now obvious that overseas investors are losing interest in Japan.

One of the authors of this book (Ishizumi) happened to see a long-term Asian investment allocation plan at a British investment company in 2008. I noticed that the plan had' EX. JAPAN' written onit. I wondered what the abbreviation 'ex' stood for — *expect,* perhaps? Could this, I wondered, have something to do with expectations of Japanese growth?

I asked the executive in charge if 'ex Japan' stood for 'expectations from Japan'. He laughed and said, "We would be happy to invest in Japanese companies if they offered us good expectations. Unfortunately, we can't find any that do. And Japanese politics don't help." 'Ex Japan', he went on to explain, stood for *Except Japan*. And indeed, there were no new Japanese companies listed. Overseas investors no longer want to invest in Japan because they no longer have any expectations from Japan.

Japan's exclusive government and business policies have caused overseas investors to look elsewhere.

As an international lawyer, I (Ishizumi) have been representing and assisting overseas investors with their Japanese investments and acquisitions since the 1980s. On multiple occasions I have witnessed the Japanese government or Japanese businesses ruin the plans of overseas investors attempting to enter the Japanese market. These investors learn never to invest in Japan as they become resentful of Japan's reaction.

During the course of my career as an international lawyer, I once represented a Chinese financial tycoon who planned to acquire a Japanese listed rival company in a hostile takeover. One of world's leading financial conglomerates planned to invest anonymously in the acquisition.

This action was perfectly legal, but the prospective purchasers' plans were crushed by the Japanese parliament, the Japanese government and finally, the Japanese business community. They created a huge commotion over this issue, claiming that adubious Chinese tycoon they had never heard of was buying a long-established listed Japanese business.

The anonymous sponsor was forced to withdraw from the acquisition, but I will never forget his words: "Kanji, the Japanese care about only themselves. Leave Japanese businesses to their debts." He voiced his frustrations with Japan: "I wanted Japan to be one of us, to share equities and profits after the acquisition. But I don't care anymore. The Japanese aren't team players."

The word 'debt' means 'something that is owed or due', but also 'an offence that requires reparation'. 'Equity' means 'the common stock of a corporation' but also 'the state or quality of being fair, impartial, or just'. In other words, the shadow sponsor announced, "we will do what they seem to want and leave the Japanese to their debts." There is a saying: *He who sows thistles shall reap prickles.* Given the current situation, it is possible that the Japanese will soon find themselves with nothing to harvest but prickles.

At the time of this attempted acquisition, the Japanese economy was still quite powerful. It has since been deteriorating, yet the Japanese government and business community still stubbornly cling to their exclusive business policies. Unfortunately, as a result, foreign investors have learned to take their money elsewhere.

## Overseas Businesses Moving Branch Offices from Tokyoto Hong Kong and Singapore

Overseas institutional investors analyse their investment destinations thoroughly. These days, Japanese equities and GBs are not even considered for their portfolio allocations.

The majority of overseas financial organisations that both of us have connections with are moving their Asian branches from Tokyo to Hong Kong or Singapore. Foreign media companies are also scaling down their Tokyo offices. “Leave Japanese businesses to their debts,” is becoming a reality.

Paradoxically, some overseas investors have been watching the Japanese financial situation with interest since the financial turmoil of 2010. Like vultures, they have been watching and waiting for Japanese government bonds to default, poised to pounce as soon as Japan is thrown into utter chaos. Once this happens, they will pick Japan clean, making good bargains of JGBs, equities, businesses and properties. They predict that this will happen in the very near future.

# 2.
# What is a Government Bond (GB)?
### The Japanese Public: Blissfully Unaware that GBs are a Debt they will Inherit

## Confidence in Japan is Declining

The world is losing confidence in the Japanese economy and the Japanese government's ability to manage it. When you speak with overseas investors and follow articles in the overseas media, you can see that this is happening. In financial affairs, confidence in a country is vital. Confidence in Japanese financial activity has, unfortunately, begun to erode.

Today, most of the world's developed countries are struggling with financial deficits and a loss of confidence in their national governments. Having said that, it is wrong to rationalise that Japan need not worry as long as other countries are in a similar position.

The GB market offers a good idea of the degree of trust enjoyed by nations. But first, I would like to clarify what a GB is. There is a common saying, *Wise men learn from history; fools are affected by present events.* If we examine the history of GB markets, we can see that Japan is at risk.

## What makes GBs a secure investment?

All financial activities have the following three basic elements in common: 1) credit, 2) trust 3) confidence.

1) Credit is rooted in the trust that the debtor will honour the repayment.

2) Trust is the exchange of goods and services for a deferred payment.

3) Confidence enables trust in the debtor. On a national scale this means that participants in economic activities expect the social, financial and monetary systems of a nation to be safe and accessible. As previously mentioned, confidence can only be ensured by the nation itself.

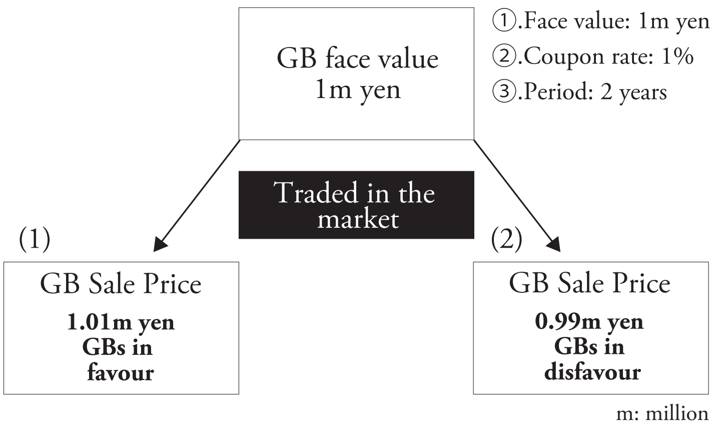
Investors' confidence in a nation is reflected in its currency, which is the nation's economic fundamental, and its GBs, which are essentially the national debt. When confidence in a nation deteriorates, its currency and GBs are sold. Trust and credit often show falls in tandem with a decline in confidence.

GBs are issued by the national government, and regarded as the most credited form of security in a financial market. Consequently, the yield rate of GBs is used as an indicator of a long-term interest rate and has a huge impact on economic activity. This is summarized as follows.

■When confidence in a nation rises:
GBs will be popular and thus will attract buyers, which pushes up the price of GBs and lowers the yield rate. This in turn lowers the long-term rate as the yield rate is its index.

■When confidence in a nation falls:
GBs will not attract buyers. This will bring about a price drop of GBs which will accordingly raise the yield rate. This pushes up the long-term rate as the yield rate is its index.

**Fig. 1-2 When the sale price of GBs drops, the yield rate rises**




**The return is the same 1.02m yen in either case.**

1m yen face value + (1m yen face value × 1% coupon rate × 2 years)

**(1)Buy a 1.01m yen GB and receive 1.02m yen return 0.01m yen difference**

**<u>When the GB price rises, the yield rate drops.</u>**

**(2)Buy a 0.99m yen GB and receive 1.02m yen return 0.03m yen difference**

**<u>When the GB price drops, the yield rate rises.</u>**

*The above is simplified to show the relationship between a GB price and its yield rate.

## Government Bonds: a Debt Incurred by Country's Citizens

From our study of the history of GBs, both authors forecast a future default on JGBs. It is necessary to examine GBs in greater detail in order to demonstrate how critical the current JGB situation is.

A GB is a deed issued by a national government for its own debt'. This is why a GB is regarded as the most important and credited security of all.

GBs came into existence along with the developments of nation states and democracy. A nation state is a country governed by its citizens. Before the modern era, most countries were regarded as the property of monarchs.

The renowned German novelist, Goethe(1749–1832), was also a politician during the time of the French Revolution. In his diary, he describes his amazement during the battle between the post-revolutionary French forces and German forces in the German territory:

> French soldiers were shouting "Cheers for the public", "Cheers for the nation!" in the midst of the battle. People are giving up their lives for abstract ideas for the first time in human history.

After this, Napoleon became the emperor, insisting throughout his reign that he was chosen by French public election. The people's army provided the strength and morale of the French forces. Previously, an army was comprised of either mercenaries who fought for money, or soldiers personally related to a ruler. For the first time, ordinary citizens began to identify with their native lands and feel that they were part of a nation.

Democracy grew popular in European countries in the 19th century, as citizens strove to participate in the governing of their own nations.

People came to accept that their country's debt was their own debt, and thus GBs gained in credibility. Previously, national debts were regarded as debts incurred by the sovereign or other leader. Debts were commonly defaulted on whenever a new sovereign took over after a revolution or other political disturbance.

Examples of this can be found in history. For instance, when the Bourbon dynasty repeatedly went to war with other countries before the Restoration, their monarchs borrowed money to cover the costs they incurred. The countries' economy became turbulent each time debts were reneged on.

Although England had a monarch, a social positional parliament was founded in the Middle Ages which subsequently evolved into an electoral parliament. The parliament was an enduring governing body in which representatives of the citizens participated. Parliament began to borrow money, pledging its future tax revenue as collateral and issuing bonds as deeds.

Obviously, national debts, as securities guaranteed by the parliament, had greater credibility than the debts incurred by a king. These debts evolved into today's government bonds.

Even under today's government, the principle of a government bond remains the same: a deed for a debt that a national government has incurred, the repayment of which is undertaken by its citizens.

With the exception of Japan, the governments of industrialized countries are cautious about issuing GBs and intent on keeping them to a minimum. In most cases, financial collapses are brought about by wars; therefore democracies that issue GBs tend to adopt a cautious approach towards wars and their financing.

## If JGBs Collapse, the Burden will Fall on Japanese Citizens.

Let's examine how JGBs are issued.

Strangely, it is not easy to tell who is responsible for the issuance of JGBs. All Japanese political parties, including the two largest, the Democratic party and the Liberal Democratic party, have lamented the national budget and its overdraft. The parliament has become fixated with government spending. In addition, the Japanese citizens allowed these happen without cautious interest in either the nation's economy or the future, moreover that, many of mercenary citizensactually accelerated the national government's expenditure by claiming frivolous settlements against the state.

These issues have widened the gap between annual government revenue and expenditures, leading to large-scale issuances of huge sums of GBs following measures proposed by officers of the Ministry of Finance. However, there is no record of any parliamentary discussion on these large-scale bond issues, nor were these measures discussed in the Diet, which is composed of selected members from the parliament.

Failure to establish where a system of accountability resides is a nationwide problem in Japan. The same lack of accountability applies for the financial deficit and the issuances of GBs. When we consider that GBs are a debt incurred by a government which is then passed on to its citizens, it is obvious who will eventually pay when this debt must be repaid.

No one has ever taken responsibility for the proliferation of JGBs. This problem was not so grave in the days when Japan's economy was robust.

Now, however, Japan's economy is declining and has reached a critical situation. It is only natural that GBs have lost much of their credibility due to the ambiguity over who issued them in the first place.

# 3.
# In What Countries Do Defaults of Government Bonds Occur?

Japan’ s Debts Over Twice the Value of GDP: Worse than WWII

## Yield rate of GBs Predicts the Future of a Country

*The wise learn from others’ mistakes, fools from their own.* This is an ancient Jewish proverb which demonstrates the importance of learning from history. The Jewish religion places a high value on scholarship and spends much time studying the Hebrew Bible. A study of history shows us that wars can bring on not only the defeat of a nation, but also its economic collapse. Japan may soon be counted as one of those fallen countries.

As an international lawyer, I specialise in support for corporate mergers and acquisitions (M&A), business law and patents. Although my parents are Japanese, I am a Jewish convert who has spent over a decade studying Judaism.

Jews have a 4000-year history. We reflect on our past before we make future decisions, both individually and as a society. The biblical saying, *There is no new thing under the sun,* also applies to the economy.

Many centuries ago, the quality of gold and silver currency declined with the deterioration of the Roman

Empire. During the notoriously extravagant Nero's reign, gold or silver content was reduced and the issuance of currency increased. As a result, confidence in the currency declined, resulting in inflation. The same happened in Japan during the Edo period. The feudal shogunate reduced the quality of its currency when it ran into financial difficulties. The smaller the coins became, the closer the shogunate was heading towards its own destruction.

Today's accumulation of JGBs is exactly the same. The issuance of huge sums in deficit-covering GBs, or 'paper currency' may give the government a short-term boost, but, the confidence in the nation's currency will start to decline.

We will look into how GB defaults occurred from country to country. The term, *the invisible hand,* was coined by 18th century British economist, Adam Smith, and refers to the market's ability to regulate itself through self-interest, competition, supply and demand. The metaphor describes the multilayered mechanism in profit-making activities, and how these determine the most efficient resource allocation.

Surely, every matter in the world cannot be appropriately determined by a market alone. However, when we look at the dissolution of socialist countries, the results speak for themselves; social systems which do not allow market efficiency are failing. This proves that a market-centred economic system is imperative.

A study of the market often reveals amazing insights. For instance a long-term interest rate, such as the yield rate on long-term GBs, can offer us a glimpse of a country's future.

## Countries with Low-yield GB Rates Win Wars

Before and during the Napoleonic wars in the late 18th century, British GBs were higher in price and lower in yield than their French counterparts. Accordingly, British GBs had higher market confidence, indicating a belief in Britain's eventual victory over France. Indeed, it was proved right.

Likewise in the American Civil War, WWI, and WWII, long-term rates of the victorious nations always remainedlower than those of the losing countries, before and during these respective wars.

Investors do not buy GBs issued by countries with a low likelihood of winning a war. They see risks of GB defaults leading to financial difficulties and an inability to continue fighting.

On the other hand, the opposite situation occurs when the market judges a country to have a high winning potential. Such a country is apt to enter a successful cycle, raising funds at a low interest rate, and securing enough resources to continue fighting. (Fig. 1-3)

## GB Yield Rates are Low in Stable Democratic Nations

Let us examine the changes of long-term interest rates, i.e. long-term GB yield rates, from another perspective.

As a nation's democracy becomes more stable and mature, reflecting a national consensus, its long-term GB yield rate tends to decline. The market foresees that the citizens of such a country will not encumber themselves or future generations by unwise investments.

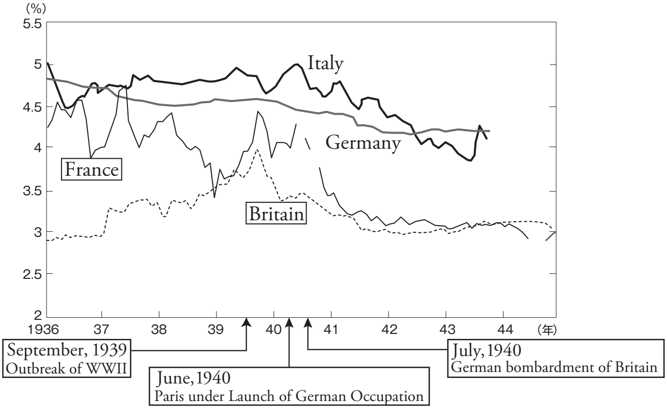
For example, Britain held the global supremacy from the 18th century to the beginning of the 20th century. It was ahead of other countries in adopting an electoral system and gradually established its democracy during this period. The British GB yield rate was also lower than that of other countries. Investors anticipated that British citizens would never take financial risks.

Since the 19th century, there have been two main centres for GB trading: the City in London and Wall Street in New York. The U.S. and Britain have devoted considerable effort to develop financial organisations such as banks, securities companies, corporate investors and stock markets to secure sources of national strength.

The great German sociologist, Max Weber, active from the end of the 19th century to the beginning of the 20th century, maintained in his seminal thesis, *The Stock Exchange,* that strong stock markets and the capital of big banks are the means by which economic powers win battles. He wrote this to advocate improvement of the Frankfurt financial market.

Although Germany was strong in manufacturing, it could not beat Britain in either world war. This was primarily because it failed to overtake Britain as the international

**Fig. 1-3 Countries with Low GB Yield Rate Won Wars**




**GB yield rates of victorious Britain and France were lower than those of defeated Germany and Italy.**

* Ref. "国債の歴史 (Kokusai no Rekishi: The History of Government Bonds)" (by Toshiki Tomita, published by Toyo Keizai, Inc.)

financial centre of Europe.

## High-yielding GBs of Non-Democratic Nations Accelerate Defaults

Fascist countries like Japan, Germany, and Italy before and during WWII rejected democracy. Socialist countries rejected the market economy. Both experienced tragic ends. During WWII, Germany and Japan built up a closed economy prohibiting capital movements, and encouraged their own central banks and citizens to underwrite the GBs.

Today, international investment is generally open to investors within leading countries. Capital can be transferred beyond the borders of countries.

During WWII, the administrations of Germany and Japan foresaw the risk of defeat; as their economic power weakened against those of Britain and the U.S. They imposed a ban on capital movements fearing a drain of domestic investment funds being sent overseas. They increased war expenditure with no holds barred, setting their own citizens' wealth as collateral. After losing the war, the countries suffered financial collapse and the resulting hyperinflation.

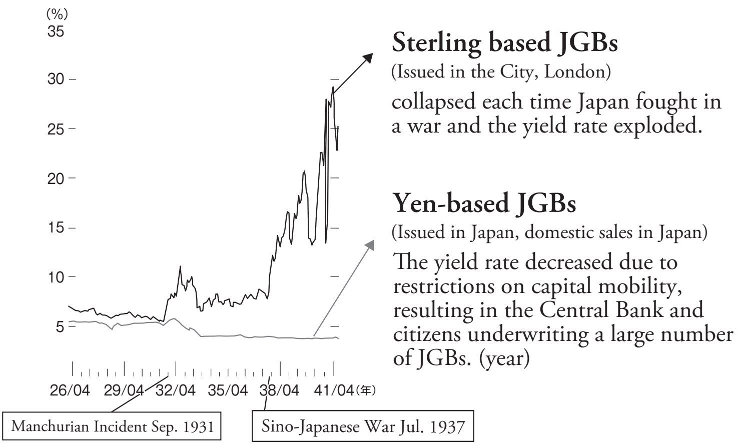
The U.S.S.R. and the Eastern European socialist countries also denied either democracy or market economy under the Communist dictatorship. These countries collapsed one after another around 1990 after suffering economic stagnation.

## GB Yield Rates of Japan and Germany Exceeded 20% as WWII Advanced

Figure 1-4 shows that the rise of JGB yield rate before WWII accurately indicated the deterioration of the Japanese democracy and its national strength, and the risk of defeat in the war.

In the pre-WWII period, British sterling-based JGBs were circulating at 4% per annum in the City, London. However, reflecting the weakened Japanese economy, they traded at a discounted rate (a lower price than their face value).

**Fig. 1-4 Yield Rate of JGBs during WWII**




**Overseas investors did not have confidence in JGBs during WWII. On the other hand, in Japan, the yield rate decreased. Japan's current situation is the same.**

* Ref. "国債の歴史 (Kokusai no Rekishi: The History of Government Bonds)" (by Toshiki Tomita, published by Toyo Keizai, Inc.)

The yield rate was at 6.18% when the international gold standard (circulation of currency is determined by the amount of gold reserve) was recovered in January 1930, but dropped to 5.52% in April 1931. However, it started rising when the Manchurian Incident occurred in September 1931, and reached 8.25% in December of the same year when Japan withdrew from the gold standard.

In July 1932, Japan enforced a law that prohibited overseas investment in order to prevent capital drain from Japan. By controlling capital movements, Japan intended to establish a closed economy. This raised the yield rate to 9.26% in the same month, then, to 9.69% when Japan amended the Public Finance Act to allow the Bank of Japan to underwrite GBs in November 1932.

The JGB yield rate rocketed through the 10% threshold when the Sino-Japanese War broke out in July 1937. It exceeded 20% in September 1939 when Germany invaded Poland and WWII broke out. The yield rate rose again to 21% in September 1940 when the Tripartite Pact between Japan, Germany and Italy was formed.

In order to attract purchasers, poorly credited GBs needed to be at a high yield rate; over 20%. These are called 'junk bonds' in financial markets. During WWII, JGBs were classed as junk. Not surprisingly, the same phenomenon occurred in another defeated country; Germany. In post-war Germany, the yield rate of German GBs issued in Germany in the 1920s and underwritten in the City, London, had exceeded the 20% threshold.

However, we find an entirely different scenario when we examine the GB rates of the victorious countries of WWII.

British GBs were under government control and the yield range was still at 4-5% in the 1930s. The U.S. boasted the world's strongest economy and its GB yield range was at 3-4%. Unlike the inflated yields in Germany and Japan, British and the U.S. GB yields remained stable and low.

These markets, guided by Adam Smith's invisible hand, had anticipated the market's reaction to WWII years previously.

## JGBs are Topped up with 'Premiums' for Market Deals

By reading the market, we can see early warning signs telling us what may happen to JGBs. It is also prudent to remember what happened the last time Japan flooded the market with junk bonds.

Unlike the GBs of other countries, JGBs have risk premiums attached to them in overseas markets.

In 1998, the long-term yield rate of JGBs rose higher than similar World Bank yen-bonds issued in the same year. (World Bank yen-bonds are issued by the World Bank. Their procurement funds are designated to finance industrializing countries.) In 1998, the JGB issuance volume went over that year's annual tax revenue.

In 2000, the JGB yield rate temporarily rose higher than that of yen-Italian bonds and of yen-Spanish bonds.

All are yen-based though the JGB yield rate went higher than the Italian and Spanish GB rates. In the same year, Japan's government debts (consisting mostly of GBs, but also of government securities and loans) exceeded its GDP (Gross Domestic Product) of the year.

This is not the first time it has happened to Japan. Japan's government debts exceeded its GDP in 1942 during

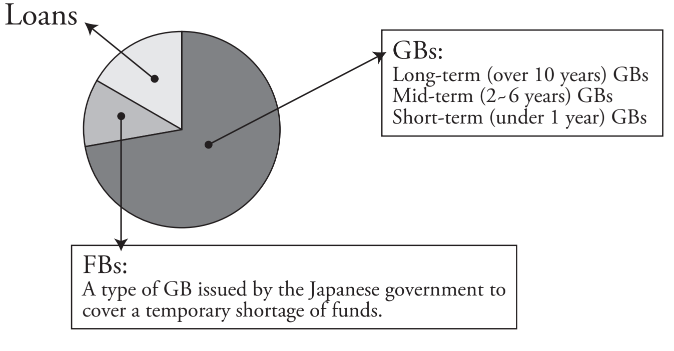
WWII. A few years later, Japan found herself suffering the devastation of defeat.

In 2010, Japan's government debts rose to twice its GDP. This is worse than the precedent set during WWII and is an unparalleled in its history. The market is reacting seriously to this new reality.

**Fig. 1-5 Transition of Japan's Government Debts**

| Year | 2004 | 2006 | 2008 |
|---|---|---|---|
| GBs | 626.3633 | 674.1221 | 680.4482 |
| Loans | 59.1122 | 59.2824 | 57.5611 |
| FBs (Financial Bills) | 96.0764 | 100.9741 | 108.4826 |

(trillion yen)




* Derived on the basis of the website of the Ministry of Finance, Japan (the Debt Management Report 2010)

# 4
# Crash of Government Bonds Occurs Suddenly after a Long Low-yield Period

- Genoa, Netherlands, the U.K., the U.S. then Japan

## The Decline of Leading Nations is Invariably Precipitated by a Crash of GBs and a Sharp Rate Rise

In 2010, Japan's long-term interest rate (in other words, the yield rate from a 10-year GB) dropped below 1%, marking a historical precedent. To date, this was the world lowest fall of long-term GBs issued on a country's credit.

The risks of JGB defaulting appear to be fairly low. The yield rate, id est long-term interest rate, is low as if confidence in Japan is high and stabilises JGB prices.

People in Japan apparently back this up, claiming that investors buy JGBs because they are confident in them, and that their low long-term interest rate means that JGBs are a safe investment.

However, when we consider the history of GBs and long-term interest rates, this logic is counterfactual. A study of history shows that leading economic nations have experienced a crash in GBs after a long period of low-interest, followed by a sudden rise in the long-term interest rate. Few people are aware of this worrying historically proven fact.

## Why do GBs Crash after a Protracted Low Rate Period?

Figure 1-6 shows the long-term interest rates of leading economic nations since the year 1500. These are: Genoa, in modern Italy, the Netherlands, Britain, the U.S. and Japan.

Only the U.S. has maintained its status of economic supremacy. Genoa, the city state of Italy, and Britain have ceased to be economic world leaders. Both experienced a sudden crash of GBs, coupled with a sharp rise in long-term interest rates after a low-rate period.

Initially, all of these countries developed state-of-the-art technology and held the enviable position of economic supremacy. They accumulated capital and attracted world-wide investment money.

At some point, however, an asset bubble rose and subsequently burst, causing them to fall into depression. They then implemented a monetary easing policy to stimulate their economy. As a result of this, interest rates dropped, but, the economy was largely unable to recover, and the prolonged economic depression caused the low interest rate to continue. Meanwhile, new economic powers grew and were emerging. The main industries of the struggling nations fell, and growth in their private sectors became even more sluggish and stagnant.

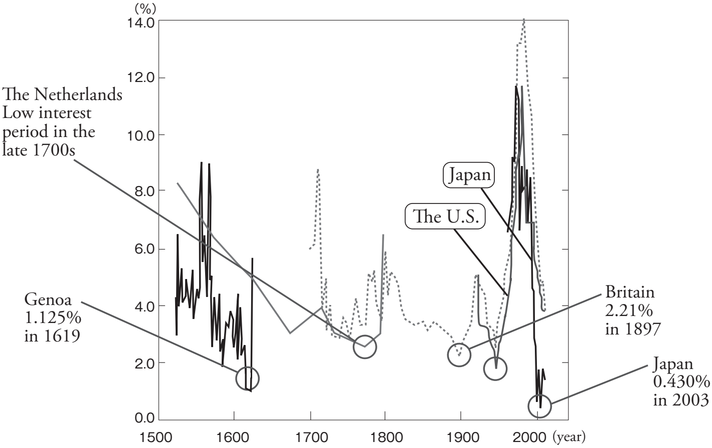
Several things happen in this sort of situation. First of all, a flush occurs with investment money under a monetary easing policy used as a counter recession (which is, in fact, a measure taken to protect banks). However, there are no attractive investment destinations due to sluggish economic growth in the country. There is no choice but to invest money in GBs. This hastens lowering of the long term interest rate.

Secondly, businesses in the private sector become less profitable, which decreases tax revenue and aggravates the cash-strapped condition in the public finances. In response, the government tries to fill the gap by taking advantage of the low interest rate. Although the volume of GBs issued is increased, the flush of investment money increases investment in GBs. This lowers the interest rate even further.

Thirdly— this is what former economic powers have experienced and Japan is soon to face—the issuance of GBs will continue and debts of the nation will accumulate. Eventually, there will be no one left to invest in GBs. Both the citizens of the country and its overseas investors will stop buying them. A crash of GBs followed by a sharp rise in the long-term interest rate will then occur.

As a result, the nation loses its economic edge and is superseded by another country. Accordingly, the fact that the long-term yield rate of a GB (id est long-term interest rate) is currently low does not mean that GBs are stable; rather this is more likely the sign of an impending crash. It appears that Japan is now treading the historic path towards a crash.

**Figure 1-6 Movement of Long-term Interest Rates of Economic Leading Countries since year 1500**




* Derived on the basis of 'The Short History of Interest' by Tashiro

## The Crash of Genoa GBs: Yield Rate Increase from 1% to 6%

Let's examine a few more past cases of low-yield long-term GBs.

In the 15th and 16th centuries, Northern Italy had economic power due to its famous wool manufacturing and winemaking, both of which required state of the art technology.

Both of the authors often visit Italy: Ishizumi for his business and Tashiro for research and meetings. The legacy of Italy's prosperous past can still be seen today. Superb woollen fabrics are still sold in northern Italy as local specialty goods. This traditional industry is the backbone of today's strong Italian garment industry and world-famous designer brands such as Benetton.

Travelling from Venezia through Milan to Turin, the hills and even mountains are covered with grapevines. Winemaking in northern Italy was so popular that the people of that time even cultivated their hilly districts. During this period, winemaking evolved into a technologically advanced industry. Indeed, Italy remains the world's leading wine producer owing to vigorous during this period coupled with the investment of both energy and resources.

However, northern Italy's prosperity did not last forever. To begin with, the production of grapes reached a limit in the 16th century. Once the hills and mountains had been fully cultivated, there was no more expansion possible. In addition, the Mediterranean trade, which supported the economic strength of northern Italy, was blocked off by the rise of the Ottoman Turks. The final straw was the discovery of the New World by the Spanish-funded Italian explorer, Christopher Columbus.

What influences did Genoa's GBs have? The yield rate of Genoese 4-5-year GBs was the index of northern Italy. This was because they were widely issued and were secured by taxes levied by the authorities. The yield rate of Genoese GBs rose to 9% in 1555, then, declined to 1.125% in 1619. This was the lowest long-term interest rate in history until

JGBs plummeted lower than 1% in 2003.

However, the Genoese long-term yield rate suddenly rose sharply to approximately 6% in the 1620s. This happened because there were no longer any buyers for Genoese GBs. The city state of Genoa has never recovered the prosperity it enjoyed hundreds of years ago. An extremely low rate was followed by a sharp rise of rate, after which the nation went into decline.

### The Crash of Dutch GBs – Yield Rate Increase from 3% to 7%

After Genoa, the next leading economic power was the Netherlands. The Netherlands were famous for navigation and textile manufacturing. Marine transportation and fabric production made the Netherlands the most advanced country in the world in that period. The country gained independence from Spain in 1581.

The well-known Tulipomania, a typical asset bubble, occurred in the Netherlands in the 1630s. Tulips were a rare flower during this time, and as a result, they were much sought after. Rare varieties were traded for phenomenally high prices, some for the value of a house. People believed that tulip prices would continue to rise forever, and for many years, a bullish market continued. When Tulipomania finally crashed, the yield rate of Dutch GBs stayed at 3-4% during the 18th century. Meantime, economic supremacy shifted to Britain. In the 1800s, Dutch GB yield rate sharply rose to almost 7%. Napoleon's occupation gave the finishing blow to the glory of the Netherlands.

## The Crash of British GBs:Yield Rate Increase from 2% to 6%

Britain, once the British Empire, also enjoyed economic prosperity for many years, but subsequently experienced deflation, followed by economical depression after the 1880s due to slim investment opportunities. This situation is comparable to today's Japan. In Britain, this slump resulted in low growth.

British long-term interest rate declined to 2.21% in 1897. However, the long-term interest rate rose sharply after WWI due to financial difficulties caused by the wartime inflation. Since that time, the U.S. has eclipsed Britain economically, establishing itself as the current world leader.

## The Crash of American GBs – Yield Rate Increase from 1.85% to 13.9%

Today, the U.S. is recognised as the world's economic superpower. The U.S. became a safe haven for various countries' funds during WWII, and its long-term interest rate dropped to 1.85% in 1941. After the War, the U.S. became the leading economic nation, replacing Britain. Under the Bretton Woods system after the War, movements of international capital were strictly controlled and GBs were circulated domestically within each country.

However, the financial and current account deficits of the U.S. worsened. After this, the so-called Nixon Shock terminated convertibility of the U.S. dollar to gold, thus ending the Bretton Woods system.

Subsequently, American long-term interest rate rose to 13.9% in 1981, and British long-term interest rate also rose sharply to 14.2% in 1974. Hence, the U.S., the leading economic power, followed in the footsteps of Britain, the former leading power.

It is not known when an interest rate will switch from being extremely low to extremely high, but one thing is certain: historically this occurs just before an economic leading country goes into a decline.

In 2010, Japan' s long-term interest rate plummeted to an unprecedented level of under 1%. According to the history of GBs, this should be regarded as an early warning of a GB crash, simply as an ongoing abnormal condition.

## Preventing a GB Crash

A study of the GB history reveals that the market shows warnings prior to GBs crashing. The market warns us about risky GBs by attaching risk premiums to them. GBs overpriced with undervalued yield rates are almost sure to crash. The market reflects a country's economic conditions and financial controls through its price mechanism.

Adam Smith's *invisible hand* plays a part in imposing sanctions too, if a country does not take market warnings seriously or handles its GBs unwisely. It is thus possible to avoid risks and even receive good returns, simply by a careful reading of the market. There is no indication that Japan has responded to market signals. On the contrary, the Japanese government continues to issue large-scale JGBs, manipulating its current low interest rate. Japanese citizens do not expect the government to secure fiscal discipline. As I have pointed out, the more mature the country's democracy is, the lower its GB yield is set. By having risk premiums attached to JGBs, Japanese democracy may be brought to question by the market.

The Japanese government, ignoring the risks, believes that JGBs are still fine. This misapprehension is backed by its citizens, who are ignorant of their own responsibilities. History has shown us that these two factors will inevitably lead JGBs to a crash — and just as surely, the country to insolvency.

Chapter 2

# Investors Losing Interest In Japanese Government Bonds

# 1.
# The downgrading of JGBs discourages investors from buying them

## JGBs downgraded to AA Negative (S&P)

*Financial market foretells the future of GBs and their issuer countries.*

In Chapter 1, we examined the history of GBs and the factors that have traditionally precipitated their collapse. Today, warnings have been raised from financial markets and players over the future of JGBs. We will examine each warning.

In January 2010, the US bond rating company, Standard & Poor's (S&P), changed its outlook for JGBs from AA Neutral to AA Negative. This implies a lack of trust in Japan's current fiscal position. By explanation, S&P cited the following concerns:

- Japan's debt-to-GDP ratio was predicted to reach 200% by the end of 2010
- The debt-to-GDP ratio was considered very likely to reach 215% in a few years
- Japan would have its rating cut if no deterrent measures were taken against deflation and fiscal pressure.

S&P decided to suspend the JGB rating cuts because of the following factors:

- Japan’s high external credit
- The yen’s high status as a reserve currency
- The fact that Japan's financial sector managed to withstand the global financial crisis
- Japan's diversified economy

The conclusion reached was that these strengths would allow Japan to retain its AA standard even if further delay in fiscal consolidation resulted in a rating downgrade.

The following is a brief analysis of S&P's rating system. The top rating is AAA followed by AA. Each rating is further divided into “Positive”, “Neutral” and “Negative.” Japan is currently at AA “Neutral” but may well be downgraded to AA “Negative.”

## The JGB Rating Could Decline to the Same Level as that of Israel and Saudi Arabia.

What exactly is the credit level of JGBs? A comparison with other countries’ ratings will help to answer this question.

First of all, the GBs of all G7 nations, the world's seven most powerful countries, are rated AAA, excluding Japan and Italy. JGBs’ rating is already significantly lower than those of the US, the UK, France, Germany and Canada.

The AA negative rating that Japan may well be demoted to is at present (October, 2010) shared by Israel, Qatar, Kuwait and Saudi Arabia. (Fig. 2-1)

Each of the above countries is beset with various issues. Israel has long been financially encumbered by the Palestine conflict, and Islamic countries such as Qatar, Kuwait and Saudi Arabia have economies that are over-dependent on the oil industry.

Moody's Investors Services is another renowned US financial rating company. During an interview conducted in February 2010, they too announced that a JGB cut was imminent unless convincing measures were taken by the Japanese government to control Japan's financial affairs.

**Fig. 2-1 GB ratings**

| Rating | Outlook | Countries |
|---|---|---|
| AAA | Neutral | US, UK, France, Germany, Canada |
| | Negative | |
| AA+ | Neutral | Belgium, Hong Kong |
| | Negative | |
| AA | Neutral | Abu Dhabi, Chile, Slovenia |
| | Negative | Japan, Spain |
| AA- | Neutral | Israel, Qatar, Kuwait, Saudi Arabia |
| | Negative | |
| A+ | Neutral | Italy, Czech Republic, China, South Korea |
| | Negative | South Africa, Botswana |
| A | Neutral | Mexico, Bahrain |
| | Negative | |
| A- | Neutral | Libya, Tunisia, Albania |
| | Negative | Thailand |

* Source: Standard & Poor (October 2010)

Moody's pointed out that the crucial issue was whether Japan could reduce its fiscal deficit post 2010, and added that they would continue to scrutinise the direction of Japan's current administration and their financial outlook.

Aaa is the top rating in Moody's system, followed by Aa, A, Baa, Ba, B, and so on. C means that the country is inadequate for investment. Apart from Aaa, each rating is further assigned with modifiers, with 1 as the top, followed by 2 and 3.

Moody's elevated the JGB rating from Aa3 to Aa2 in 2009. However, they have since served a notice of a possible cut.

According to analysts within the company, even with its sizeable debt, Japan still has some financial slack primarily due to factors such as Japan's stable domestic financing, solid savings, such as postal savings, and the strong home bias of domestic investors. (*The Wall Street Journal online, Japanese edition, February 26, 2010*)

## GB Rating has a Major Influence on Global Financial Organisations

Rating companies have a major influence on financial organisations in Japan and throughout the world, as their ratings are routinely used by investment companies as dependable, independent references. Indeed, financial organisations typically make it a rule to consult them when deciding investments.

In particular, institutional investor managers of, for example, pension funds and life insurance companies, buy GBs at their highest possible rating and control GB holding ratios according to ratings. The fact that rating companies have started to voice their fears about Japan's mounting debts has had an impact on financial
and throughout the world.

## According to the Market JGBs are Higher Risk than Chinese GBs

GB ratings have shown us another important fact: that according to the financial market, the risk of JGBs is now higher than that of Chinese GBs. Derivative insurance rates known as Credit Default Swaps (CDS), indicate this as well.

Since CDS are utilized exclusively by institutional investors, an indicative price at an insurance rate gives us an idea of financial experts' assessment of JGBs.

CDS are a risk-reducing financial product covering defaults of GBs and loans. They guarantee payments on defaults. Investors who own GBs or receivable loans pay insurance to other investors to guarantee payments in the event of defaults.

In GB trading, unreliable or high-risk GBs with blemished credit used to be bought and sold at prices that reflected 'risk premiums.' Today, large-scale GB investors use

CDS to offset risks.

Insurance rates are shown as percentages of the GB or loan principal, and the higher the default risk, the higher the insurance rate. In many cases, insurance rates range between just under 1% to approximately 3% of the bonds'spot price, however when credit in Greek GBs dropped sharply in 2010, their insurance rate rose to around 10% of the spot price.

It is useful to compare the insurance rates for Japanese and Chinese GBs.

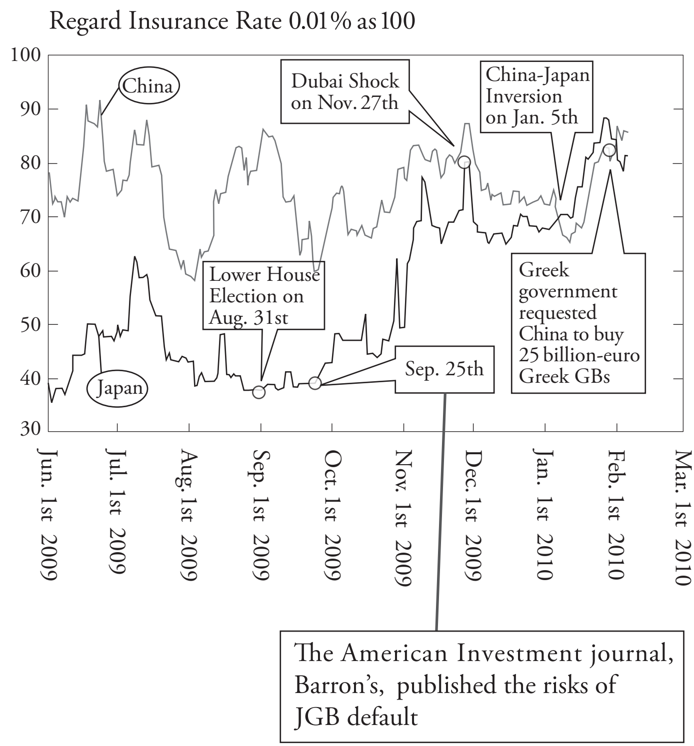
Figure 2-2 shows the CDS insurance of 5-year Japanese and Chinese GBs in U.S. dollars. Chinese GBs were initially higher than their Japanese equivalents, but by the end of 2009, they were at almost the same level. However, by January 2010, JGBs went higher than Chinese GBs, most likely because news about Japan's financial circumstances had reached investors and rating companies' concerns about JGBs had become common knowledge. Concerns about Japan or any other country experiencing financial difficulties are quickly reflected in the financial market.

Stability was restored by leading countries injecting their public funds into financial institutions in 2009, bringing about an end to the crisis. Although this had serious fiscal consequences in the countries involved, Japan and China were less affected than other countries. From the graph it can be seen that overseas investors had more confidence in China than in Japan.

When the Chinese government proceeds to open their financial market to the world and their financial products become more readily available to overseas markets, some

**Figure 2-2 Which is Safer JGBs or Chinese GBs?**

**(Changes in CDS Insurance Rates)**




*Compiled by the author (Tashiro), various sources.

overseas investors may well choose Chinese GBs in preference to JGBs. Japanese financial institutions and individual investors will no doubt do the same.

The money currently invested in JGBs will be transferred to Chinese GBs which will then trigger a crash of JGBs.

## Japan Ranked Lower than Turkey and Egypt in List of Investment Destinations

In 2010, A.T. Kearney, a global management consulting firm which releases the biannual *Foreign Direct Investment Confidence Index,* made an interesting release. Their index, which evaluates the security of investments and return rates based on the company's consulting activities and information, indicated that Japan has dropped from its top 20, although it had ranked 15th two years prior to that, in 2008. (Fig. 2-3)

Overseas investors make their investment choices by referring to information supplied by these research companies. No one would choose to invest in a low rated country when a range of attractive higher rated investment destinations are available. In other words, they would not choose to buy GBs of low rated countries.

## The Japanese: Unaware that Japan's Presence in the World is Declining

Although ordinary Japanese people rarely notice CDS insurance rates or the Investment Confidence Index, these sources indicate that confidence in Japan has been declining with the Japanese oblivious as to what is occurring.

The Japanese have become complacent about Japan's influence, convinced that Japan is still the center of Asia and a major global power, blissfully unaware that China is now superseding Japan. However stubbornly the Japanese government and the people insist that Japan is a safe investment decision, it is nothing more than self-complacency when investors do not share this perspective.

Japan's relationship with China and Russia deteriorated in the autumn of 2010 due to territorial disputes. History shows that territorial disputes are won by countries with superior military power. Similarly, the international financial market will not consider purchasing a country's GBs if there is no proof of that nation's integrity.

JGBs are competing with tens of thousands of attractive financial destinations. Unfortunately, due to the decline of market confidence in JGBs, they are rapidly losing their competitive edge.

Few JGBs have been bought by overseas investors and in the near future, even fewer will be bought. This means that there will be no alternative funds to hold up JGBs when Japanese financial organisations or individuals pull their funds from JGBs for whatever reason. The fact that there is limited overseas investment in JGBs is a highly risky situation, much like a tightrope walker working without a net.

**Fig. 2-3 Ranking list of Attractive Investment Destinations**

**(Foreign Direct Investment Confidence Index 2010)**

| | | | |
|---|---|---|---|
| 1 | China | 11 | U.A.E. |
| 2 | US | 12 | Vietnam |
| 3 | India | 13 | France |
| 4 | Brazil | 14 | Hong Kong |
| 5 | Germany | 15 | Other Arabian countries |
| 6 | Poland | 16 | Romania |
| 7 | Australia | 17 | Czech Republic |
| 8 | Mexico | 18 | Russia |
| 9 | Canada | 19 | Saudi Arabia |
| 10 | UK | 20 | Indonesia |

* Source: A.T. Kearney

**Japan is not listed in the top twenty countries and is ranked lower than other Asian countries such as China, Vietnam, Hong Kong, and Indonesia.**

# 2
# Financial Organisations will not Invest in JGBs if it is not in their Best Interests to do so

## JGBs Outstanding Balance Already a Staggering ¥741 Trillion Yen

By the end of September 2010, Japanese government debts had reached the astronomical sum of 954.6 trillion yen. The greater part of this, 741.3 trillion yen, is made up of GBs.

Historically, wars have reduced nations to financial ruin. Japan's situation is extremely unusual, as its financial collapse has come about in a time of peace.

Ever since Japan's economic bubble burst in 1991, Japan has repeatedly continued to increase public spending. Despite those efforts, however, the Japanese economy has not recovered. On top of that, tax revenues remain low while the financial deficit and outstanding balance of GBs have ballooned. How has all of this happened?

## Government Debt has Continued to Rise since 1965

In post-war Japan, the issuance of deficit-covering GBs was banned by the Public Finance Act. During the war, there had been wide-scale issuance of GBs, leading to the subsequent post-war default and hyperinflation, which the government then hoped to avoid a recurrence of.

Despite these past experiences, in 1965, Japan introduced a special measure to lift the ban in order to steer the country's economy out of the post-Olympic recession. Since then, the Japanese government has continued to issue deficit-covering bonds, with the only exception being during the bubble years when tax revenue increased, and year by year the government debt has steadily continued to grow.

In the year 2000, the total balance of GBs passed the 300 trillion yen mark. This occurred during the tenure of Prime Minister Keizo Obuchi, who called himself the 'King of debts of the Heisei era'. Time after time, Obuchi increased public spending in order to keep the economy strong.

## GB Issuance Exceeded Tax Revenue in 2010

Ten years later, in 2010, the situation grew worse. At the beginning of this year, the budget stood at 92.3 trillion yen, with a breakdown of 37.4 trillion yen in tax revenue and 44.3 trillion yen in GB issuance. This marked the first time since the immediate post-war period that the Japanese economy had been so unbalanced.

Just over half a century after Japan's defeat in World War II, the country is facing an alarming situation: the issuance of GBs now outweighs income tax revenue. The dependence of the national budget on GBs is at a 48% high, almost half the amount of the total budget. What is worse, the government has shown no inclination to address the situation.

The 2010 fiscal budget was compiled by the Democratic Party, who announced they would “conduct an expenditure review and improve the budget balance with national assets and special reserve funds” when they came into power in 2009. However, in the following years there has been no sign of any significant progress on fiscal deficit reduction. Quite the contrary, doling out money to the unemployed has taken priority to the enhancement of economic growth, and consequently, welfare spending has increased.

## Japanese Financial Organisations are Buying JGBs

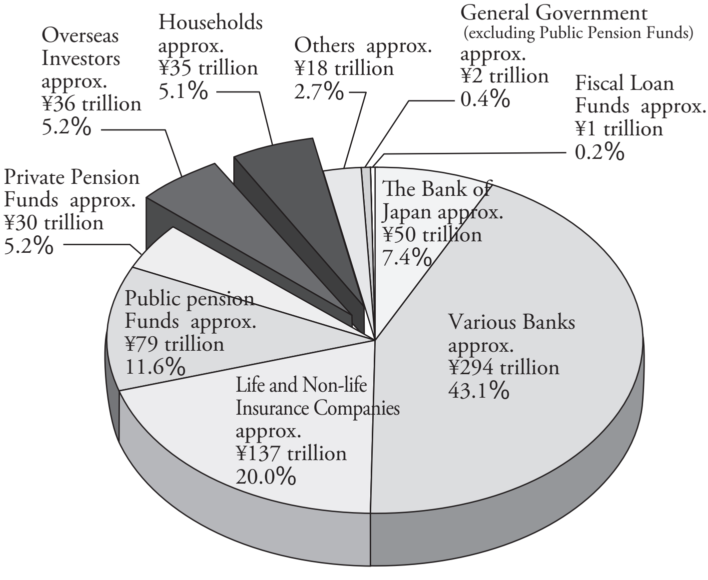
Although Japan is deeply in debt, the country has yet to hit financial rock bottom.

This is because, amazingly enough, people are still buying the mass issued JGBs.

The buyers are Japanese financial organisations such as banks, credit union banks, public pension funds, JP Bank (formerly the Japan Post Office), as well as life and non-life insurance companies, and other financial institutions.

These financial organisations use the financial resources they obtain from households and companies to purchase JGBs. It should be noted that there is a close and important connection between Japan's household financial assets of 1,456 trillion yen at the end of 2009 and JGBs.

**Fig. 2-4 Breakdown of JGB Ownership**




Late December 2009 (flash report)

**Japanese domestic financial institutions are the majority.**

*Source: Japanese Ministry of Finance

Figure 2-4 shows that a large share of JGBs is indirectly incorporated into household financial assets.

Japanese readers may say that they have never bought JGBs. Whether they know it or not, however, their money is being spent on JGBs as long as they live in Japan and use financial organisations there.

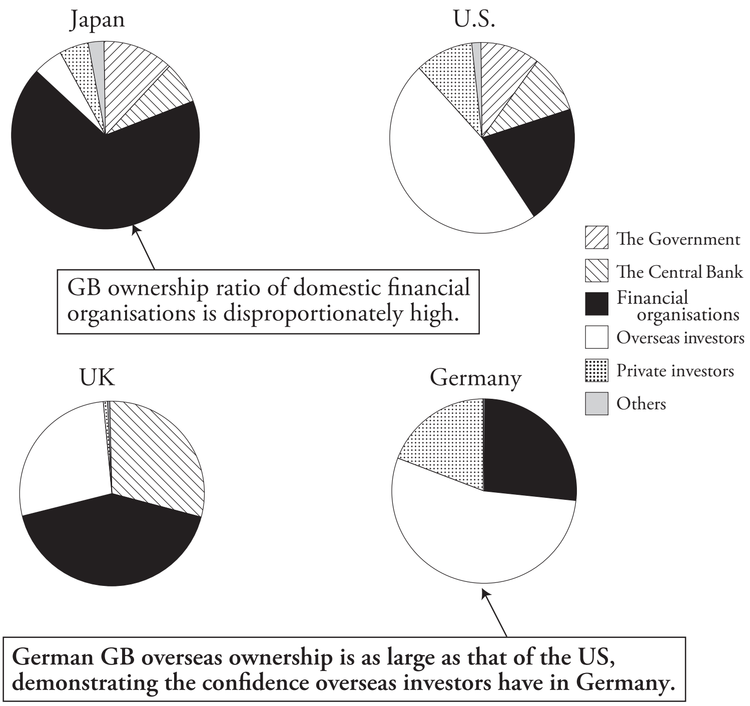
For this reason, everyone who lives in Japan will be affected by a crash of JGBs when it happens. There is no precedent of such an over-dependence on domestic investors among the world's leading countries. This preponderance of domestic investors is neither wise nor safe. Any business is bound to fail when the only buyer stops buying.

The percentage of overseas JGB ownership is as low as 5.2%. On the other hand, that of Japanese financial organizations is disproportionately large. Overseas investors in US Treasury Bonds amount to 47.7% and overseas investment in German GBs, considered to be the most reliable GBs in the European Community, is 53.6%. Also, both the US and Germany have a larger proportion of private investors than Japan has. (Fig. 2-5)

A brief look at history will illuminate the reasons for these differences in GB ownership ratios.

The US and Germany are popular investment destinations because people have faith in their economic systems and hence, their currencies. Germany is the strongest country of all the EU nations, and the American dollar is generally considered a strong currency.

## Figure 2-5 Breakdown of GB Ownership by Nationality




*Source: Japanese Ministry of Finance

## Why do Japanese Financial Organisations Continue to Buy JGBs ?

It is difficult to understand why the Japanese continue to purchase JGBs. Most people seem to buy them simply because no other choice seems to be available.

Historically, economic collapses in major economic powers are followed by a long period of low-interest rates. There are a number of causes for this, including the implementation of quantitative easing in order to lessen the effects of a depression, and few choices of investment options due to low economic growth followed by consequent capital glut.

With no other choices available, fund managers will also buy GBs, reasoning that they are relatively secure national assets, and most governments, content with the low interest rates, keep issuing GBs.

However, eventually a saturation point is reached. With no firm reason for purchasing JGBs in the first place, holders might stop buying and sell at the slightest sign that they are not dependable or secure. This would greatly increase both the risk of a bond crash and a sudden rise in interest rates.

## Investing in JGBs because they are 'Better than Nothing'

This is the current status of Japan for investors: with few investment options available due to low economic growth and sluggish share prices, investment funds are funnelled into JGBs.

Like the chicken-and-egg question, when private sector money is used to purchase JGBs, both the stock market and industry suffer due to the resulting stagnation in money circulation. This in turn results in low economic growth.

Banks, asset management companies and pension funds do not keep money lying around, dormant. They need to generate as much profit as possible, however small, to pay out profits to their stakeholders. For this purpose, they invest in JGBs to scrape up thin yields even at low-interest rates.

When the author, (Tashiro) questioned Japanese bank and fund managers as to why they have continued to buy JGBs over the past ten years, the answer has invariably been: There are no other options."

In fact, there are few companies able to offer investors good returns on their capital and few new ventures which anticipate rapid growth in Japan. In economically depressed areas there are few large projects or investment demands since big companies collect funds from shares and corporate bonds. All of these factors contribute to the phenomenon of surplus funds being used to purchase JGBs.

After further questioning, however, most managers gave other reasons for purchasing JGBs: "We're just doing what other financial organisations are doing," "So far, government bonds are low risk investments," "I'm doing what my boss told me to do," and "I'm only doing what the last manager did," are some of the reasons they gave. These replies show that many purchasers have been investing in JGBs without well thought out reasons.

If any of our readers happen to know any Japanese investment fund managers, we would encourage them to ask them why they continue to buy JGBs. We feel certain that the one answer they will not hear is " Because JGBs are the best investment."

## The Naiveté and Inertia of Japanese Financial Organisations Lead to Bulk Buying of JGBs

As we explained on page 10, financial organisations are entrusted with their investors' money. In return, they are obliged to invest the money and pay it back with dividends. Financial organisations are obliged to work very hard to find the best way to increase their clients' money.

Japanese have little respect for institutional investors such as investment funds. They have derogatory terms for them, such as 'vultures' and look down on their for-profit approach as not in keeping with the Japanese style of business. However, working to increase their clients' investments is the right approach of any financial organisation. 'Vultures' who aim to increase dividends for their clients are certainly doing a better job than the Japanese financial organisations who invest in JGBs simply because others are doing it.

Japanese household assets amount to about 12 million yen per person, a sum which most would agree is perfectly respectable on a world scale. However, the breakdown of their assets differs substantially from that of other major countries.

Although deposits and savings make up half of Japanese household financial assets, in western countries, they make up only 20 to 30% of household assets, the rest being tied up in financial products such as investment trusts or stock shares.

In Japan, household financial assets are disproportionately composed of deposits and saving due to a public mistrust of equities and the government's historical tendency to encourage saving. Also, Japanese retail investors are 'silent depositors' who are not aggressive in pursuing their own profits. All of these factors make Japanese banks reluctant to take risks.

## A Crucial Issue: Japanese Public-fund Managers Lack Financial Know-how

Japanese public-fund managers take fewer risks than their private sector counterparts.

Formerly, the Financial Bureau of the Ministry of Finance managed the country's massive funds for the government's Fiscal Investment and Loan Programme. Under the present system, state pension funds, deposits with JP Bank and JP Insurance, are managed independently by people who have no management know-how or spirit of risk. Hence, these public funds are also used to buy JGBs.

This raises serious concerns, as it appears that Japanese institutional investors are buying JGBs for no specific reasons, but simply because, as previously mentioned, they are complying with orders, copying others, or merely following convention. When other bond holders decide to sell, these half-hearted investors may well follow suit, resulting in a sudden mass sale of JGBs.

International financial markets have started talking about the risk of JGBs. There is a high possibility that Japanese institutional investors will decide to sell JGBs at a profit if there happens to be any shake-up such as a downgrading of JGBs, unsuccessful bidding for newly issued GBs, or the Chinese government's decision to open their GBs to the world market.

# 3
# JGB holders will sell them when their savings vanish

## Government Propaganda: Promoting JGBs to the Public

The Japanese Ministry of Finance is aggressively promoting JGBs to the public. In June 2010, taking advantage of the so-called 'marriage hunting boom' they launched an advertising campaign with the following copy: *A guy with GBs can be a big hit with girls.* That the Ministry of Finance is prepared to sell JGBs using such ridiculous strategies shows just how difficult the situation in Japan has become.

It is not surprising that the Ministry of Finance is desperate to sell JGBs at any cost. The system employing household assets to prop up JGBs through financial institutions and state pension funds could easily fail as early as 2013.

Until recently, the view of most Japanese on JGBs was that since Japan has household financial assets of 1400 trillion yen, there should be considerable leeway even if the outstanding balance of GBs surpassed 600 trillion yen.

Also, people feel that overseas speculators cannot contribute to a crash because 95% of JGBs are owned by Japanese.

People reason that if JGBs are at risk, there will probably be an increase in long-term yields whereas lately yields have been at a rare low level.

Successive Liberal Democratic governments seem to have put on rose-colored glasses by inflating the financial deficit and accumulating government debt.

The present Democratic government is simply accelerating the process that their predecessors have set in motion. However, it is obvious to every clear thinker that the situation is far from rosy.

## How much of the Domestic Reserve is Allocated for JGBs?

Professor Masaharu Takenaka of Ryukoku University has extensive experience as chief dealer at the New York office of Currency Option Trading, then office manager of the Washington Office of Tokyo-Mitsubishi Bank and manager and chief economist of the Economic Research Department at the Institute for International Monetary Affairs. He too is concerned about the risks of JGBs and says, 'the GB issue should be discussed in terms of net, not gross values. The authors agree with this opinion.

①Net value of household financial assets: ¥1000 trillion
→ Deduction of debts from household financial assets of ¥1400 trillion

②Net value of government debts: ¥500 trillion
→ Deduction of assets from the financial debt total of national and local governments

The ¥500 trillion difference between ① and ② is the present high limit of reserve (③) for JGB investments.

Since 2006, net household financial assets have been declining due to the falling birth rate and the ageing population. In 2009, they increased briefly, however, little of the increase went to JGBs as most of it was latent profits from high stock prices.

Based on the figures from 1980 to 2009, it is predicted that domestic reserves will reach zero in 2018 (Fig. 2-6)., However, taking the drop from 2006 to 2008 into account, it will take only three years for the domestic reserve to hit zero, in 2013.

### JGB crash will come before domestic reserves run dry

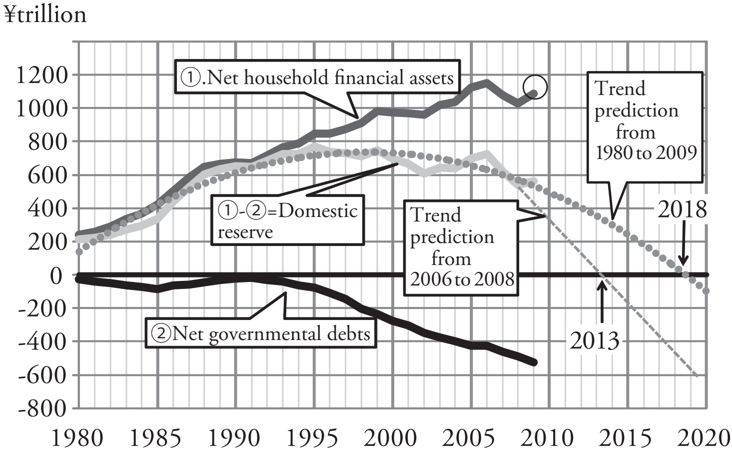
JGBs will crash before domestic reserves hit rock bottom.

Household financial assets include mortgages, business funds of private shops as well as equities and bonds. As the recession worsens, people will struggle to pay back mortgages or finance their businesses. Faced with these difficulties, they will start cashing in their stocks or bonds even at losses, or dig into their savings. Consequently, domestic reserves will decrease and when this happens, there will be no back up for JGBs.

It is wrong to believe, as many people do, that JGBs are securebecause the Japanese government has enormous real assets.

Both the central and local governments are experiencing cash-flow problems and have been unloading their assets. The actual net worth of the central and local governments is the deduction of debts such as GBs, local government bonds and borrowings from assets such as government-owned properties and equities. At the end of 2008, the actual net worth was 11 trillion yen, which was 50 trillion yen less than the previous year. This figure then fell to a negative value for the first time at the end of 2009.

**Fig. 2-6 Net household financial assets and government debts**




**Domestic reserves are drying up.What will happen to JGBs?**

* Source: The 'Fund Flow' by the Bank of Japan

If these were private companies, they would be in asset deficit and on the brink of bankruptcy. A JGB crash can come without warning. It may well happen when financial institutions such as JP Bank, JP Insurance and public pension funds are no longer supported by massive household financial assets.

As a point of reference, figure 2-6 is an update of a previous figure, using current data. The previous one was produced for the National Strategy Council in 2010. Having been invited to speak at one of their committees, I hoped to deliver my recommendations to the then Prime Minister Hatoyama at the Prime Minister's Office on the 5th of January 2010. However, I do not know whether Mr Hatoyama ever read it, as I was removed from the list of attendees at the last minute.

## 4. In the event of a reserve shortage, the national pension fund will stop buying JGBs

### Japanese National Pension's benefits as high as Germany's; contributions as low as America's

As households and businesses run low on money in the private sector, the public sector will loose margins in funds and investment power.

The national pension system of Japan is also referred to as the basic pension, as every adult earning a basic level of income is obliged to join it.

The scheme collects contributions from the working population and pays dividends to senior citizens who are over 65. People can opt to receive their pensions from the age of 60 or greater. The basic pension allotment varies depending on the length of time one has contributed. It is also annually revised. The basic annual pension allotment is about 800,000 yen while the basic monthly contribution is about 15,000 yen.

Overseas pension experts say that the Japanese national pension scheme is a strange system, offering benefits as generous as those of Germany but demanding contributions as light as those of the US; an annual pension income of 800,000 yen is relatively large in comparison with that of other countries, particularly so when the contribution is fairly small. Such a system operates successfully only if there are substantially more young people, in employment, than those drawing down a pension income. However, with an ageing population and a low birth rate, it could collapse. Accordingly, this current model is viewed as unsustainable.

## The pension reserve will dry up in the near future if the present trend continues.

There is another pension system called the Employee Pension Scheme which every company employee is obliged to join. Both policy employees and employers make a fixed rate contribution to the employee pension fund of their own industry sector or governmental fund.

Both national and employee pensions are partially managed by the Government Pension Investment Fund (GPIF).

The GPIF manages the world biggest independent fund (116.8 trillion yen at the end of June 2010) with the world poorest operation. Instead of looking for new investment destinations they invest in JGBs which offer only small returns. They do this simply because JGBs are handy, and perhaps because purchasing JGBs they will receive less criticism from Diet members.

As a consequence, it would appear that the GPIF has become the largest single stakeholder of JGBs. By the end of June 2010, they appeared to own 83 trillion yen worth of JGBs.

Although the breakdown of their holdings has not been disclosed, JGBs are the only bonds of such a great amount in the market. Unfortunately, even the GPIF are running out of money to buy JGBs.

The reserve amount of the national pension fund declined from 99 trillion yen at the end of March 2003 to 74.8 trillion yen at the end of March 2010. The reserves of the employee pension fund have also shown a continuous decline; after hitting a peak of 137.7 trillion in late March 2003, they fell to 119.5 trillion yen at the end of 2010. If these decreasing trends continue, both funds will dry up within thirty years from 2020. (Fig. 2-7)

**The worst-case scenario: Selling GPIF-held JGBs due to reserve shortages**

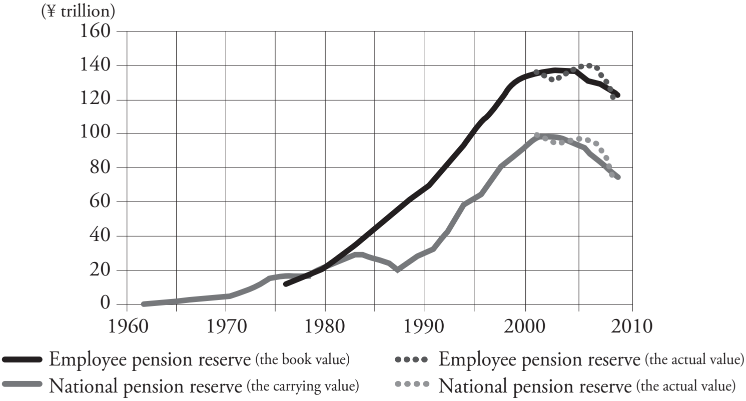
According to the Ministry of Health, Labour and Welfare, the national pension contribution rate in 2009 was 59.9%, marking the first time that the rate had dipped below the 60% threshold. This drop has been attributed to the increasing number of low-income contract workers.

Although the national pension contribution rate was almost 100% in 1979 and over 80% in 1995, it has now declined to this low figure. People who have not made contributions for a certain period of time will be disqualified from receiving a pension. When these people reach retirement age and can no longer work, they may find it very difficult to survive.

The national pension system was founded during the 1960s when Japan's economy was steadily growing, along with the population and annual income. Over the years the system has remained virtually unchanged, however within a few years a root and branch review of the national pension system is to be conducted. When that takes place, fundamental changes may be implemented, including the reduction of pension entitlement, extensions to the contribution period and premium increases.

However, if such a restructuring does not save the national pension system, the GPIF will be forced to sell their JGBs. If no other powerful investors can be found, the crash on JGBs will commence.

**Fig. 2-7 Changes in Japan's public pension reserve**




**No other option but to cash in JGB holdings when reserves run out**

* Source: author, Tashiro, based on *Summary of balance statement of employee pension and national pension in 2008,* Japan Pension Service

# 5
# As savings decline, JP Bank and JP Insurance will stop buying JGBs

## JP Bank savings deposits and JP Insurance: a sharp increase in the number of JGB holdings since 2000

JP Bank (formerly the Post-Office Savings) and JP Insurance, once referred to as the 'national piggy bank', are two other public financial institutions that have been buying JGBs. They too have been strained to breaking point, and it is looking increasingly likely that this so-called piggy bank may soon be empty.

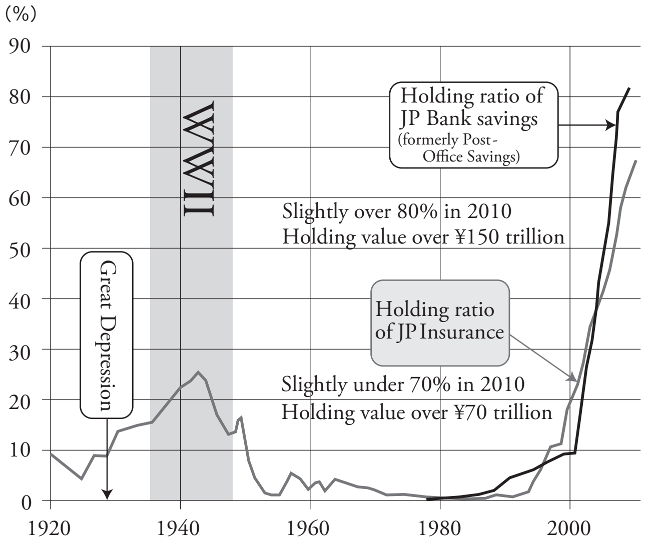
JP Bank's deposits and savings peaked in 1999 and JP Insurance reached its peak in 2001, but both are now declining. Their JGB holdings, on the other hand, have shown a rapid increase. This tells us that these institutions have diverted their funds into JGBs.

An examination of the GB holding ratios of these institutions reveals that approximately 80% of JP Bank's savings, now valued at approximately 150 trillion yen, were made up of JGBs in 2010.

70% of JP Insurance's holdings are made up of JGBs, valued at approximately 70 trillion yen.

In 2007, Japan's postal service was privatised. Japan Post, a government-funded public corporation, was founded

**Fig. 2-8 JGB holding ratios of JP Bank and JP Insurance**




**JP Insurance currently holds far more JGBs than it did during WWII.**

*Source: *JP Insurance Asset Management* (Statistics Bureau of the Cabinet's General Administrative Agency), *Asset Management of JP Insurance* (JP Insurance), *Flow of funds analysis'* (Bank of Japan) and *Financial Report* (JP Bank) in 2003 and established as the Japan Post Group in 2007. The flow of its funds clearly show that this corporation is purchasing JGBs.

There is another point that we can learn from history. Before the end of WWII, JP Insurance's JGB holding ratio was below 15%, rising to around 25% just after the war.

The Post Office was forced by the government to take on a huge number of war loans. The present situation is similar, but even more serious. It is easy to see that something is wrong when JP Insurance owns a greater share of JGBs than it did during the war.

## Why did JP Bank and JP Insurance increase their JGB holdings so rapidly?

Why did JP Bank's JGB holdings rise so sharply after 2001? This increase can be traced to the reform of the Fiscal Investment and Loan Programme (FILP) implemented in 2001.

Up until that time, JP Bank and JP Insurance deposits were kept by the government and invested by the Financial Bureau of the Finance Ministry as FILP funds. Their investment destinations were not disclosed.

After FILP was reformed, however, money from both the JP Bank and fund of JP Insurance was not supposed to be under the government's domain, but entrusted wholly to the Post Office. However, the Post Office had no experience or knowledge of investment strategies. Hence, they kept investing their funds in JGBs.

As almost everybody knows, diversification is a fundamental investment principle. It is extremely risky to ignore this and focus on only one investment destination, as the post office did when it continued to buy up JGBs.

The privatisation of the postal service was a key issue for the Lower House election in 2005. The then Prime Minister Junichiro Koizumi and the ruling Liberal Democratic Party advocated the promotion of efficiency and diversification of investment management of both JP Bank savings and JP Insurance. Unfortunately, they did not back up their words with action. The democratic government, established in 2009, is tightening its grip on the postal service and bringing it under state control.

In another ten years' time at the most, it is highly unlikely that there will be any public or private investment funds which can be used to buy JGBs. When JGB funds have dried up, JGBs will crash. When that happens, the risk of national bankruptcy will become chillingly clear.

# 6
# Baby Boomers: Savings Withdrawals commencing in 2012 will dry up JGB Investment

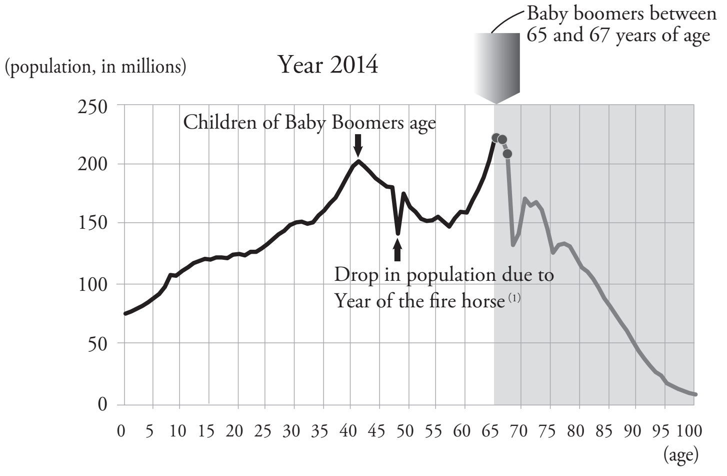
## Rapid decrease in population precedes JGB crash

When no more money is available to buy JGBs, there will be no option but to stimulate the economy to increase annual revenue and reduce annual expenditure through government reform. In EU countries, massive cuts in spending have been carried out. In the U.K., huge cuts in military spending were carried out in 2010. One in five soldiers and one in ten government employees were made redundant and tuition fees were increased to such an extent that students staged public demonstrations and protested in anger. However bad this may be, the situation Japan is facing is even worse.

One of Japan's main problems is the rapid decrease in population as a result of fewer children being born combined with a rapidly ageing society. Figure 2-9 shows Japan's projected population in 2014 when around 2 million people will be between the ages of 65 and 67.

In Japan, baby boomers (the Generation X) are people born between the years 1947 and 1949. (The author (Ishizumi) belongs to this generation.) As can be seen in Figure 2-9, after the baby boom, the population steadily decreases until

## Fig. 2-9 Population age breakdown for the year 2014




**The national pension system is heading for a collapse as pension payments to baby boomers rapidly increase.**

*The oldest baby boomers reach the age of 65 in 2012. All baby boomers cross the 65-year threshold in 2014.

(1) Year of the fire horse: one of the Chinese zodiac signs. Traditionally, fewer children are born during this year owing to a superstition that girls born during this year will grow up tobe unmanageable women (Annotated by co-translator).

there is a sudden increase for Generation Y, the children born to baby boomers, aged around forty in 2014.

This age breakdown practically guarantees a crash of JGBs for the following reasons.

Nowadays, most people work for a living until they are old enough to retire and live off their pensions, at age 65.

Although the government is fond of slogans such as, "towards a healthy and active ageing society," efforts to create employment opportunities for the elderly have not shown promising results. This is only to be expected, given that there are insufficient job opportunities for young people in the first place. With no income to rely on, elderly people will have no choice but to live off their pensions and, when necessary, dig into their personal savings.

From 2012, around 2 million baby boomers will start withdrawing their money from financial institutions. This will result in decreased savings at financial institutions as investments in JGBs drop. When this happens, JGBs will face great difficulties.

The Japanese social system has stayed essentially the same since it was created during Japan's period of high economic growth, between the 1960s and the beginning of the 1970s. From a financial point of view, this system is supported by institutions like the national pension system, JP Bank and JP Insurance.

Although the system itself is now collapsing, it remains unchanged.

## People over the age of 65 will make up a quarter of the population by 2050, but life for the elderly will be full of uncertainty

The rapidly decreasing population trend Japan is now facing is virtually unprecedented in Japanese history. The Japanese population has steadily risen ever since the end of the Edo Period[2] up to recent years, reaching its peak of 127.8 million in 2004.

During the Meiji Restoration in 1868, the population of Japan was 33.3 million. Since then, the population kept growing until the year 2004 increasing by roughly 94 million people. This amounted to a growth of over 1% per year, around 0.7 million people. (Fig. 2-10)

The economic growth of a nation is affected by its working population and the value of its capital. An annual 1% increase in a country's working population means an annual 1% rise in its growth potential. When its population was still rising, Japan's prospects for economic growth were promising. However, Japan's population started to decline in 2005.

[ Note 2. The end of the Edo Period: from 1853 to 1867
(Annotated by the co-translator) ]

The National Institute of Population and Social Security Research, a subordinate agency of the Ministry of Health, Labour and Welfare, has issued a report on future demographic trends in Japan. The report has transitional models at high, middle and low population growth. Japan's actual population growth trend has been following the low growth model. If this trend continues, the population will drop to 46.5 million in 2100, which means a decrease of almost 0.7 million people, or 0.7 - 1%, every year.

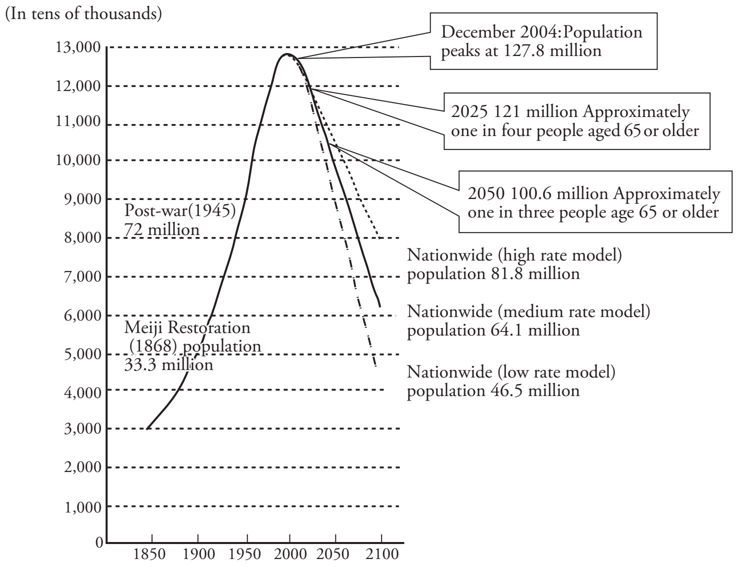
According to the low growth model, Japan's elderly population (i.e., people 65 years or older) will exceed 30% in 2050. At the present time, there is a ratio of four working-age (18 through 65) people to one elderly person; in 2050, this will increase to a ratio of two to one. It seems very likely that the present national pension system will collapse.

In 2009, the Japanese average life expectancy was 79.59 years for men and 86.44 years for women. Japan has had the world's longest life expectancy for the past four consecutive years. Japanese women have now had the world's longest life expectancy for 25 years running, though Japanese men moved down from 4th place in 2008 to 5th on the list in 2009. Although Japan's record of longevity is to be celebrated, there is no guarantee that elderly Japanese people will have a good quality of life.

There are many causes for anxiety; for instance, 2 million elderly Japanese now suffer from dementia and this number has been increasing at the rate of 0.2 million per year. In addition, there has been an increase in the number of elderly people who cannot work due to lack of mobility associated with osteoporosis or other serious illnesses such as cancer and diabetes.

Here again Japan's inadequate government policies are exposed. Given the fact that Japan's population has begun to age, it becomes increasingly clear that preventive healthcare measures should have been implemented 20 years earlier to promote the general health and well-being of the Japanese. For instance, public health campaigns promoting moderate physical activity, a ban on public smoking, and public service campaigns to improve Japanese dietary habits, including control

**Fig. 2-10 Changing trends in the Japanese population**




Source: (General Affairs Bureau) National census report:projected population report based on national census results from 1999 and 2004 (provisional figures National Institute of Population and Social Security Research: population projections for Japan, January 2002; National Land Agency Long-term analysis of population distribution in Japan (1974) of salt intake and calorie restriction, would have had enormous benefits. Additionally, high taxes on cigarettes and tobacco products such as those imposed in Western countries should have been considered. However, Japan has only recently begun to take an interest in such preventive healthcare measures. Frankly speaking, it is now too late.

Take smoking, for example. Although the data from many countries show that banning smoking helps to prevent a variety of illnesses, it is still easy to buy cigarettes in Japan since the tax on cigarette is low compared with the average of other major countries. The Japanese Ministry of Finance has been reluctant to raise cigarette prices, presumably because they did not want to lose the tax revenue from tobacco sales. It was not until October 2010 that cigarette taxes were finally raised in Japan.

In order to sell cigarettes, the government closed their eyes to the fact that a smoking ban would result in lower medical costs. Japan is the only country among the world's leading nations that has not yet implemented a total ban on smoking in public places such as restaurants.

For many years, medical care in other countries has been one step ahead of Japan's. In the U.S., former President Nixon mounted a public campaign against cancer in 1971. The U.S. government, medical community and pharmaceutical industry worked together to prevent cancer by promoting such measures as good dietary habits, regular physical exercise, and routine health check-ups.

During the past ten years, cancer deaths in the U.S. have shown a 0.5% decrease every year. In Japan, on the other hand, they have shown an increase. In the U.S., the projected number of cancer patients for 2010 is 1.5 million, but the American Cancer Association has set a five-year goal to reduce cancer deaths by 50% and cancer morbidity by 25%, starting in 2010. The U.K. has also shown a continuous decrease in cancers and cancer-related medical costs after imposing a total ban on public smoking. In this respect, the American and British governments and health authorities are quite different from the Japanese government and medical community who fail to back up their rhetoric with action. The above are only a few examples of the differences between Japan and the US and the UK Japan's health policies are short-sighted and not based on reason.

In Japan, the elderly cannot rely on their government when it comes to financial and health issues. They have no choice but to look out for themselves.

# 7
# Shrinking government revenue due to economic stagnation will curtail JGB investment

## Creating high value is the only way to strengthen the economy when the population is declining.

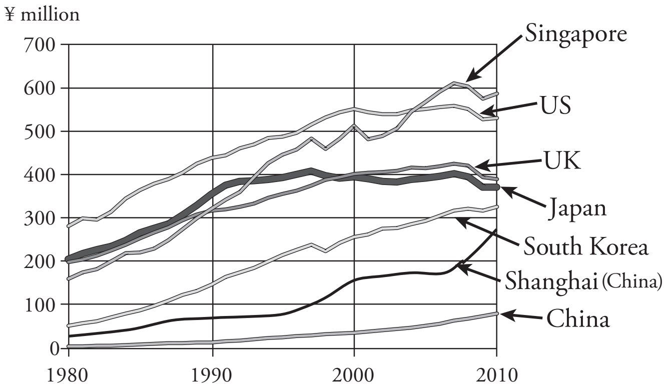
With Japan's dwindling population, the only way to prevent a JGB crash is for Japan to produce goods of high quality. Every Japanese citizen must strive to attain this goal.

With enough high-quality products on the market, the economy will grow, enabling Japan to avoid a crash on its bonds.

Unfortunately, Japan has not been able to pull itself out of its economic slump.

According to IMF (International Monetary Fund) statistics, Japan’s GDP per person has not grown at all since approximately 1995. In fact, in terms of economic growth, Japan has now been surpassed by Singapore, and a comparison of purchasing power parity (PPP) GDP per person in price levels shows that Japan is being overtaken by South Korea and is predicted to be surpassed by Shanghai in 2015. (Fig. 2-11)

**Fig. 2-11 PPP GDP per person of countries**




**•In price levels, China is catching up with Japan**
**•Japan has shown no growth since 1990s**

*Source: IMF data

## The emergence of new businesses: a key factor in growing a healthy economy

Japan's current economic slump can be attributed to the lack of new competitive businesses.

The decline in the number of publicly trading enterprises in Japan does not augur well for Japan’s economic recovery.

The Market of the High-Growth and Emerging Stocks (known as 'the Mothers') is part of the Tokyo Stock Exchange, and was especially developed for high-growth start-up companies at the beginning of 2000. Initially, it listed more than 150 companies annually, but by 2009, this number had declined to around 20. It appears that an increasing number of companies abandoned their listing plans not only due to the flagging market, but also because their business did not perform well enough to be listed or had failed to fulfil the listing requirements due to a drop in performance.

Today, very few Japanese companies are able to introduce innovative products. Over the past several years, American service providers have been transforming international communication at a global level with unique products and services such as iPad, iPhone, iPod, Twitter and Google; however no businesses in Japan have managed to come up with globally successful products. A prime example of this failure is that no Japanese mobile phone models are selling in overseas countries.

## The emergence of new industries will decide Japan's future

Many of the major performers in today's world economy are young companies which have emerged in the last 20 years, such as

Google and Amazon. Apple and Microsoft, although founded in 1970s, are also young companies at the centre of today's world economy. Emerging countries such as China and India have also produced new companies which are lively and robust. On the other hand, all of Japan's leading companies are manufacturers which have been in business for well over 30 years.

Although no one can deny the importance of such economic 'heavies', if no new companies emerge, the Japanese economy will almost certainly go into a decline.

History shows us that no nation has been able to remain a manufacturing giant indefinitely. Technology can usually be copied, and companies in countries with cheap labour forces can drive their competitors out of the market through lower production costs and pricing competition. Eventually, Japan too will lose its competitive edge in manufacturing.

There are multiple reasons why successful new companies have not emerged in Japan. Both of the authors suspect that Japan's dwindling number of new businesses is due to a nationwide lack of competitive entrepreneurial spirit.

Whatever the reason for it, if this situation continues, the Japanese economy will almost certainly decline to an unrecoverable state

## Unavoidable crash of JGBs

Japan's financial collapse, its ageing population and declining birth rate, combined with a lack of internationally competitive companies are problems which were forecast during the 1980s, however to date there has been a limited response.

As a legal apprentice, the author (Ishizumi) once had the opportunity to learn about drug addiction while working on a criminal case.

Many addicts ruin their health until they eventually die. Very few people take drugs because they want to die; rather, they use drugs for the fleeting pleasure they get from taking them, telling themselves 'just once more time' or 'I can quit any time.'

In much the same way, Japanese politicians and Finance Ministry government officials have continued to issue JGBs, perhaps telling themselves that everything will work out when the economy recovers or that they will be able to straighten the mess out at some future point. Instead of taking the opportunity to shape the future of Japan and make the nation a model of wealth and prosperity, they opted for a cheap fix with budgetary handouts and avoided making substantive reforms.

Even with an increase in fiscal expenditure after budgetary handouts, the GDP growth rate for 2009 was the worst ever recorded at minus 5%.

The Japanese government is shoring up the economy not only financially but also with banking policies. The Bank of Japan implemented a zero-interest rate policy in October 2010. Further, in an effort to lift the sluggish economy, the government is considering the unprecedented measure of a market operation to temporarily invest in JGBs and increase investment in corporate bonds and stocks. This has had little effect so far because Japan's strength is deteriorating and its economic power is clearly weakening.

Other countries have managed to reverse their struggling economies by changing their fiscal policies in line with global trends. Japan, however, has failed to do this.

Japan has long been known by the rest of the world as a manufacturing country and Washington's Asia-Pacific ally against socialism. Having now lost these roles, Japan has been unable to find new ones. After the Cold War, China reinvented itself after many changes and has become the world's major manufacturing power. As a consequence, Japan has lost its role as the world's top manufacturer.

Just as human fortunes may change for better or worse, so can the fortunes of nations. As their fortunes change, countries, like people, may fade from the scene and be forgotten. With no allies to help her, Japan could very easily die a solitary death. The US would not be particularly concerned, and China still nurtures feelings of hostility towards Japan.

Although Japanese politicians and government officials have been piling failure on top of failure, they have not been taken to task by the Japanese public for their blunders. Furthermore, society relies on the government to bale them out and in times of trouble. Even though the national debts have ballooned, the Japanese people show no sign of changing their way of thinking. This is unfortunate as JGBs will eventually be aburden they themselves must bear.

Japan's huge government debt problem did not happen overnight. It has resulted from years of poor management and unwise, ill thought out government policies. There are multiple reasons for the situation that is now too great to be handled. Japan's national dependency and blind trust in the government have resulted in irresponsible finance administration. We can no longer afford to neglect this problem as the day of reckoning is fast approaching, and Japan will stand alone when the crisis comes.