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CONTAINING CONTINGENCY GAMES

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The sovereign debt crisis in Europe has unmistakably changed the way policy options are debated in Japan. Excessive selling of government bonds in the market have made it clear that a country's comprehensive economic policy must be prepared for both ordinary times and contingencies. If such an understanding is to change the rules of the game, there is also a growing recognition that it is necessary to prepare contingency legislation to provide for emergencies should the game's structure undergo a drastic change.

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During normal times, government bonds are exchanged within a certain price range. Different investors have different expectations of how the bond will perform, depending on their speculations of future economic growth, inflation, the degree of risk foreign investors are willing to take, and so on. The game starts based on this assumption. Random interaction among bulls (those anticipating lower yields) and bears (those anticipating higher yields) determines actual bond prices. This process works to keep the prices within a certain range, producing profits or losses for investors in every bond transaction. In other words, investors function as price finders.

For Japanese investors accustomed to this “peacetime” game, the squall that blew through the euro zone came as a surprise. It was all the more surprising because the contingency crisis was triggered by investors. What drove the game beyond “ordinary” limits was an emergency created by investors who placed massive selling orders in futures markets. Investors who determined that a state was no longer serious about repaying its debts started selling that state’s bonds at an accelerating rate. The contingency crisis made it clear that there are three groups of investors: (1) crisis strikers who managed to make profits even during the sovereign debt crisis; (2) intelligent investors equipped with risk management methods who took stop-loss measures at an early stage; and (3) less intelligent and timid game losers who suffered a massive amount of loss and who will appear in the Private Sector Involvement (PSI) in debt restructuring.

The importance of “bonds” (in the sense of interpersonal ties) has gained renewed recognition throughout Japan since the great earthquake hit the country a year ago. However, once sovereign debt degenerates into a contingency, the game produces callous results that cut off human bonds. The euro crisis has taught the Japanese people the importance of preventing financial games from turning into a contingency. For the time being, this has resulted in heightened awareness about the need to improve primary balances. It cannot be overemphasized that containing contingency games requires a political agreement designed to resolve the primary balance deficit, which currently stands at more than 22 trillion yen. If dealt with by consumption tax

alone, this translates into a 10 percent hike. A political process has just begun, albeit belatedly, to confirm this reality. The question of how to contain contingency games in order to restore “bonds” will emerge as an important agenda item in the next general election campaign or perhaps immediately after that.

Another lesson from the European debt crisis is that, once a contingency game begins, it wipes from society the spirit of respecting diversity altogether. The fear of sovereign states being ranked according to their credit rating alone, which then determines their degree of involvement in the international community, is about to become a reality. The FIFA World Cup is a competition in which those who want to compete in the final tournament must first win a regional tournament. The international order since World War II has been premised on the assumption that determining winners by a single standard à la FIFA is an imperialistic thing of the past. When it comes to attaining social fairness and accumulating national wealth, different societies should have different policies. Acknowledging fungibility has been seen as contributing to tolerance. However, the time has come when a FIFA-like ranking list determines, and makes public, how capable a state is in the international community.

In fact, I often feel these days that intellectuals from countries off the ranking list are growing dispirited even at international conferences organized by nongovernmental organizations. In such circumstances, how can we make proposals reflecting diverse ways of international involvement? We need to contain contingency game situations in every corner around the globe. Otherwise we will never be intellectually armed against the global issues facing the 21st century. Maintaining diversity is the pressing challenge of the day. 

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