

**Minister's Summary by Minister Ota**



**18th Meeting (July 22, 2008)**

- (1) The current economic situation and macroeconomic management.
- (2) "FY 2008 Budget Overview"
- (3) Report of Expert Committee on "Structural Changes and the Japanese Economy."

Hiroko Ota here. Today, the Council on Economic and Fiscal Policy (CEFP) held its 18th meeting of the year and conducted discussions on the current economic situation and future macroeconomic management, the "FY 2008 Budget Overview" and the report of Expert Committee on "Structural Changes and the Japanese Economy."

Regarding the current economic situation and future macroeconomic management, first, the Cabinet Office and Member Shirakawa, governor of the Bank of Japan, explained the macro economy, respectively. Discussions proceeded as follows:

Expert member: At present, small and medium-sized enterprises are experiencing funding difficulties, because they are being in a vulnerable situation due to poor sales of building materials and other material-related businesses. Accordingly I would ask the Bank of Japan to implement flexible policies. Present price hikes for resources and foods are not transient. Both producers and consumers have to somehow share the pains of the price hikes. Yet this will present a good opportunity to make better use of energy saving technologies in which Japan holds a superior position.

Expert member: Rising prices of crude oils and food stuffs represent changes in relative prices and a transition to a new price system. We must accept and coexist with the new price system. It means that Japanese as a whole will be poorer in terms of export and import balance, and everyone has to share the pains piece by piece. Some are demanding compensation for recent price hikes for crude oils; however, I am afraid that the Government cannot pay direct compensation for fuel price hikes. Instead, people have to consider the price hikes as a great opportunity to make better use of Japan's technological edge. In addition, in policy responses, the Government should make a serious try to grow more foodstuff and grains in the country and eliminate mechanisms which have been discouraging an increase of foodstuff production.

Mr. Nakano, Vice Minister of Economy, Trade and Industry: We have been making efforts for promoting energy saving technologies and new energy sources and at the same time, extending financial guarantee arrangements which serve as a safety net against crude oil price hikes. However, regional economies themselves are facing a very difficult situation, and this has impaired the financial soundness of private-sector small and medium-sized enterprises. I can fully understand that

it is difficult to pay direct compensation for fuel price hikes, but I believe that the Government has to address current crude price hikes in any way.

In response, taking marine products as an example, an expert member pointed out the need to streamline distribution costs which are significantly driving up the prices paid by consumers. Another expert member referred to the necessity for measures to streamline the country's economic structure when the Government takes some actions. He insisted that the Government should transforming inefficient parts of the structure, instead of keeping these parts as they are. He also cited the country's past experience in which the Japanese economy successfully overcame the first oil shock and strengthened its structure.

Then the Prime Minister made the following comments:

With the current global economic climate, including the US economic climate, volatile as it is, ministers in charge should pay special attention to global economic trends and their impact on the Japanese economy with a sense of urgency, and quickly respond to situations when necessary.

Regarding "FY2008 Budget Overview," expert members presented their paper on "Budget Overview" and the Cabinet Office explained a revision of reference estimates incorporated in "Direction and Strategy for the Japanese Economy." In response, the following comments were voiced:

Mr. Taniguchi, Vice Minister for Internal Affairs and Communications: Achieving a combined surplus of the primary balance in fiscal 2011 is our top priority, and for that purpose, both the central and local governments should do their best to push forward toward the integrated reform of expenditure and revenues. Local government are also currently making expenditure reform efforts, and the wage level for local public workers employed for simple labor services, which has been criticized as too high in the CEF, is now being painstakingly reviewed and corrected. However, local government expenditures are closely linked to national policies. Accordingly, not to have local governments to pay for the cost incurred by the central government is essential.

Mr. Taniguchi made detailed comments, indicating his intention to make some requests when expenditure ceilings for the next fiscal year's budget request are to be approved by a ministerial meeting.

Member Nukaga, Minister of Finance, made the following comments:

The revised reference estimates expect a primary balance deficit, equivalent to 0.7% of GDP, in fiscal 2011 even in the case of an economic growth. Though the path to financial consolidation will be difficult, we must not shift financial burdens to future generations, and we must achieve a

combined surplus of the primary balance without fail to internationally gain market confidence. We should continue our efforts to achieve the integrated reform of revenue and expenditure.

Regarding the fiscal 2009 budget, striking a good balance between financial consolidation and responses to priority issues is the main point in the budget formation. Regarding financial consolidation, fiscal year 2009 marks the third year of the five-year program, and in line with “Basic Policies 2008,” we should cut public investment by 3% and should curb a natural increase in social welfare costs by 220 billion yen. Furthermore, in our responses to priority issues, as instructed by the Prime Minister, we will make an inventory of policies to sharply modulate policy measures. We will adjust expenditure ceilings for the budget request in that direction.

The expert members’ paper pointed out the need for raising the portion funded from the Government’s budget for the payment of basic pension plans to 50%. In this regard, laws provide that the Government shall implement the fundamental tax reform for securing stable revenue sources. Indeed, the Government should do so without fail. The Government should also specify these policies in the draft of “Budget Overview.” We should squarely address the fundamental reform of the taxation, including the consumption tax.

Expert members made the following comments:

What is the most remarkable in the next fiscal year’s budget is the shifting of the earmarked revenues for road construction into general revenues. This is quite noteworthy in Japan’s post-war financial reform and the Government has to squarely address this issue. Another point of importance is the Government’s efforts for a “zero futility government,” including the correction of problems concerning public interest corporations. The Government should manage to find a revenue source for covering costs to address priority issues. A mere token of reform efforts could lead to inadequate public finance reform and the return to lax financial policies. The CEFPP also has to sufficiently discuss the reform of special accounts.

Various sectors are now demanding an increase in government expenditure, but the Government must not waver in its commitment to the reform. Once one distorts the principles of the reform, there will be no limit to how far actual policies will deviate from the original purposes. We have really entered crucial stages in striking a balance of growth potential enhancement and financial consolidation. The Government must never give up achieving a combined surplus of the primary balance by fiscal 2011. We should not let our ongoing efforts vanish in smoke, and instead, the Government should continue its reform efforts based on a Pay-as-You-Go system.

The revised reference estimates sound quite shocking. However, future prospects are still uncertain, and some US economists indicate a US economic recovery as late as spring next year. Current estimates indicate that the US economy will start a gradual recovery toward next year. However, the

recovery may be further delayed, and there are some downside risks to growth scenarios. The next 12 months will be a crucial period for Japan.

With Japan's growth potential now in a slowdown, we have to consider this tough time as a good opportunity. The best way to cope with these difficulties is, inevitably, to implement the fundamental tax reform. Of course, government expenditure reduction and the realization of a "zero futility government" are important. However, to maintain the quality levels of medical services and of elderly nursing care services, the remaining shortfall must be covered by the consumption tax. In addition, Japan's high corporate tax burden is being felt internationally, and this will discourage foreign investment in Japan, and may encourage Japanese businesses to leave the country. Increased corporate activity will surely lead to higher levels of people's life. In addition, an income tax reduction should be introduced for supporting families with small children and for coping with the declining number of births. To prevent Japan from being left out of global developments, the Government should squarely address the tax reform.

Mr. Nakano, Vice Minister of Economy, Trade and Industry, made the following comments:

We should make efforts to achieve a "zero futility government" in both general and special accounts. The Government will not be able to build public understanding about its reform efforts, unless it sets a deadline and does its best to implement the reform within certain time limitations. Similarly, the Government needs to make an inventory of policies in a manner easily understandable to the public.

Member Machimura, Chief Cabinet Secretary, made the following comments:

While the "Budget Overview" conveys the importance of the government spending reduction very well, I still think that the "Overview" needs to carry some forward-looking messages. The "Budget Overview" as a whole needs to convey forward-looking views in addition to harsh realistic views.

In response, an expert member pointed out the need of enhancing the country's growth potential in parallel with the above mentioned reform efforts.

I added as follows:

"Basic Policies" has incorporated the need of the country's growth potential enhancement, too, and accordingly, I believe that, in line with the "Basic Policies," the "Budget Overview" should also convey the necessity of growth potential enhancement.

Member Nukaga made the following comments:

Basically, what is important is the country's economic strength enhancement; each minister should identify and select which sector is most promising in the "selection and concentration" practices, and

based on their selection, we should make better use of the government budget to upgrade the country's growth potential.

At the end of the discussion, the Prime Minister made the following comments:

Striking a balance between the country's growth potential enhancement and financial consolidation is no easy task, but Japan has no other choice but to pursue this path which is narrow and difficult. For that purpose, we should pay careful attention to economic outlooks both in Japan and abroad. At the same time, we have to continue our ongoing expenditure reform efforts in formulating Fiscal Year 2009 budget. Simultaneously, it is essential to properly address policy issues with high public needs. We need to launch the sharp review of expenditures to strike a good balance between financial consolidation and responses to priority issues. In line with these policies, parties concerned should promptly draft the "FY2008 Budget Overview." I would like the Minister of Finance to establish expenditure ceilings for the next fiscal year's budget request accordingly, following the development of the draft "Budget Overview."

At the next meeting, we will draft a CEFP-version of the "Budget Overview."

Regarding the last item on agenda, we invited Mr. Ueda, president of the Expert Committee on "Structural Changes and the Japanese Economy." Mr. Ueda presented his report on the Expert Committee, and in response, the following comments were voiced by expert members:

The beauty of this report is that it substantially describes what is important but is seldom discussed in political scenes. For example, it warns us not to saddle younger generations with financial burdens and it attributes an increase in irregular employment to the delayed fundamental reform of the employment system in the age of globalization. Reform efforts based on such awareness need to be confidently promoted. Through this report, we have to globally demonstrate the country's commitment to reform.

During discussions on the "Budget Overview," some pointed out that the "Overview" needs to carry some forward-looking messages. Fulfilling recommendations listed in the report will offer brighter prospects. For example, when we ask ourselves what it would take to improve the country's birth rate to 1.8, and for that purpose, how much budget would be needed, we can see the future with a more optimistic approach. Foreign demand is still essential to the Japanese economy, and we need to implement environment modification that will facilitate the export of Japanese agricultural products. What is important is how to provide a concrete path toward the realization of visions listed in the report 10 years from now. Based on the report, we have to work out the path

At the end of the meeting, I summed up the discussions as follows:

In the age of globalization, the report has well provided the direction of the road ahead for the Japanese economy 10 years from now. Based on recommendations listed in the report, the CEFP will also continue its reform efforts.

(End)