

**Basic Policies for Economic and
Fiscal Management and Structural Reform 2003
(Summary)**

Section 1 Challenges Facing the Japanese Economy

1. Strengthening the Japanese Economy

While steady efforts have been made to implement structural reform, the reform program is still in mid-stream. The only viable path for achieving sustained economic growth is to promote structural reform and to realize a "revitalized Japanese economy" by improving the nature of the Japanese economy.

Thus, upon assessing the past achievement of structure reform, the government's basic policies for structural reform are being presented in a new form consisting of "Three Declarations" and "Seven Reforms."

2. Overcoming Deflation

Although Japan registered a real economic growth rate of 1.5 percent in fiscal 2002, it corresponds to minus 0.7 percent in nominal terms. Deflation has still been persistent.

Under unexpectedly severe domestic and foreign economic conditions, a deflationary trend has persisted. Overcoming deflation as early as possible remains as a big issue to be solved.

To overcome deflation, the government and Bank of Japan will tackle this problem together vigorously and comprehensively.

As suggested in "Reform and Perspectives - FY2002 Revision" (Cabinet Decision of January 25, 2002), deflation will be overcome after an intensive adjustment period.

3. "Three Declarations" and "Seven Reforms"

The objectives of structural reform are "revitalization of the economy," "ensuring the security of the people," and "establishment of responsible

fiscal balances for future generations." Bold and flexible policy measures will be implemented in line with emerging economic conditions.

(1) Revitalization of the Economy

Declaration: Regulations, systems, and government intervention impeding the vitality of the private sector will be eliminated to generate private demand.

Reforms:

- * Regulatory Reform and Special Structural Reform Zones
- * Flow of Funds and Financial and Industrial Revitalization
- * Tax Reform
- * Employment and Human Resource Strategy

(2) Ensuring the Security of the People

Declaration: Developing a sustainable social security system to create a society that provides young people with a promising outlook for the future and older people with a sense of security.

Reform:

- * Reform of the Social Security System

(3) Establishing Responsible Fiscal Balances for Future Generations

Declaration: Generating confidence in the fiscal system and emphasizing the outcome.

Reforms:

- * Reform of Central and Local Governments
- * Reform of Budget Formulation Process

Section 2 Specific Initiatives for Structural Reform

To achieve the "three declarations," structural reform will be pursued in seven specific areas.

1. Regulatory Reform and Special Structural Reform Zones

Regulatory reform and special structural reform zones will be promoted in areas directly linked to peoples' lives, such as medical and health services and child-care, and in areas with high potential demand. These reforms will also ask such businesses to expand the range of consumer choices, to

create new business opportunities, and to expand employment. In addition, together with relaxing and repealing ex ante regulations, development of ex post assessment systems will be conducted.

2. Flow of Funds and Financial and Industrial Revitalization

Financial reforms will be implemented to return the flow of funds from the "public to the private sector" and to facilitate the investment of an ample stock of financial household assets in areas of growth in the private sector.

3. Tax Reform

The tax system will be reformed with an aim to sustain the revitalization of the economy and society, and to generate a sense of security in the future.

4. Employment and Human Resource Strategy

Regarding employment, labor markets will be expanded to allow people of all ages to develop their abilities and to find employment in the growing service sector and elsewhere in the economy. In particular, measures will be taken to encourage the youth to work. Further, all youth who are willing to work should be given a chance to achieve vocational independence. Measures will also be implemented to encourage women to fully exercise their abilities. Moreover, Japan must draw on the vitality of the elderly, and efforts to do that will be promoted. The quality of education will be improved at all levels from compulsory education to university education.

5. Reform of the Social Security System

The social security system will be reformed to achieve intra-generational and inter-generational equity, and to create a sustainable and reliable system.

6. Reform of Central and Local Governments

The "plan on the Reform of the Three Major Policies" will be promoted to realize the fundamental objective of local autonomy, which is to allow local government authority to make its own decisions.

7. Reform of Budget Formulating Process

On promoting fiscal structural reform, the government improves the quality of the budget and strive toward transparency. Therefore, the budget process will be developed featuring prior goal-setting and rigorous ex post

assessment to fulfill accountability about how taxes have affected the lives of Japanese citizens.

Section 3 Economic and Fiscal Management and the Budget in FY2004

1. Principles of Economic and Fiscal Management

(1) The Economic Outlook and Near-Term Principles of Economic and Fiscal Policy Management

(Japanese Economy in FY2003 and FY2004)

For FY2003, a mild recovery, powered mainly by demand in the private sector, is expected. However, the income and employment environments will remain severe.

For FY2004, a mild recovery led by the demand in the private sector is expected.

(Near-Term Principles of Economic and Fiscal Policy Management)

To overcome deflation, the Government and Bank of Japan will also act as one to vigorously implement effective and comprehensive measures based on "Reform and Perspectives-FY2002." Bold and flexible policy measures should be taken, according to the economic condition.

Structural reform of regulations, financial systems, the tax system, and government expenditures will continue to be implemented in an integrated and consistent manner to establish an environment that will create private sector demand continuously. The Bank of Japan is also expected to operate monetary policy effectively so that deflation will be overcome as early as possible.

(2) Medium-Term Principles of Economic and Fiscal Policy Management

The process of structural reform will be accelerated, with top priority given to expanding private demand and employment. The government and Bank of Japan will act as one to turn the price growth rate into a positive figure as soon as possible.

The goal will be to ensure that government size (ratio of general government expenditures to GDP) in FY2006 will not exceed the FY2002 level. Thereafter, the goal will be to achieve a surplus in the primary balance for the central and local governments combined will be targeted during the early part of the decade beginning in 2010s by keeping the same level of effort as before to improve the fiscal balance.

2. Basic Principles of the FY2004 Budget

(1) Remaining on Course for Expenditure Reform and Ensuring Fiscal Sustainability

As in FY2003, the budget will remain on course for expenditure reform. Maximum restraint will be exercised in the issuance of government bonds. The goal will be to reduce the size of government, including special accounts and local governments, as much as possible..

(2) Principles of Prioritization and Restraint in Budget Formation

[1] Principles of Prioritization

Priorities are given to policies that utilize maximum private sector potentiality.

More concretely, budgets are allocated to the policy packages. That, in combination with policies to enhance private initiative (i.e. regulatory reform, PFI, outsourcing to private sector, etc), ensures that specific goals are met most effectively.

Policy measures will be concentrated in the four priority areas (set in Basic Plan 2002). Further narrowing of policies (prioritization and efficiency) is not exempt in these priority areas.

[2] Principles of Restraint

- * Reducing unit prices while taking into account price trends and the simplification and streamlining of administrative services.**
- * Restraining total personnel expenses through strict restraint on increase in civil servants and continued efforts to reduce the total number of civil servants. Review of civil servant pay-scales, taking into account regional conditions.**

*** Elimination and reduction of local subsidies in line with the promotion of the “plan on the Reform of the Three Major Policies ”**

(3) Reform of Principal Budget Areas

[1] Social Security

[2]Employment Related

[3] Science and Technology

[4] Education and Culture

[5] Development of Social Infrastructure

[6] Agriculture, Forestry and Fisheries Related

[7] Local Finances

[8] Environment Related, Miscellaneous