

**Annual Report on
the Japanese Economy and Public Finance
(2001-2002)**

--- No Gains Without Reforms II ---

Summary

November 2002

Cabinet Office

Government of Japan

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Introduction

The Japanese economy bottomed out in early 2002, supported by export growth and an end to the decline in production. Thereafter, the impact of this has been gradually spreading throughout the economy, and the economy is now about to move towards recovery. Whether or not this recovery will be a self-sustained, vigorous one depends on the developments of private demand. However, in Japanese business cycles since the 1990s, private demand has remained sluggish and momentum for economic recovery has continued to be weak due to the downward pressure from such factors as balance sheet adjustment.

The vital measure for eliminating the weakness of the economic conditions and bringing about sustained economic growth is to carry out structural reform. As part of such efforts, tax reform is an urgent task. The government aims to “conduct comprehensive and fundamental tax reforms suitable for the 21st century” by construing the three established principles for a desirable tax system, “equity, neutrality, and simplicity,” as “fairness, vitality, and simplicity” to meet the demands of the times. The tax reform has an important meaning in terms of activating the economy. Therefore, the challenge is how the tax system should actually be revised in light of this aspect.

Vitalization of the economy must be accomplished in order to recover Japan’s dynamism and achieve sustained improvement of the national life in the medium and long terms. In particular, since the rate of productivity growth of the economy slowed down in the latter half of the 1990s, in contrast to that of the United States, it is necessary to strengthen measures for boosting this rate. The issue is closely linked with the resolution of problems in extensive fields, such as innovating corporate management, improving resource allocation, and enriching research and development activities.

The Annual Report on the Japanese Economy and Public Finance 2001-2002 analyzes and examines the economic trend, particularly on the issues above.

Chapter 1 surveys the strength of economic recovery. First, the current state of the economy and prospects of recovery phase are reviewed, and analysis is made on the deflation observed in both general prices and asset prices, which are proceeding with recent business cycles. On that basis, analysis is conducted on the adjustments and measures the corporate, banking, and household sectors are respectively being pressed to carry out under the present circumstances and the impact the macroeconomic policies are having on the economy. Lastly, the expected scenario for the economic future and the risks involved are examined based on such circumstances.

Chapter 2 overviews the current state of tax burden as a premise for comprehensive and fundamental tax reforms. Specifically, the tax burden structure is analyzed for individual income tax and for corporate income tax from a variety of viewpoints, such as macroeconomic and microeconomic approaches and country-by-country comparison. Such analysis offers essential basic material for designing a new tax system that will support the vitality of Japan's economy.

Chapter 3 discusses the issues to be tackled for activating the economy. First, the necessity of vitalizing the economy is revealed through examining the background of the frequently pointed-out concern of the "hollowing out of industry." Then, the current situation of economic vitalization and the issues that remain to be resolved are reviewed for the areas of efficiency improvement in corporate management, efficiency improvement in resource allocation, and efficiency improvement in research and development. Lastly, the future economic structure of Japan that would come to pass upon the accomplishment of structural reform is discussed.

Through above analyses and examinations, this Annual Report aims to clarify the current conditions and problems of Japan's economy and indicate the path that it should follow.