

Tentative Translation

Structural Reform Evaluation Report 2

- Progress and Effects of Government Expenditure Reform -

(Main Points)

April 2004

Cabinet Office

1. Efforts for Expenditure Reform

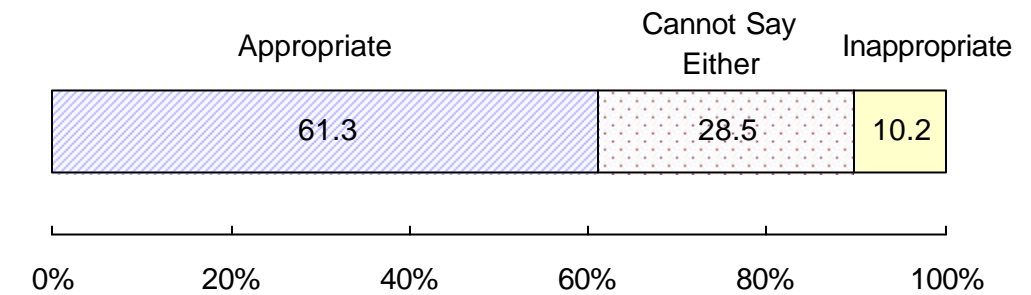
< Progress and Effects of Reform >

- About 60% think it was appropriate that the government started fiscal reform as an important component of the structural reform.
- Budget formulation process has changed. Prime minister and other ministers has been taking initiatives toward bold reforms through the Council on Economic and Fiscal Policy (CEFP).
- Reform toward result-oriented budget system, such as the "Model Projects" and the "Policy Packages", has started.

< For Further Reform >

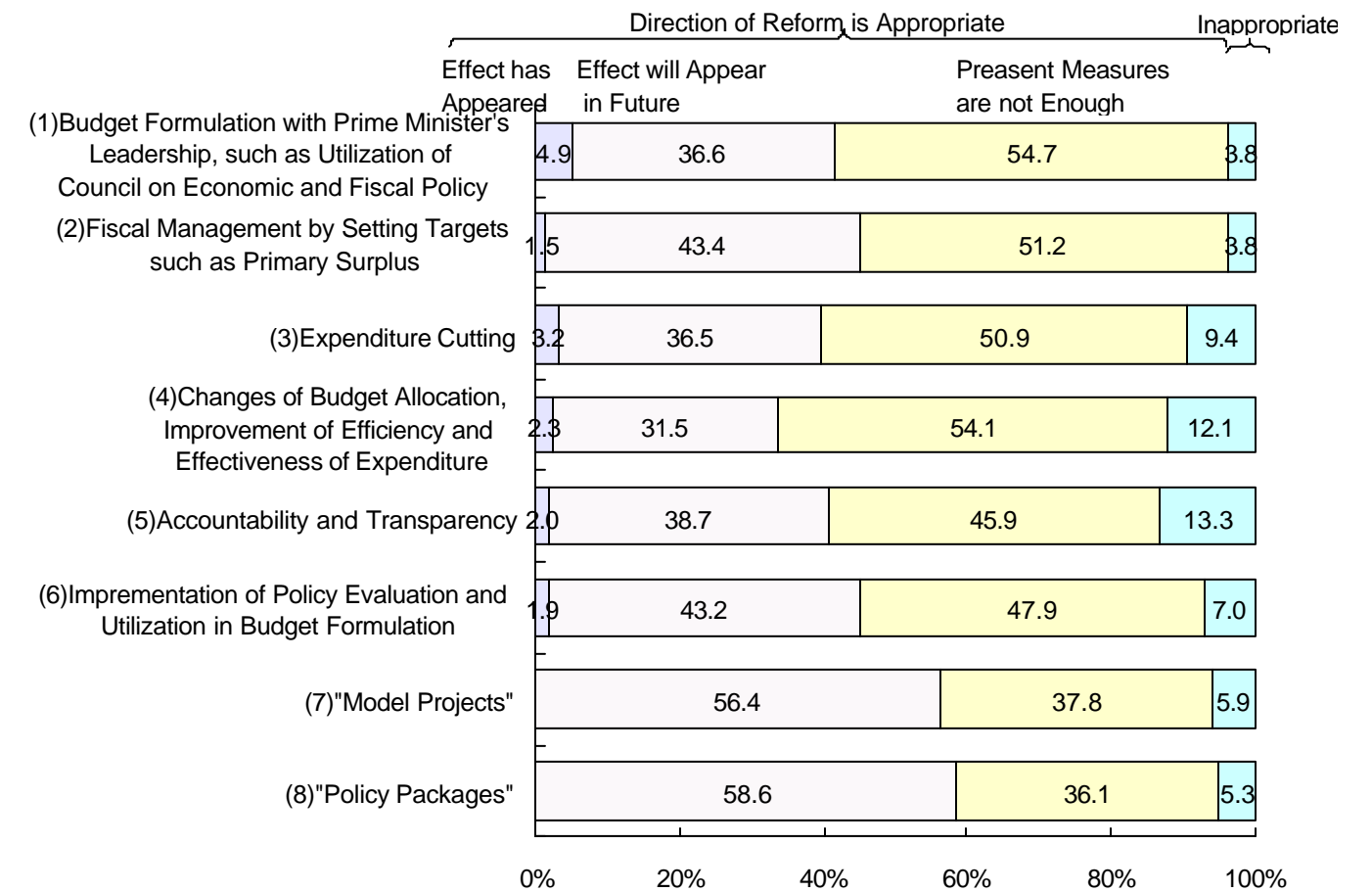
- Directions of major reforms in past 3 years are mostly evaluated as appropriate. But at the same time, a certain part of respondents think actual reform measures taken so far are not enough yet. Further reform is required.

Figure 2. Evaluation for Starting Fiscal Reform as an Important Part of the Structural Reform



(Note) Based on a survey of economists firm managers and local governments (Number of respondents = 1145)

Figure 3. Evaluation for Major Budgetary Reforms in Past 3 Years



(Note) Based on a survey of economists firm managers and local governments (Number of respondents = 1145)

Figure 1. Major Expenditure Reforms since the 2002 Budget

	FY2002	FY2003	FY2004
Expenditure Cutting	Government Bonds below 30 Trillion Yen; Setting Med-term Target of Primary Balance	General Expenditures and General Account Expenditures below FY2002 (excl. some exceptional factors)	General Expenditures and General Account Expenditures below FY2003 (excl. some exceptional factors)
Improving "Quality" of Expenditures	Priority 7 Areas; Reallocation of Budget by "-5 trillion, +2 trillion"	Priority 4 Areas	Priority 4 Areas
Social Security	Medical System Reform	Employment Insurance Revision; Price Slide of Pensions	Pension System Reform
Public Investment	10% Reduction of Public Investment; Reform of Specific-purposed Revenues	Unification of 9 Public Investment Plans; Public Investment Cost Structural Reform	
Central-Local Relationship	Revision of Ways of Distribution of Local Allocation Tax	Reforms in Advance of the Comprehensive Central-Local Relationship Reform	Start of the Comprehensive Central-Local Relationship Reform (Subsidy Reform of 1 Trillion Yen, etc.)
Others	4 Priority Areas of Science Technology; 1 Trillion Yen Reduction of Special Public Corporations Budget	Priority Grading (SABC) of Science Technology Research Projects	Reform of Special Accounts
Budget Process	Start of Council on Economic & Fiscal Policy; Policy Evaluation	Budget Implementation Investigations	Model Projects; Policy Packages

2. Expenditure Cutting

(i) Expenditure Cutting

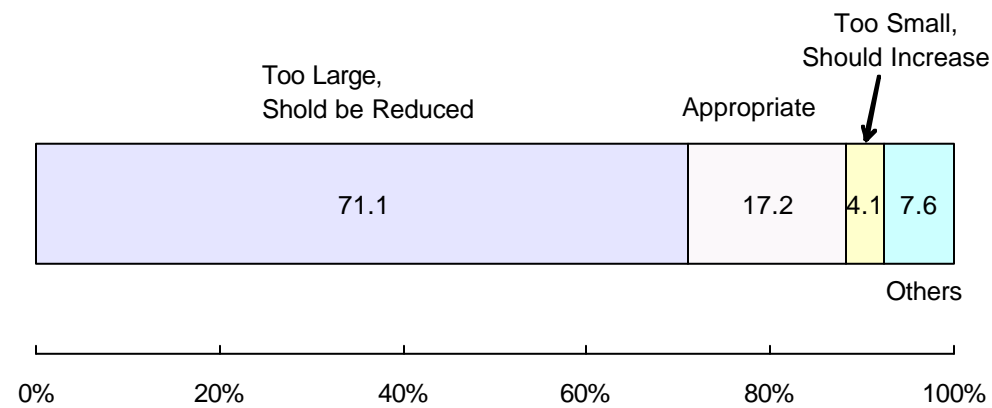
< Progress and Effects of Reform >

- Over 70% recognize the need for expenditure cut.
- Government has achieved its targets of expenditure size of annual budget, which were set in line with the mid-term expenditure target.
- Compared to the case in which expenditure reform was not taken, the general expenditure of 2004 budget is retrenched by 4 trillion yen.

< For Further Reform >

- Steady curtailment of expenditure with attention to the consistency of mid- and short-term framework is still required.

Figure 4. Assessment of Current Expenditure Size



(Note) Based on a survey of economists, firm managers, and local governments (Number of respondents = 1145)

Figure 5. The Size of the Government Has Been Restrained under the Target

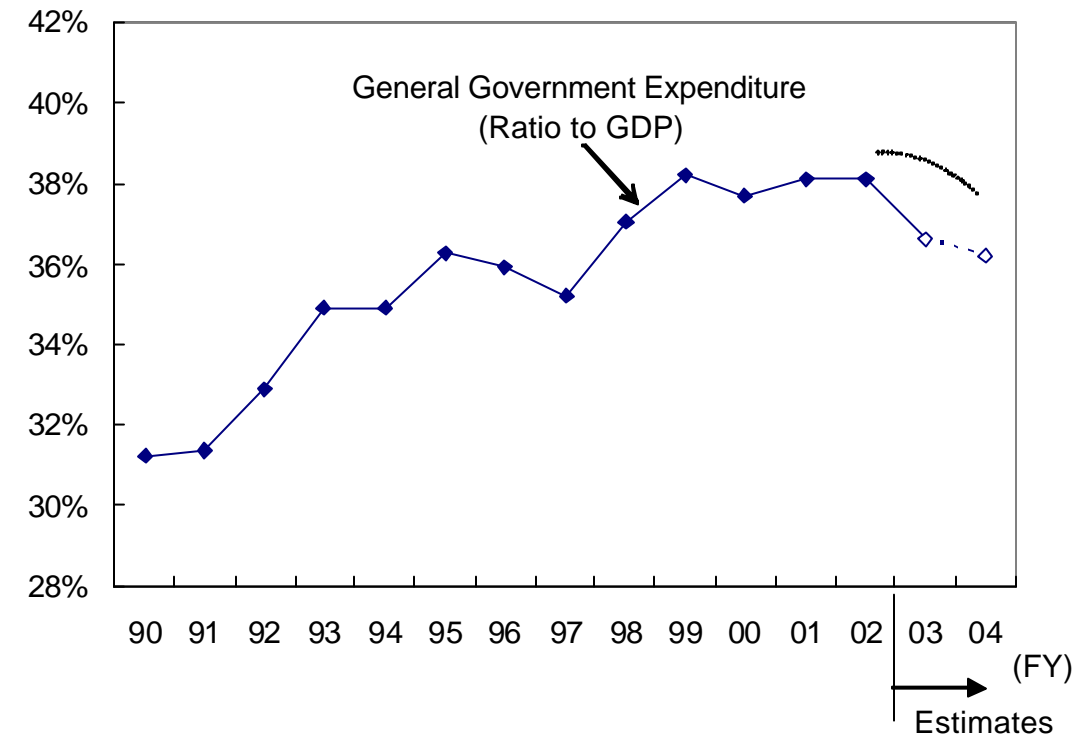


Figure 6. Expenditure Targets for Annual Budget and Their Achievements

	Targets	Results
FY2003	Keep General Expenditures and General Account Expenditures below the Level of FY2002 Budget, Excluding Some Exceptional Factors	General Expenditures 47.6 Trillion Yen (+450 Billion Yen) General Account Expenditures 81.8 Trillion Yen (+5990 Billion Yen)
FY2004	Keep General Expenditures and General Account Expenditures below the Level of FY2003 Budget, Excluding Some Exceptional Factors	General Expenditures 47.6 Trillion Yen (+400 Billion Yen) General Account Expenditures 82.1 Trillion Yen (+3220 Billion Yen)

(ii) Primary Balance

< Progress and Effects of Reform >

- Government sets the medium-term fiscal consolidation target: achieving primary surplus in early 2010s.
- The targeted timing of primary surplus (early 2010s) is considered as appropriate by 45.3%.
- The primary balance of the total of central and local governments improved in FY2003 and will continue to improve in FY2004 according to the estimation by the Cabinet Office.

< For Further Reform >

- There still remains long way to achieve primary surplus. Steady reform is required.

Figure 8. Primary Balance of the Central and Local Governments

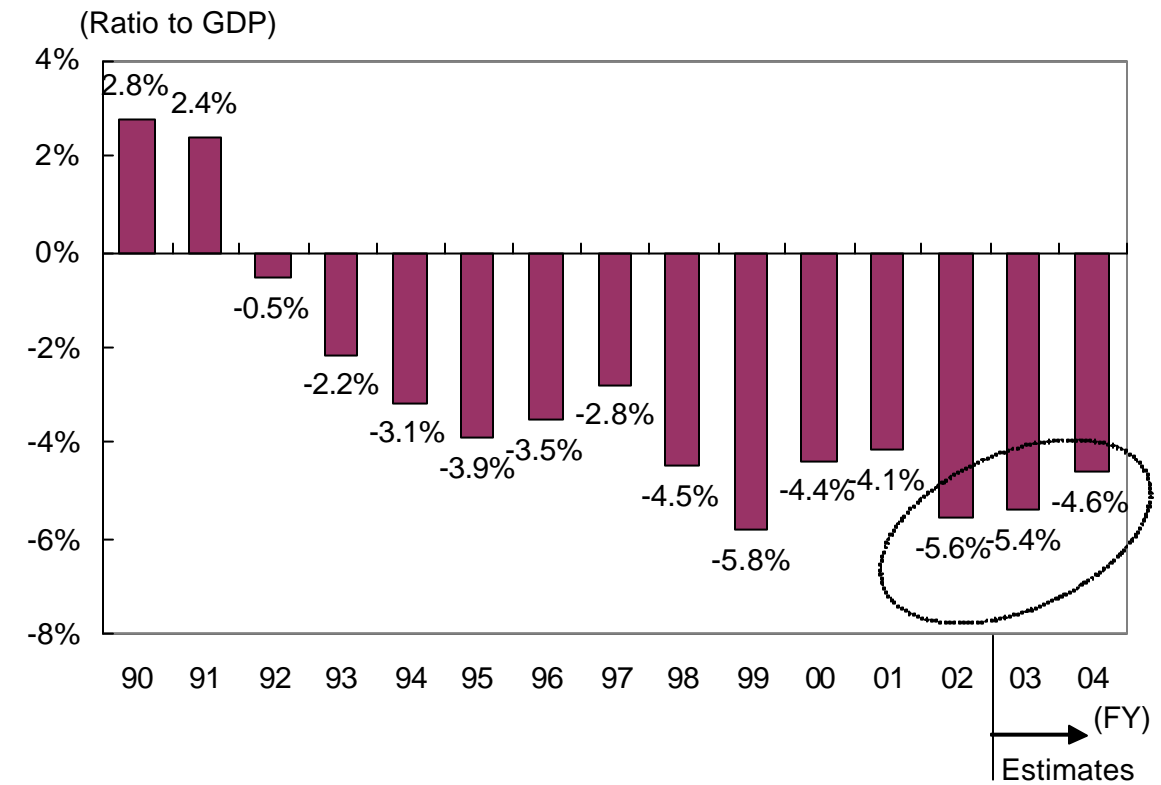
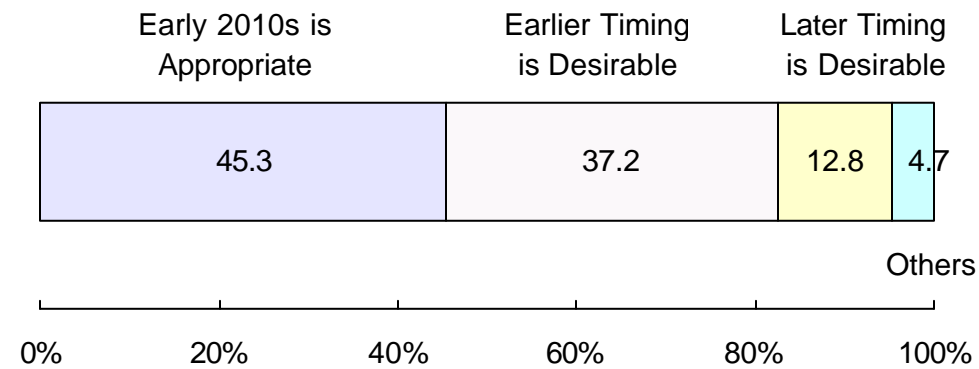
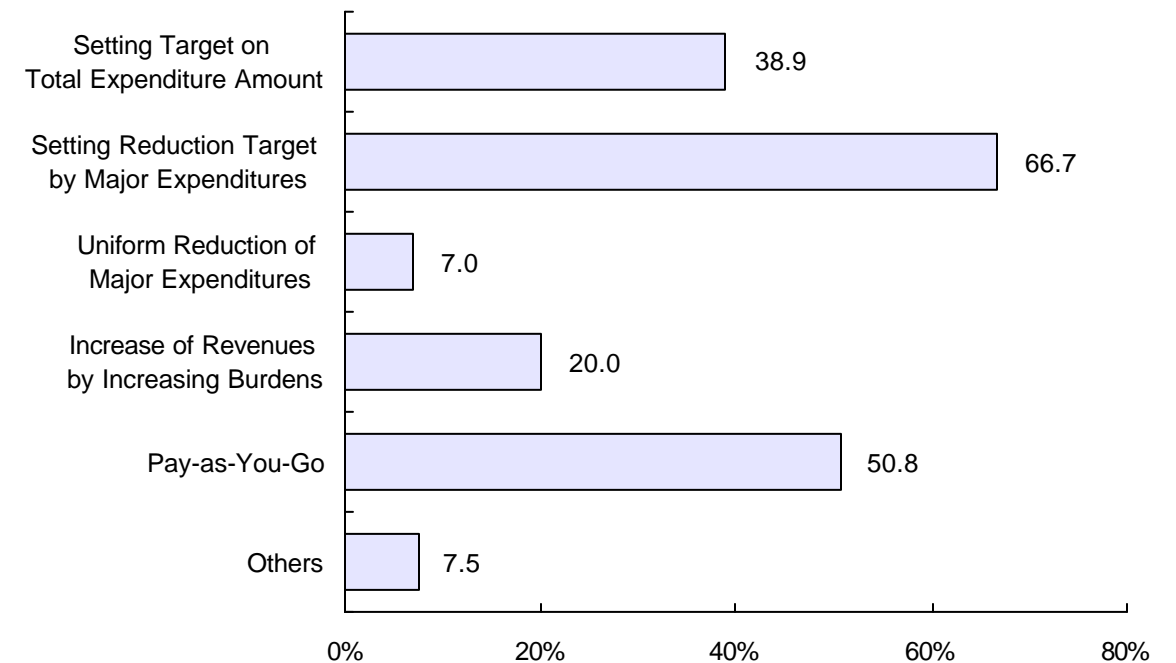


Figure 7. Evaluation of the Targeted Timing of Primary Surplus (Early 2010s)



(Note) Based on a survey of economists, firm managers, and local governments (Number of respondents = 1145)

Figure 9. Measures Considered to be Effective in Achieving Primary Surplus



(Note) Based on a survey of economists, firm managers, and local governments (Number of respondents = 1145)

(iii) Private-lead Recovery in the Expenditure Cut

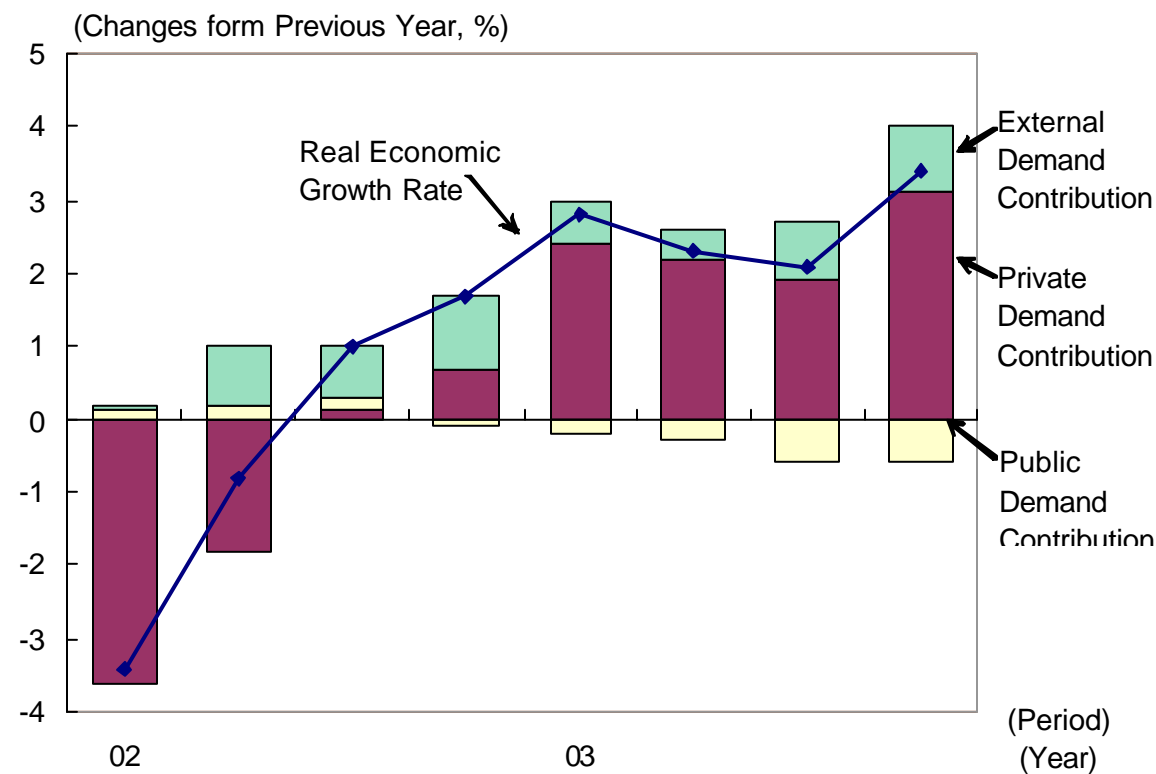
< Progress and Effects of Reform >

- Economic recovery driven by private demand is achieved while public demand decreased by government's expenditure cut.

< For Further Reform >

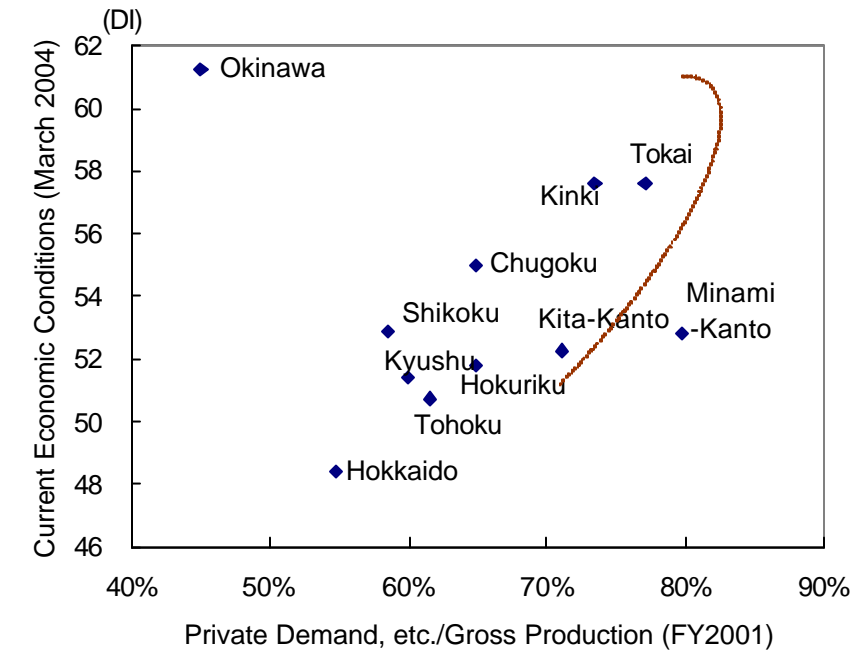
- Extent of recovery is not even among regions.
- Regions where private demand occupies larger share are showing faster recovery in the face of government expenditure cutting. Revitalization of regions without depending on public demand is required.

Figure 10. Private-lead Recovery in Public Expenditure Cut



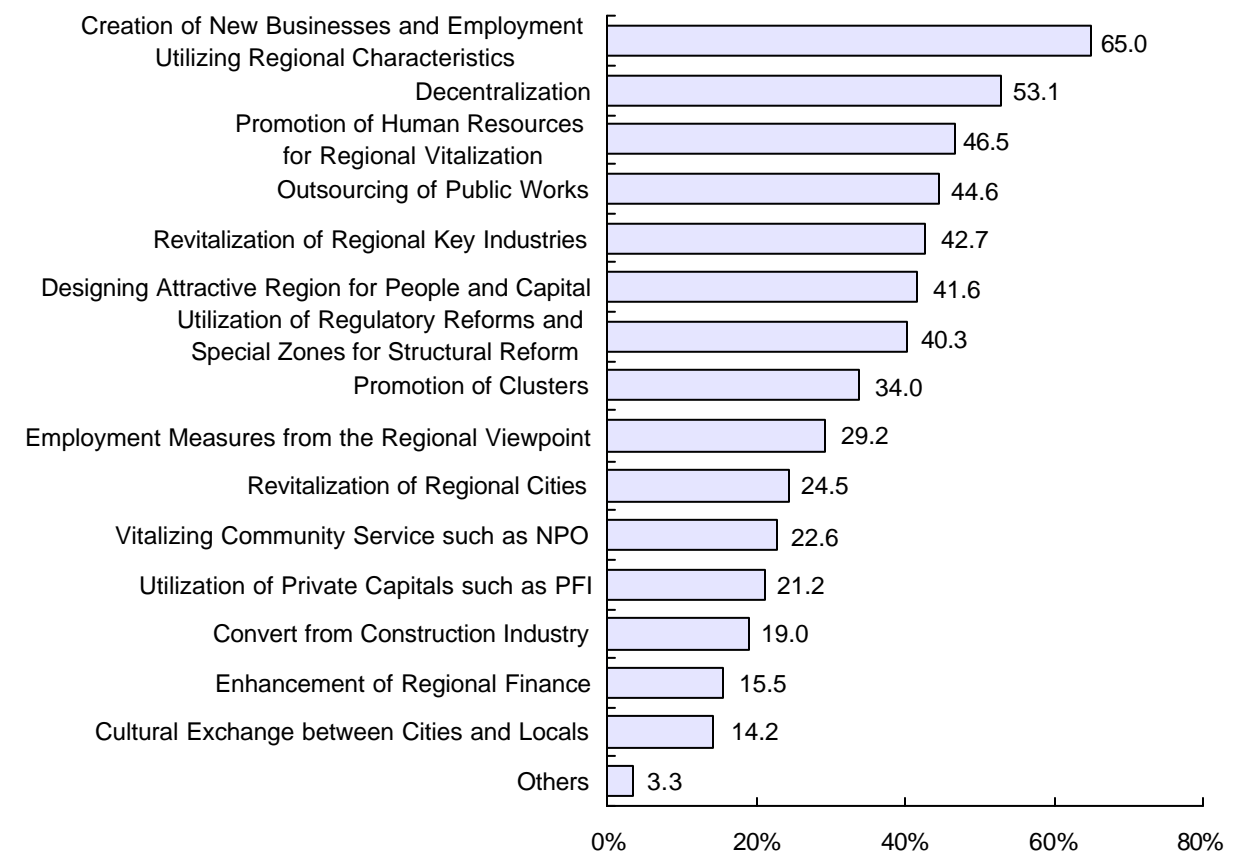
(Source) National Accounts Statistics

Figure 11. Recovery Progresses Faster in Those Areas Where Private Demand Occupies Larger Share in its Economy



(Notes) 1. Source: Prefectural Accounts (FY2001), EconomyWatchers Survey (March 2004)
2. Private Demand, etc = Gross Prefectural Product - Public Demand

Figure 12. Effective Regional Revitalization Measures in Expenditure Cut



(Note) Based on a survey of economists, firm managers, and local governments (Number of respondents = 1145)

3. Improvement of the "Quality" of Government Expenditure

(1) Whole Expenditure

(i) Allocation of Budget

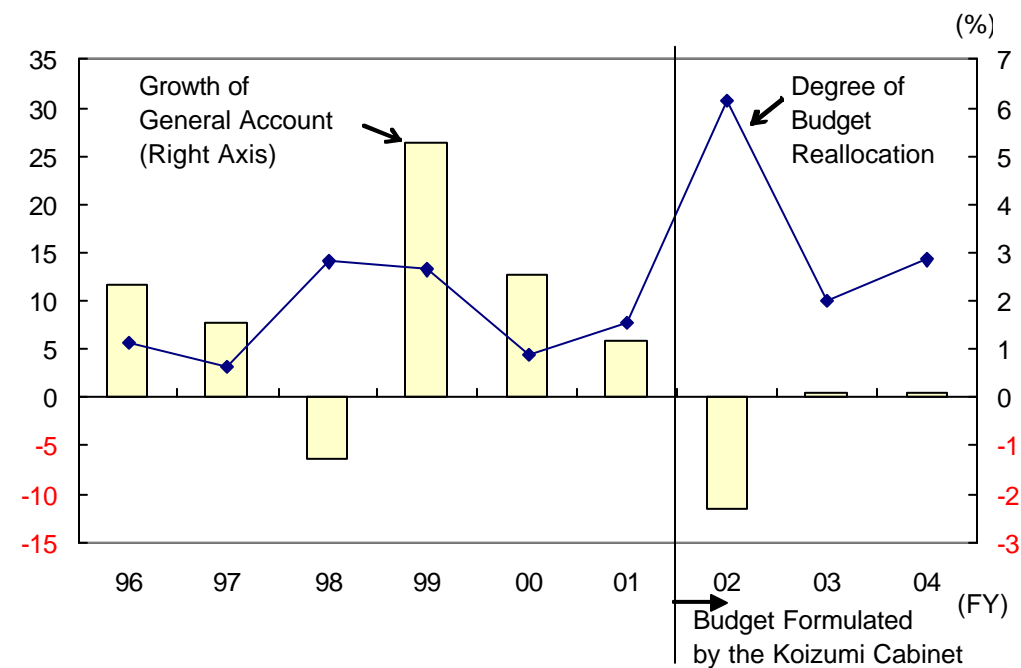
< Progress and Effects of Reform >

- Large reallocation of budget has been implemented while the total amount of budget has been restrained since the 2002 budget.
- Compared to the earlier budgets, the degree of increases and decreases of individual expenditures are more thorough in the budget of last 3 years.

< For Further Reform >

- Reflecting those efforts, about 60% respondents evaluate that "the expenditure structure has been changed to some extent". But the respondents who consider "the expenditure structure has been changed boldly" are only 3.3%. Still more reform is needed.

Figure 13. Large Reallocation of Budget since FY2002 Budget



(Notes) Degree of Budget Reallocation = Variance of Growth Rates of Major Expenditures

Figure 14. Individual Expenditures has been Increased / Decreased More Thoroughly in Recent Budgets

(Growth of Major Expenditures - Growth of General Expenditure)

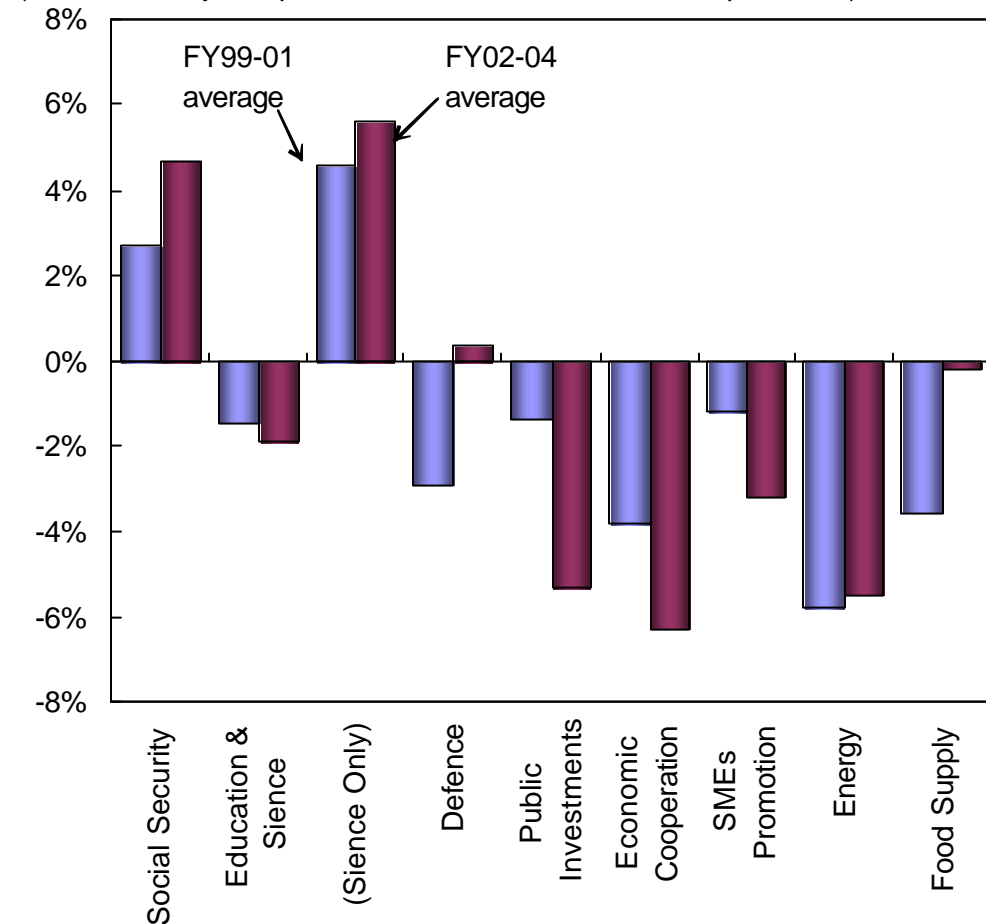
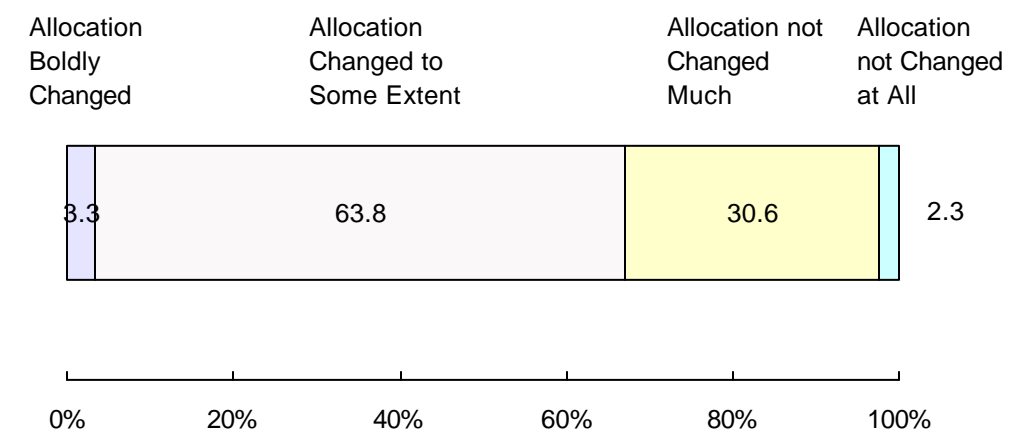


Figure 15. Evaluation of Changes of Budget Allocation



(Note) Based on a survey of economists firm managers and local governments (Number of respondents = 1145)

(ii) Four Priority Areas

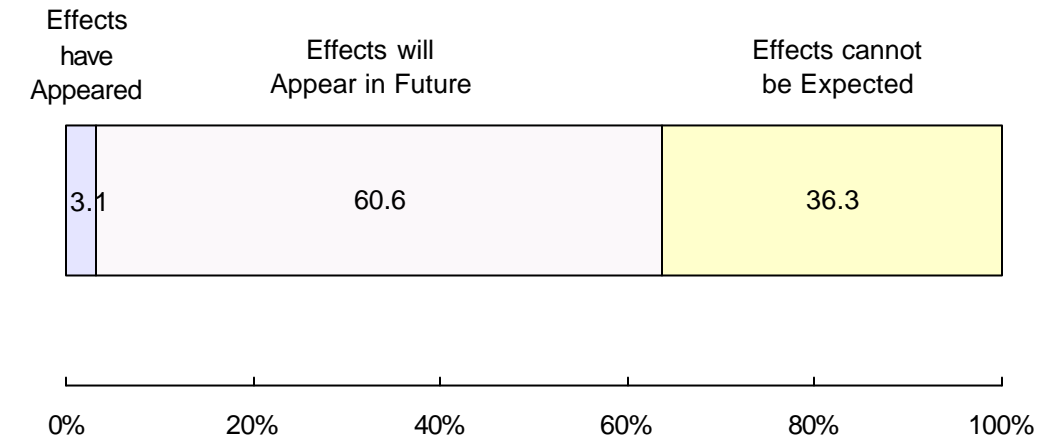
< Progress and Effects of Reform >

- “Four Priority Areas” for budget allocation are evaluated as appropriate by about 80%.
- About 60% expects the effect of prioritization to appear.

< For Further Reform >

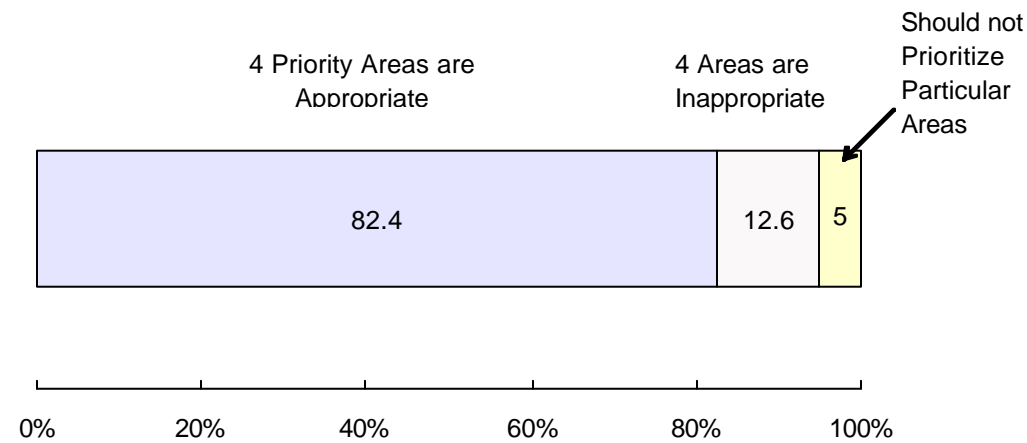
- Four priority areas already occupy about 80% of total public investment. For further prioritization, some improvement of the four areas is needed.

Figure 17. Evaluation of the Effect of Prioritization



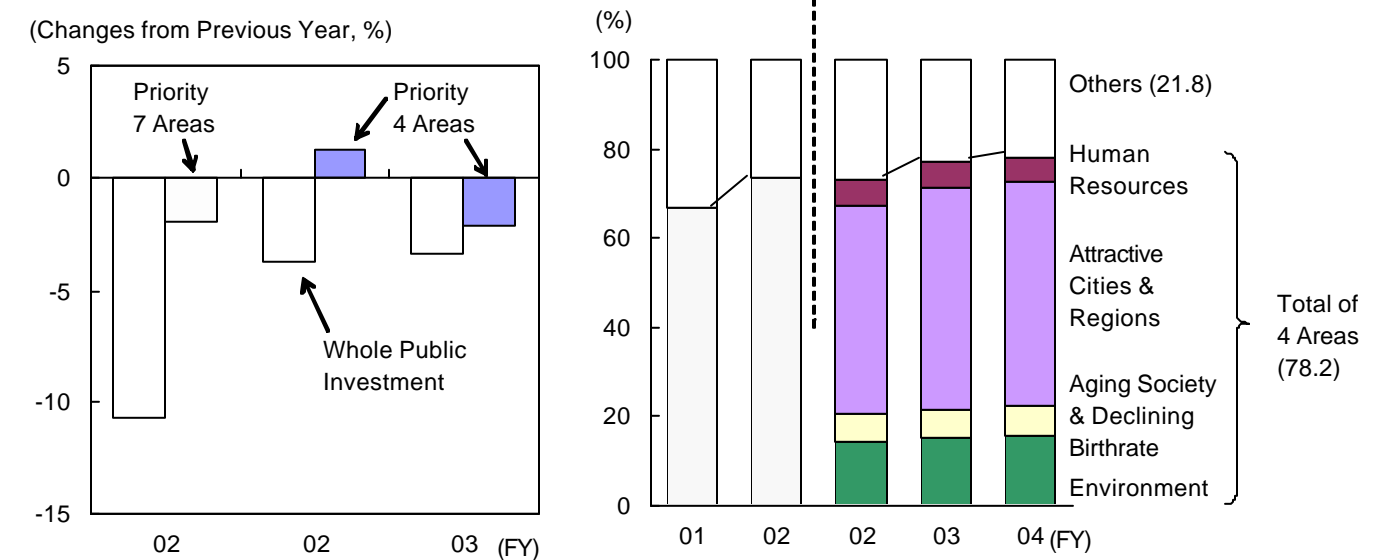
(Note) Based on a survey of economists firm managers and local governments (Number of respondents = 1145)

Figure 16. Evaluation of Direction of Prioritization



(Note) Based on a survey of economists firm managers and local governments (Number of respondents = 1145)

Figure 18. Rates of Increase and Shares of 4 Priority Areas in Public Investment



(Notes) Priority 7 areas () are: (1)Environment, (2)Measures against Aging Society & Declining Birthrate, (3)Regional Vitalization, (4)Revitalization of Cities, (5)Science Technology, (6)Human Resources, (7)IT

(2) Public Investment

< Progress and Effects of Reform >

- Reduction of the size of public investment has progressed. Allocation of public investment by sector has also changed in recent budgets.
- Over 90% see the direction of public investment reform (reduction of the size and improvement of the contents) as appropriate.

< For Further Reform >

- The effectiveness of public investment in promoting production and in inducing private investment has declined in recent years. Effort to improve the quality of public investment from the viewpoint of efficient and effective infrastructure development is required.

Figure 19. Size of Public Investment

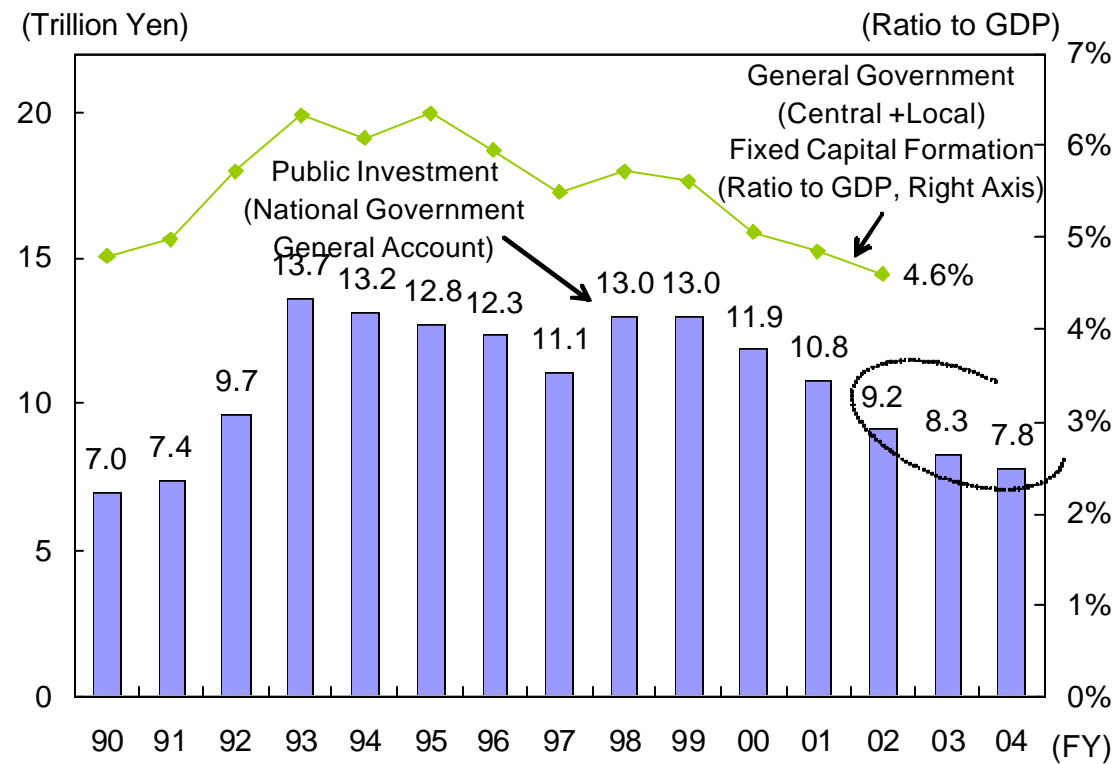


Figure 20. Dependence on Public Investment is High in Low Income Regions

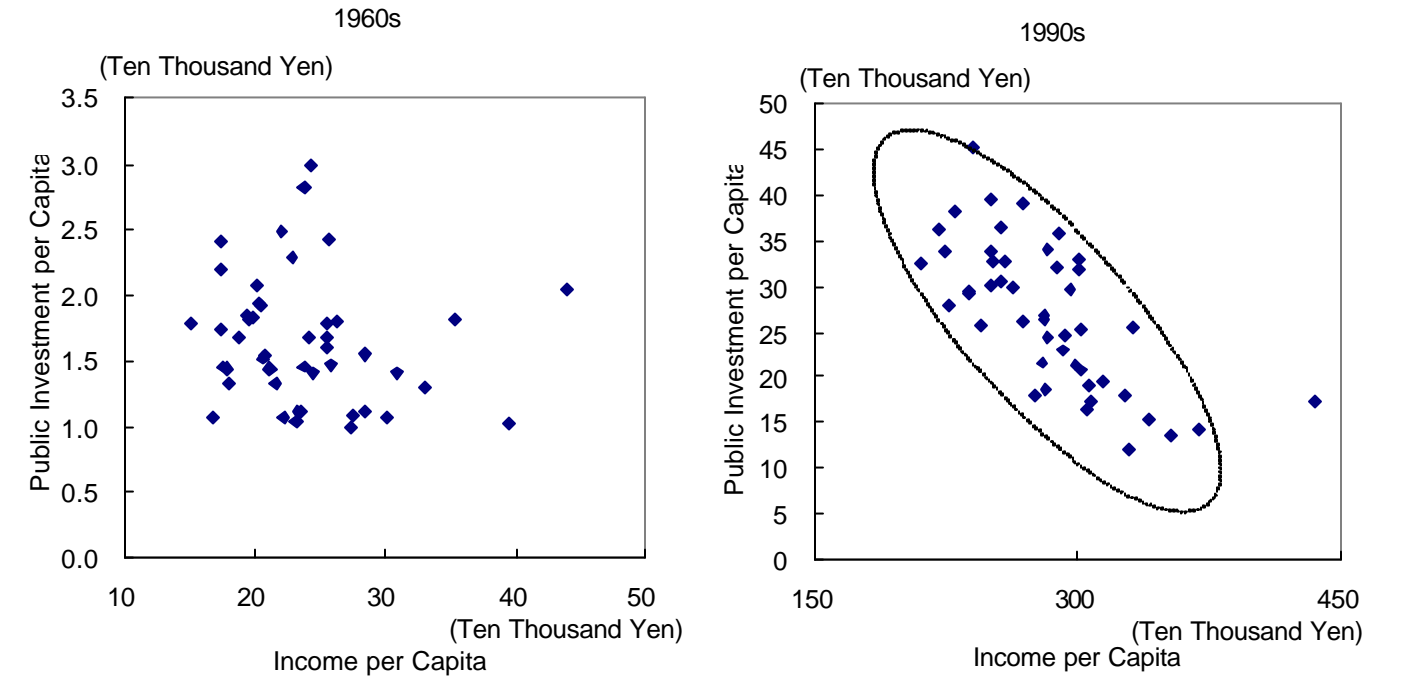
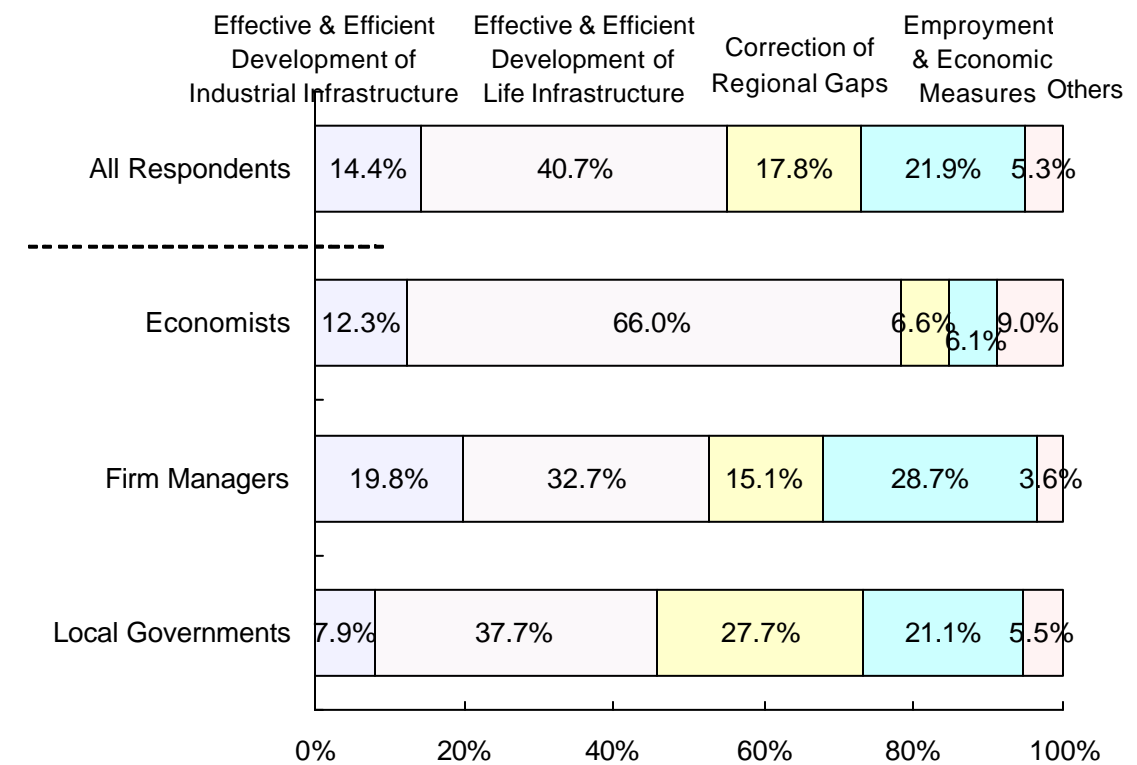


Figure 21. Viewpoints to be Attached Importance in Public Investment



(Note) Based on a survey of economists, firm managers, and local governments (Number of respondents = 1145)

(3) Social Security

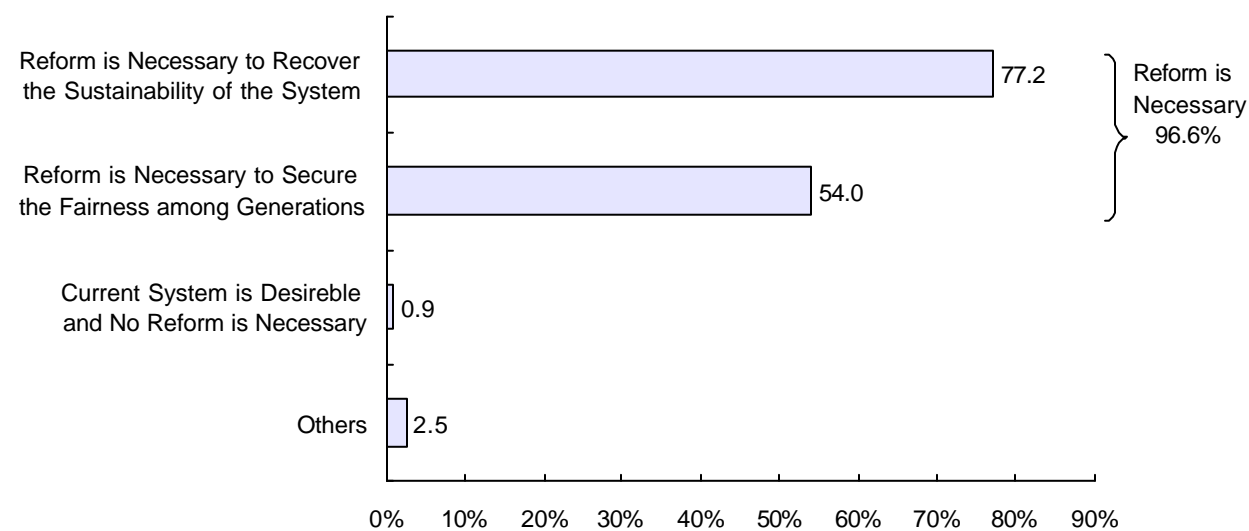
< Progress and Effects of Reform >

- 96.6% consider the reform of social security system is necessary. The necessity of social security reform is a consensus.
- National medical expenses have been reduced by the medical insurance system reform. Measures to improve the efficiency of medical service have also been taken.
- Government compiled its pension system reform plan through broad discussions on benefits and burdens.

< For Further Reform >

- About 70% require the speed-up of the social security system reform.

Figure 22. Recognition on Necessity of Social Security System Reform



(Note) Based on a survey of economists firm managers and local governments (Number of respondents = 1145)

Figure 23. Progress and Schedule of Social Security System Reform

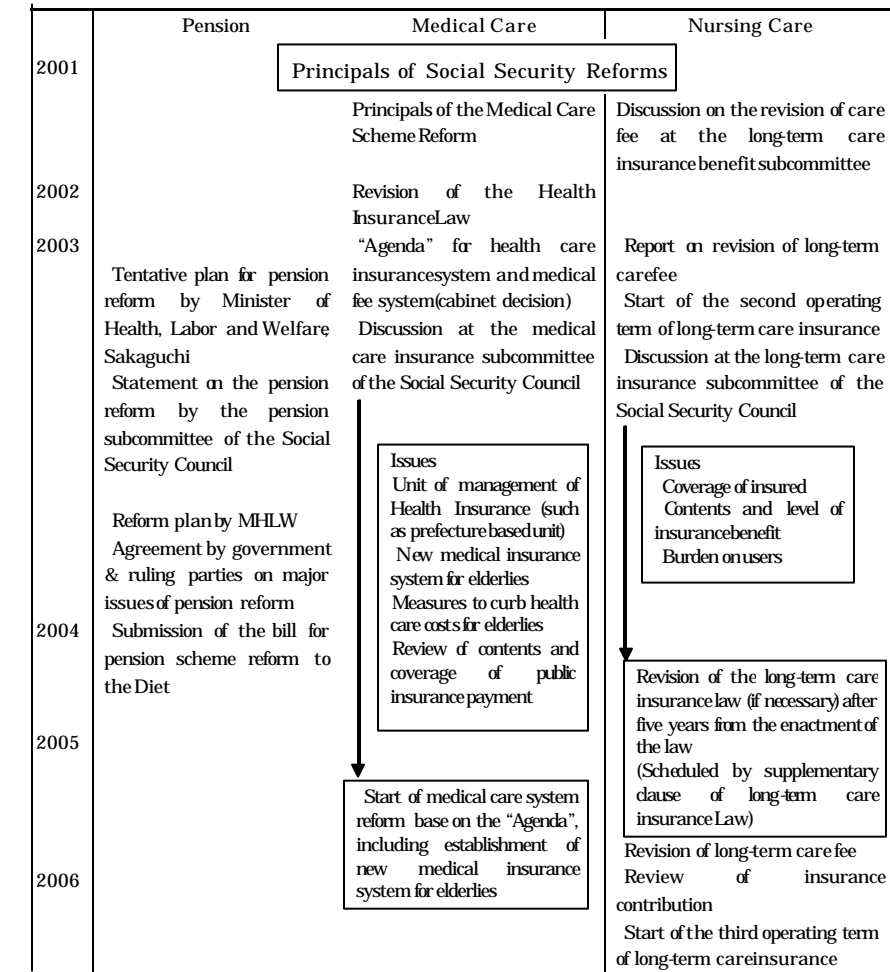
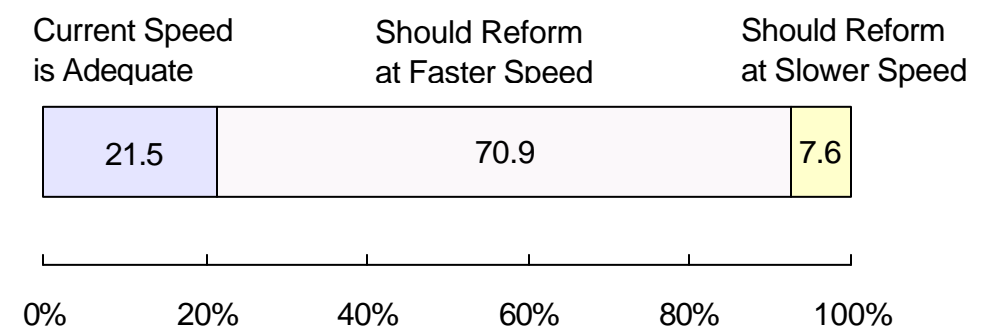


Figure 24. Assessment on the Speed of Social Security System Reform



(Note) Based on a survey of economists firm managers, and local governments (Number of respondents = 1145)

(4) Central-Local Fiscal Relationship

< Progress and Effects of Reform >

- About 90% support the promotion of the comprehensive reform of the central-local fiscal relationship. 60% says the reform "should be promoted boldly", while the remaining 30% says "prudently".
- The ratio of local government's general revenue resources turned increase from the 2004 budget. The ratio of local tax revenue also rose.
- The number of local governments which does not depend on local allocation tax has been increasing.

< For Further Reform >

- Further reform are needed to achieve the aimed "ideal state"
 - Although the population living in local bodies with no reliance on local allocation tax has increased in recent years, it is not yet high compared with past level.
 - Although the shortage of local government finance started decreasing, there still remains about 14 trillion yen shortage.

Figure 26. General Revenue Ratio Turned Increasing in 2004 Budget

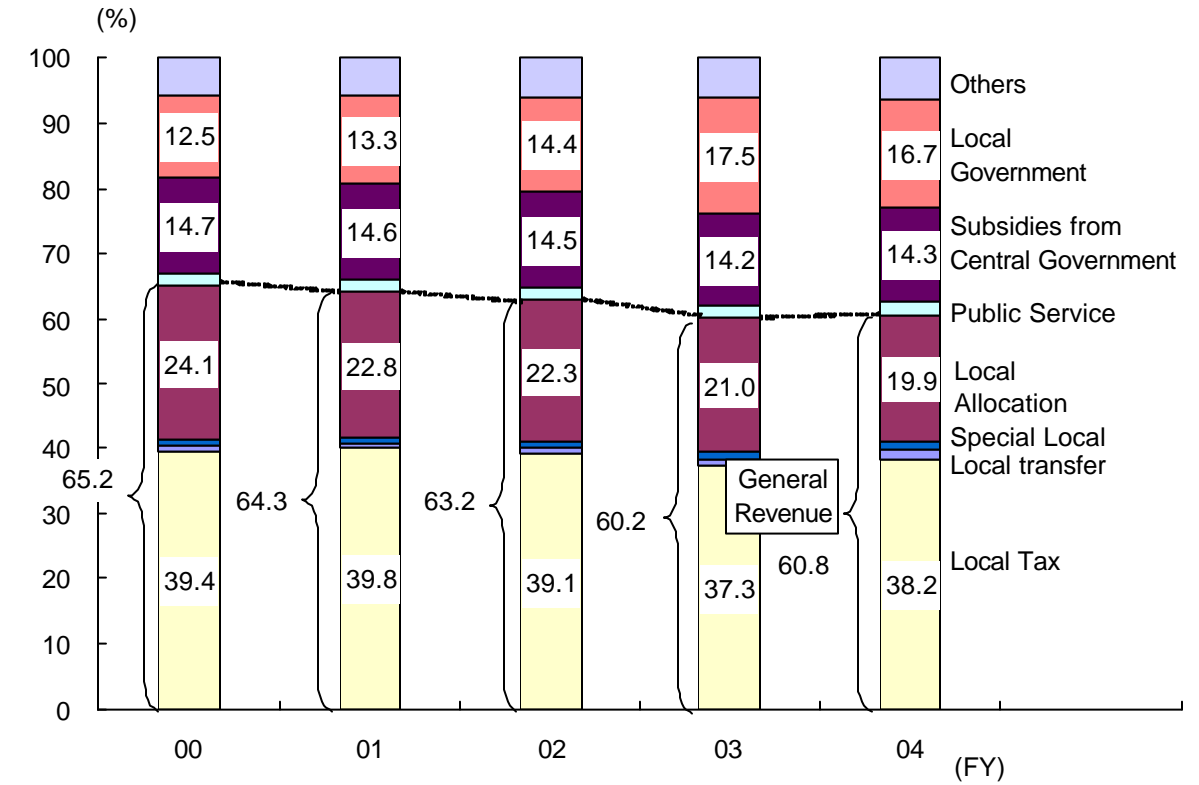
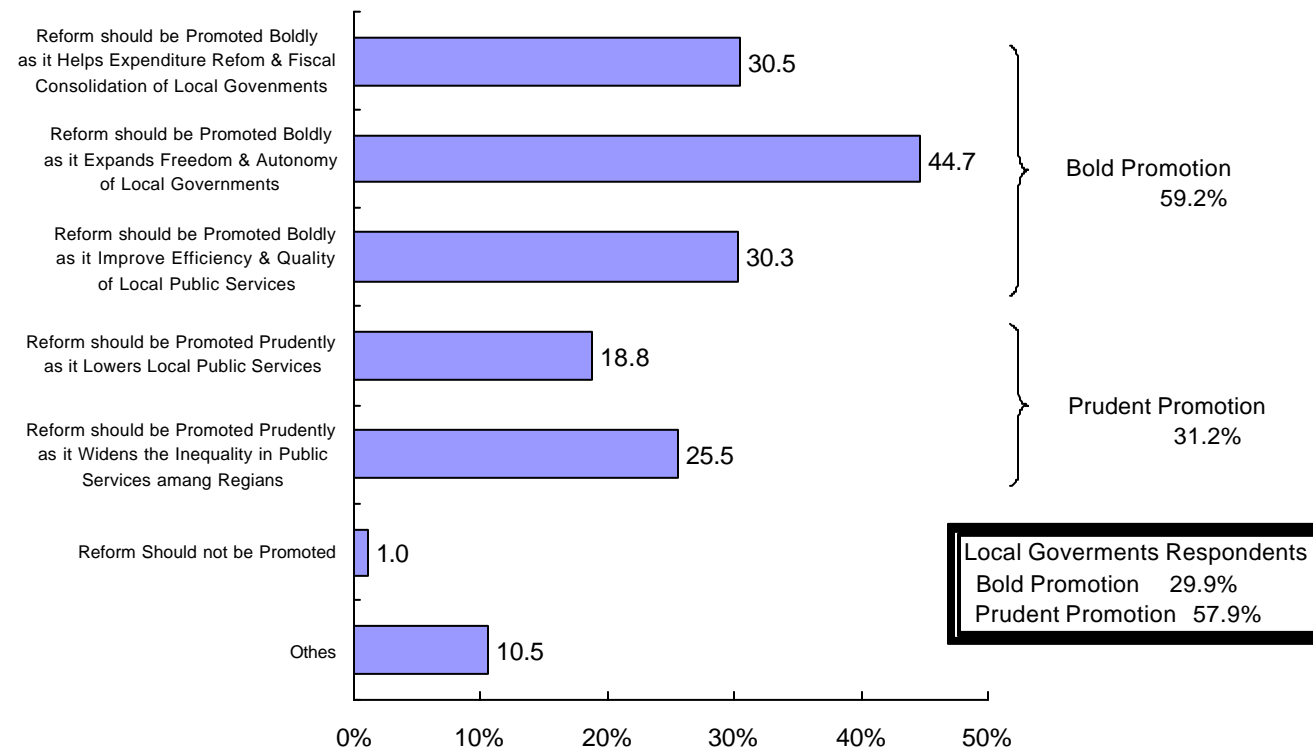
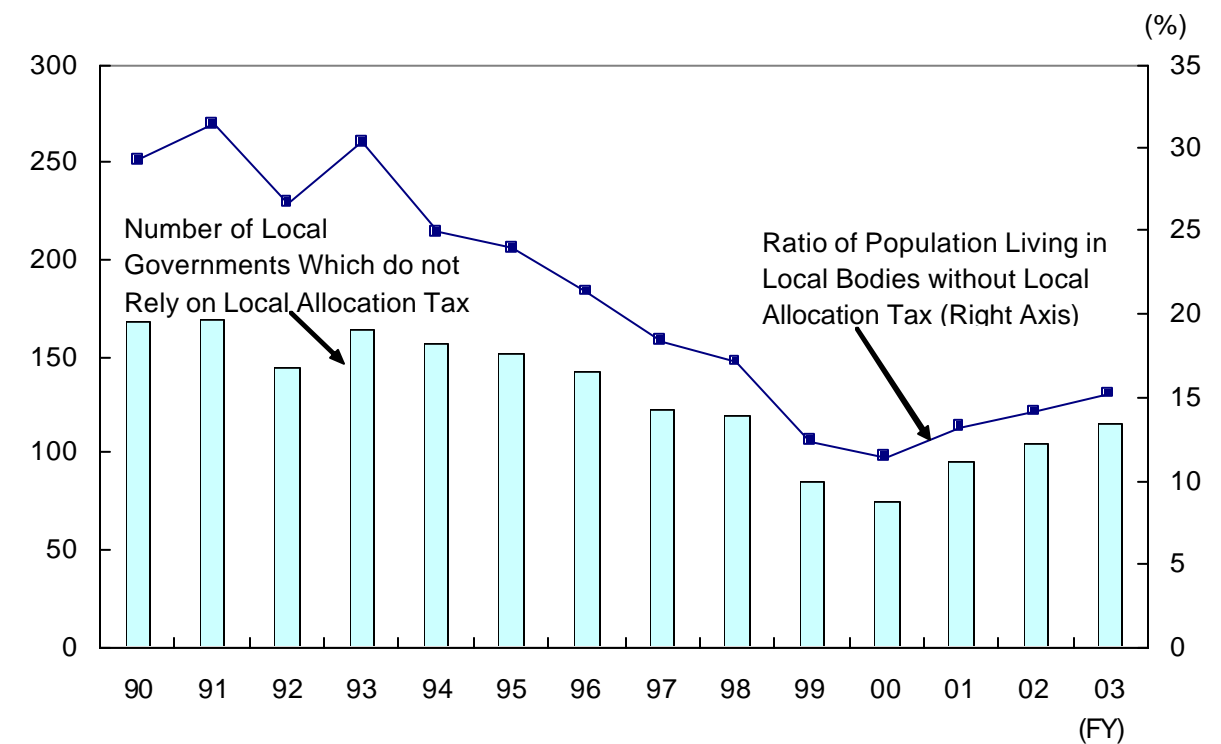


Figure 25. Evaluation of Central-Local Relationship Reform



(Note) Based on a survey of economists firm managers and local governments (Number of respondents = 1145)

Figure 27. Number of Local Government without Reliance on Local Allocation Tax is Gradually Increasing



(5) Science Technology

< Progress and Effects of Reform >

- Over 90% see the increase of science technology budget as appropriate.
- Prioritization of budget to the four science technology priority areas are evaluated as effective by over 90%. Actual effects have begun to appear such as the increase of the share of patents related to the four areas.
- Budget allocation reflects the priority grades (SABC) of research projects.

< For Further Reform >

- Although the budget of the four areas has increased, the shares of them are not yet larger than those of other areas. Few respondents assess that the prioritization progressed thoroughly.
- Reflection of SABC should be through in the special accounts as well.

Figure 28. Growth of Budget of 4 Science Priority Areas

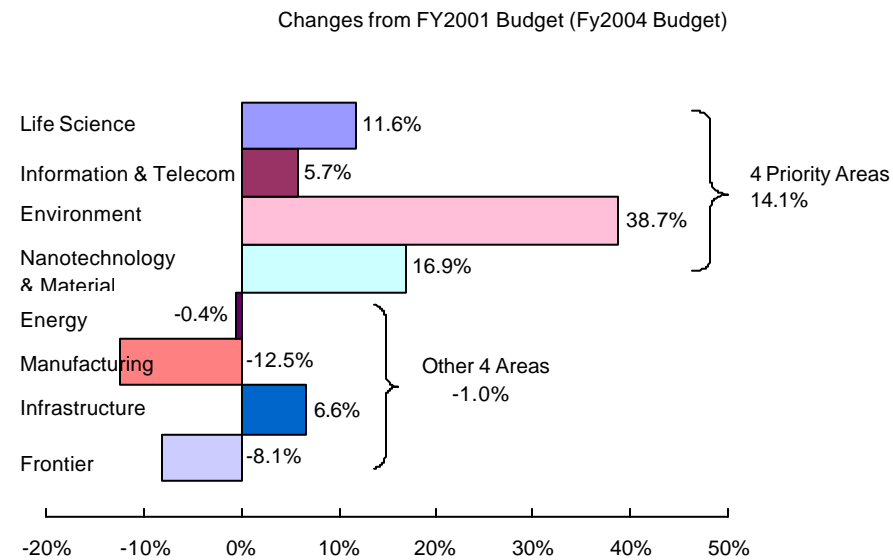
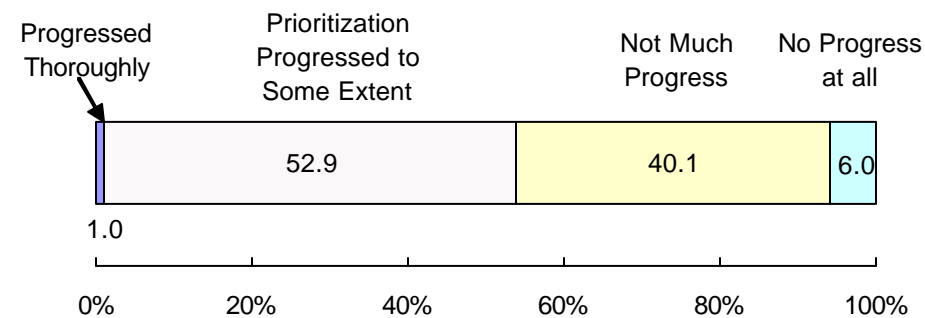


Figure 29. Evaluation on Progress of Prioritization to 4 Priority Areas



(Note) Based on a survey of economists firm managers and local governments (Number of respondents = 1145)

Figure 30. Share of Patents of 4 Priority Areas

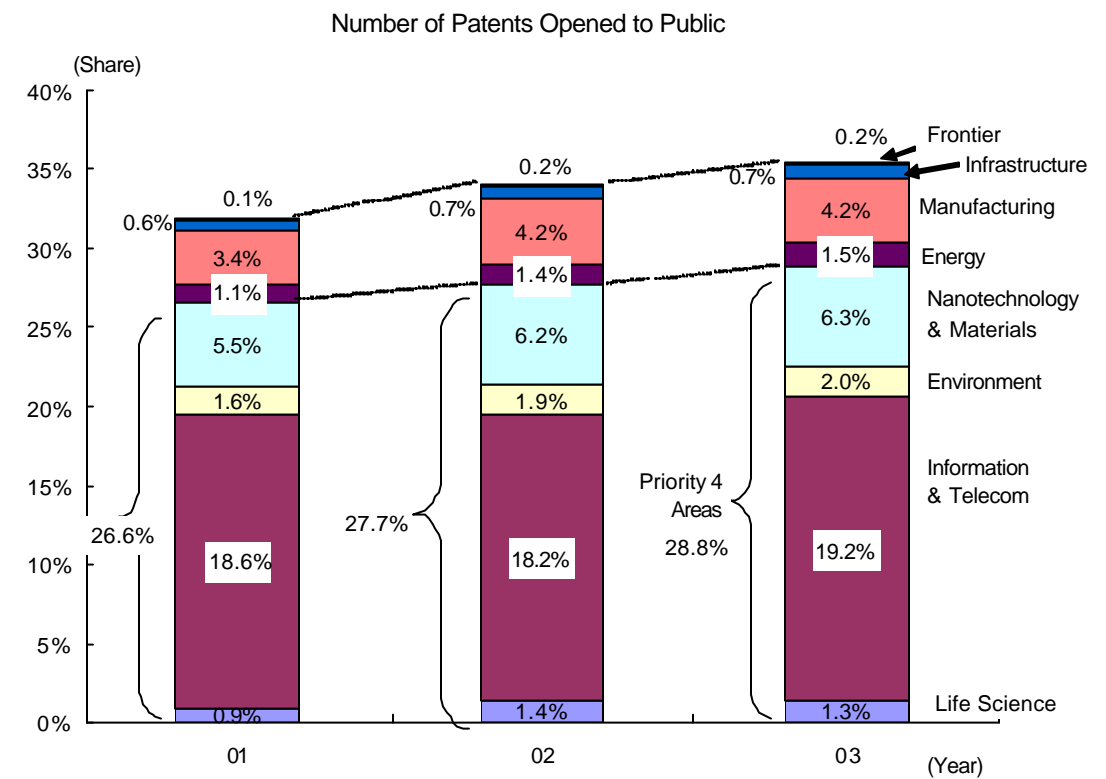
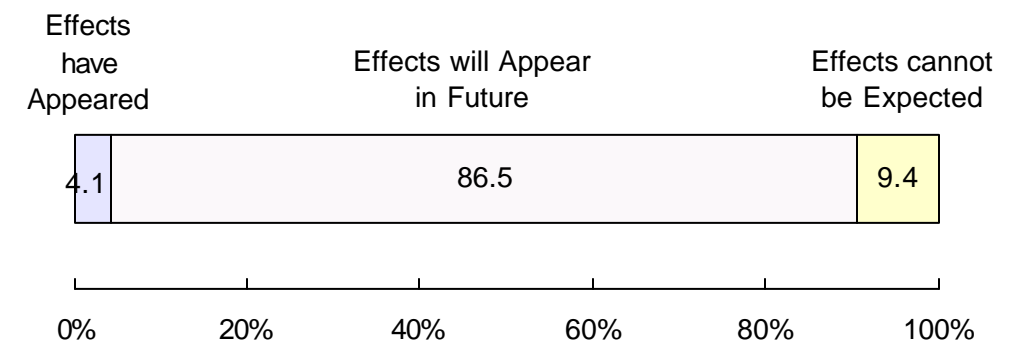


Figure 31. Reflection of Priority Grades (SABC) of Research Projects

	FY 2003 Budget			FY 2004 Budget
	General Account	Incl. Specific Accounts		
S	+21.2%	+12.5%	S	+16.7%
A	+3.4%	+4.3%	A	+5.9%
B	-4.7%	-1.0%	B	-2.8%
C	-73.5%	-20.6%	C	-20.5%

Figure 32. Evaluation on the Effect of Priority Grading (SABC)



(Note) Based on a survey of economists, firm managers, and local governments (Number of respondents = 1145)

(6) Special Accounts

< Progress and Effects of Reform >

- Special accounts reform has started based on over 50 of concrete reform proposals.
- Financial documents in line with the principle of corporate accounting have been developed.

< For Further Reform >

- Many evaluate that the reform of special accounts has not progressed enough. About 20% does not even know whether the special account reform has progressed or not.

Figure 33. Proposals on Concrete Measures of Special Accounts Reform by the Financial System Council

Revision of Works and Projects (Reduction of Costs, Prioritization of Projects, Improvement of Efficiency, etc.)	19 Special Accounts 22 Proposals + 2 Proposals for Whole Special Accounts
Revision of Structures of Revenues and Expenditures (Removal of Rigidity in Revenue –Expenditure Structure, Sound Finance, etc.)	13 Special Accounts 15 Proposals
Enhancement of Accountability	Whole Special Accounts 6 Proposals
Examination of Necessity of Separate Accounting as an Special Account	7 Special Accounts 7 Proposals

Figure 34. Evaluation on Reforms of SpecialAccounts, etc.



(Note) Based on a survey of economists, firm managers, and local governments (Number of respondents = 1145)