Toward the Implementation and Establishment of "Responsible and Proactive Public Finances"

—FY2027 Budget Formulation and Future Economic and Fiscal Management —[1]

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The Basic Policy on Economic and Fiscal Management and Reform 2026 set out a direction for reforming budget formulation and fiscal management under "Responsible and Proactive Public Finances." While advancing necessary growth-oriented investment in a planned manner, it called for moving away from structural reliance on supplementary budgets, placing the steady reduction of the debt-to-GDP ratio at the core of fiscal management, and strengthening multifaceted analysis and verification.

The FY2027 budget will be the first budget to translate these reforms into actual budget formulation and economic and fiscal management. **Taking into account important policy decisions, including the "Strong and Prosperous Japan" Investment Framework, the reduction of the consumption tax rate on food and beverages, the strengthening of defense capabilities, and social security reform, the overall fiscal picture, including revenues, expenditures, and government bond issuance, should be presented in an integrated manner.** At the same time, the public should be provided with a clear explanation of the economic and fiscal vision being pursued and the framework for sustainable economic and fiscal management, and policy should be implemented steadily while securing public understanding.

Furthermore, if FY2027 is to become the first year of "Responsible and Proactive Public Finances," **it is essential not only to formulate the budget but also to establish a concrete framework for economic and fiscal management that reviews and reassesses policies as necessary in light of economic conditions, prices, tax revenues, interest rates, policy outcomes, and market developments. Such a framework should become the standard model for fiscal management in the years ahead.**

From this perspective, we offer the following recommendations regarding the formulation of the FY2027 budget and future economic and fiscal management.

1. Economic and Fiscal Objectives of the FY2027 Budget

（Achieving a "Strong Economy" through Domestic Investment and Productivity Growth）

- In order to place the Japanese economy on a sustained growth path and realize a "Strong Economy" capable of responding to changes in the domestic and global environment, **it is necessary to significantly expand domestic investment through the FY2027 budget and related measures and thereby strengthen the economy's supply capacity.**

[1] This document is a policy proposal submitted for discussion by the expert members at the Council on Economic and Fiscal Policy.

- With respect to the **"Strong and Prosperous Japan" Investment Framework**, **sufficient resources should be secured, both in quality and quantity,** for initiatives with a high impact on strengthening growth potential and supply capacity, enhancing economic security, and achieving other policy objectives. In doing so, policy objectives and expected outcomes should be clearly defined, and contributions to stimulating public and private investment and raising productivity should be continuously assessed. A mechanism should be established to ensure **ongoing prioritization and reallocation of resources**, based on PDCA and EBPM principles, with a view to maximizing the overall effectiveness of the investment framework. In this regard, certain areas of particular importance for economic security and other strategic priorities are to be managed separately through special accounts. Adequate financial resources should be secured on a multi-year basis, and funding should be provided on a sufficient scale.
- In addition to expanding public and private investment across the 17 strategic sectors, efforts should be made to **institutionalize the mechanisms that generate innovation through such measures as fostering startups, reforming the labor market, developing human capital, and accelerating regulatory reform designed for the AI era.**

（Budget Formulation Aligned with Changes in the Economic Environment, Including Higher Prices）

- It is important to shift away from the uniform budget-constraining approach that characterized the deflationary, low-growth era and move toward a **budgeting framework that appropriately reflects rising prices and wages and is commensurate with the expansion of the nominal size of the economy**, while strengthening the economy's growth potential.
- One factor behind the current lack of strength in consumer spending is **the decline in households' real income caused by higher prices** since FY2022. To alleviate the burden of higher prices, measures aimed at increasing the real incomes of low- and middle-income households are essential. Consideration should be advanced, in the context of the FY2027 budget and budget formulation for FY2028 and beyond, for such measures as **a reduction in the consumption tax rate on food and beverages, working individuals' burden relief support benefit, and social security reforms aimed at reducing the insurance premium burden on the working-age population**.
- In this context, the necessity of the temporary measures that have repeatedly been introduced to address higher prices should be carefully reassessed. Policy priorities should gradually shift toward measures that support sustained income growth and structural reforms to the burden-sharing system.

（Review of Expenditures and Revenues）

- To maintain market confidence, **the overall picture of major fiscal demands**, including growth investment, tax reductions, defense, and social security, **should first be clearly presented. Revenues, non-tax revenues, and existing expenditures should then be considered in an integrated manner, with revenues, expenditures, and government bond issuance managed comprehensively on a whole-of-government basis. The sources of funding should also be specified concretely through future budget formulation processes.**

- In doing so, the following initiatives should be pursued in a comprehensive manner:
  - **Fundamentally strengthen the review of tax expenditures and subsidies, including rigorous policy evaluation and the incorporation of evaluation results into the budget process, while thoroughly promoting wise spending across the entire budget through social security reform and greater prioritization within non-social-security expenditures.**
  - **Promote, from a zero-based perspective, further efforts to secure revenues** from all available sources, including special accounts and government funds, thereby increasing non-tax revenues. With regard to government funds, **the fund management rules should be revised** to make full use of their role in enhancing multi-year predictability, while preventing the prolonged accumulation of idle resources and returning unused funds where appropriate.
  - Given that the working individuals' burden relief support benefit and the temporary reduction in the consumption tax rate on food and beverages are intended as measures to address higher prices, **the measures against rising prices that have previously been financed through supplementary budgets** (approximately ¥3 trillion in the FY2025 supplementary budget) **should be reviewed as necessary**.

（Ensuring Fiscal Sustainability and Maintaining Market Confidence）

- Throughout the planning period through 2040, **the ratio of national and local government debt outstanding to GDP**, the core fiscal management target, **should be placed on a steadily declining path** in order to ensure fiscal sustainability. To this end, **efforts should be made to strengthen growth potentia**l, while **the primary balance (PB) should be improved and managed on a multi-year basis** in a manner consistent with achieving the core target.
- During the budget formulation process toward the end of the year, comprehensive consideration should be given, including from the perspective of macroeconomic management. **As a result, the overall fiscal outlook, including total annual government bond issuance and the amount of bonds issued to the market, should be clearly presented**. At the same time, it is important to **maintain market confidence through transparent communication regarding the assumptions and risks underlying economic and fiscal management**.
- In doing so, **multifaceted analysis and verification** should be conducted not only with respect to the debt-to-GDP ratio and the primary balance, but also economic growth, interest rates, interest expense, government bond market, and policy effects. Policies should be reviewed as necessary while taking into account uncertainty and the fiscal space available for responding to future challenges.

2. The Council's Agenda for Deliberations Through the End of the Year

（Macroeconomic Management and Budget Formulation）

- To ensure that the FY2027 budget is worthy of being the first budget of "Responsible and Proactive Public Finances," the government should specify the design of the "Strong and Prosperous Japan" **Investment Framework**, the framework for multi-year budget management through mechanisms such as **government funds** and government debt commitments, and **the strategy of moving away from reliance on supplementary budgets** associated with large-scale economic stimulus packages. Based on these efforts, the **Basic Principles for Budget**

Formulation should be revised at an early stage.

- In the process of revising these guidelines, **the appropriate design of the FY2027 budget should be discussed from a macroeconomic perspective,** taking into account current developments and future prospects for the economy, prices, tax revenues, and other relevant factors. Reviews should be undertaken on both the revenue and expenditure sides while carefully assessing revenue trends. In particular, as policy shifts away from reliance on supplementary budgets based on large-scale economic stimulus packages, the accuracy of revenue projections, including tax revenue estimates at the initial budget formulation stage, will become more important than ever. The Cabinet Office and the Ministry of Finance should work closely together to thoroughly analyze recent tax revenue performance, nominal economic growth, corporate profits, and other relevant indicators from both macroeconomic and microeconomic perspectives, thereby enabling the Ministry of Finance to produce more accurate tax revenue estimates.
- The budgetary response to rising government debt-servicing costs resulting from higher interest rates should also be examined from the standpoint of macroeconomic management.
- With regard to social security, **conclusions or clear policy directions should be reached by the end of the year on key issues, including institutional reforms centered on healthcare and long-term care; the design of targets for the social security burden ratio and the specification of reform measures and implementation timelines; the review of public investment evaluation methodologies and social discount rates in non-social-security areas; and the appropriate approach to substantially expanding operational grants and Grants-in-Aid for Scientific Research (KAKENHI)**.

（Medium- to Long-Term Economic and Fiscal Management）

- The initiatives to be concretized through the FY2027 budget formulation process **should be institutionalized as an integrated cycle of economic and fiscal management, consisting of the Basic Principles for Budget Formulation, the government budget based on the government's economic outlook, the Economic and Fiscal Projections for Medium to Long Term Analysis, multifaceted analysis and verification, and the review and reassessment of policies. This framework should continue to serve as the standard approach to economic and fiscal management in the years beyond FY2027**.
- With respect to “Medium- to Long-Term Economic and Fiscal Plan” based on “Responsible and Proactive Public Finances,” **the government should further clarify its near-term approach to economic and fiscal management with a view toward achieving the economic and fiscal vision set out in the plan, including the core fiscal management target of steadily reducing the debt-to-GDP ratio**, while looking ahead to a comprehensive review and assessment in five years' time. In doing so, **multifaceted verification should be conducted in light of uncertainties surrounding economic growth, interest rates, and other key variables, and economic and fiscal policies should be reviewed and reassessed as necessary**.

（Consideration of Medium- and Long-Term Challenges）

- Deliberations should be advanced on **medium- and long-term challenges looking ahead to FY2040**, taking a comprehensive view of the economy, public finances, and social security. This

should include identifying the desired future state and the challenges to be addressed, while making use of appropriate indicators to monitor progress.

- **The macroeconomic effects of key policy initiatives**, including Japan's Growth Strategy, the Strategy for the Future of Regions, and the Basic Plan for Science and Technology, **should be reviewed and assessed**.
- With respect to **social security**, discussions should take a comprehensive view of the system while considering its future direction, from the perspectives of ensuring security and security in people's lives, containing social insurance premium burdens, maintaining neutrality toward employment, and ensuring long-term sustainability.
- Taking into account overall labor shortages and regional demographic trends, consideration should be given to **the appropriate framework for the sustainable provision of long-term care, education, local government services, and other essential public services**.
- **Progress in various initiatives aimed at raising total factor productivity (TFP) and any additional measures required** should be examined, including the deployment of AI, investment in human capital, and public and private investment in research and development.