

Minister's Summary by Minister Ota



15th Meeting (June 17, 2008)

- (1) The Integrated Reform of Expenditures and Revenues
(Reform of public investment)
- (2) Toward the “Basic Policies 2008”

Hiroko Ota here. Today, the Council on Economic and Fiscal Policy (CEFP) held its 15th meeting of the year and conducted discussions on the integrated reform of expenditures and revenues (reform of public investment) and the “Basic Policies 2008.” In addition, at the end of the meeting, Member Nukaga (Minister of Finance) presented a report on the effective use of state-owned assets.

Regarding the integrated reform of expenditures and revenues (reform of public investment), expert members and Temporary Member Fuyushiba (Minister of Land, Infrastructure, Transport and Tourism) made presentations on their papers. Discussions, including the presentations, proceeded as follows:

Expert member: The Government should continuously reform its spending without cutting back a reduction of expenditures which the government has been seeking so far. After all the Government already achieved a reduction of 3.5% in the budget for fiscal year 2007 and a reduction of 3.1% for fiscal year 2008.

Temporary Member Fuyushiba: The Government has already obtained a sufficient reduction in public investment. The GDP deflator has been in minus territory, but Japan is getting out of deflation little by little. In addition, because of soaring building material costs, reduction efforts have already reached their limit.

Expert member: When reexamining medium-term road construction plans, the Government should review existing estimated traffic demand for road transportation, and recalculate the estimates, considering the country's shrinking population and declining working-age population instead of assuming an increase in the country's population. In addition, nationwide uniform standards and manuals applied to public investment make it impossible to streamline social capital improvement programs. For example, the need for sidewalks is different for Yubari and for the Tokyo metropolitan area. To prevent local authorities from carrying out wasteful public investment just for receiving subsidies, the Government should formulate medium-term plans in the light of decentralization reform, for example, by revising existing subsidy systems. The Government should seek a full reduction of expenditure. People carefully watch non-transparent practices of retired governmental

officers obtaining positions in related organizations, price-fixing and bid rigging schemes, and how the government budget is being wasted. How to demonstrate its intention to correct these practices is extremely important for the Government. It needs to demonstrate the reform efforts in a manner understandable to people.

Expert member: The Government should review how to calculate the cost and benefit as well as how to estimate traffic demand for road transportation. The current cost benefit analysis method computes the effect of shorter journey times as a product of the reduced hours and the mean wage, but in reality, not all of those using roads earn the average wage, and some use roads for leisure activities. Accordingly, the Government should review the validity of the scope of benefits and of the evaluation method in the cost benefit analysis. In addition, soaring building material costs mean an increase in the cost for the cost benefit analysis. With price hikes of materials, some roads will turn out to be unprofitable. Then it is essential *not* to construct roads that are below the borderline range in terms of profitability. In addition, as you can see in the paper presented by Temporary Member Fuyushiba, the amount of government's social capital investment in GDP is dropping significantly in Japan, but the level of Japan's social capital investment share in GDP is still relatively high as compared to those in western nations. Following the Government's recent efforts to reduce social capital investment, the share has at last reached a level just above the average level for G5. There is still room for reduction. In addition, maintenance costs for roads tend to increase year by year, and for this reason, the Government should be careful enough to select new investment. It is necessary to implement projects for roads with higher priority through "the selection and concentration" process. In addition, so called "collusive bidding at the initiative of government officials, or *kansei dango*" is very bizarre. Those who are supposed to make efforts to reduce costs are, in reality, boosting costs. The Government should completely eliminate these wasteful spending practices and reexamine its expenditures, considering the possibility of organizational changes.

Expert member: It is true that some wasteful investments have been made so far. However, it is also true that some road projects essential to vital industrial development have been left undeveloped in rural areas. To make the regional economy more self-reliant, we should effectively invest in infrastructure development. Local authorities have to develop infrastructure in a large area at their own cost and discretion.

Mr. Taniguchi, Vice Minister of Internal Affairs and Communications: When shifting the earmarked revenues for road construction to general revenues, the Government needs to secure tax revenue resources for local authorities, including government budget contributions and government subsidies. In addition, it is necessary to increase the discretionary power of local authorities.

Expert member: Price hikes of construction materials have been observed nationwide, and private sector has been making efforts to cut costs. Public investment has to cut costs, too. In addition, wasteful spending on road-related budgets has been repeatedly pointed out at Diet sessions, and if

the reduction in public investment spending this time falls short of 3%, people will not find the Government's efforts for reform persuasive enough. Considering the review of medium-term plans concerning road construction, I believe that there is still room for more reduction. The Government should pay attention to such a possibility. Local authorities should develop infrastructure at their own discretion in line with decentralization.

Member Nukaga: Of course, we have to consider regional vitalization, people's safety and security and price hikes in construction materials. However, at the same time, when thinking about the country's extremely severe financial conditions, we have to reduce costs, eliminate "collusive bidding or *dango*," reform bidding systems, and achieve "zero waste" practices. Whether the Government will comply with "Basic Policies 2006," including public investment, shows whether the reform is being carried out or not. Therefore, the Government has to reduce its expenditure for public investment, by clearly defining what is really needed. Even if special revenues earmarked for road construction are shifted to general revenues, the amount itself will remain unchanged. So we have to prevent ministries concerned from scrambling for a limited amount of budget. In addition, we have to make efforts to maintain existing tax rates of the gasoline tax and other taxes, giving consideration to environmental issues and current financial conditions. I would like the CFP to discuss the issue in the direction of maintaining existing tax rates.

Temporary Member Fuyushiba: The newly estimated traffic demand for road transportation will be developed based on data obtained in 2005, and is forthcoming this fall. In addition, regarding the current cost benefit analysis method, we will correct problem areas like the concept of costs and benefits, as you have pointed out today. The correction of the method will be completed this fall. In addition, we will carefully select new investment, and we will also review road construction projects now under way to assess their compliance with new standards. We will conduct cost benefit analysis for road construction projects, by giving consideration to price hikes in construction materials. Furthermore, though the level of Japan's social capital investment share in GDP is still relatively high as compared to those in western nations, as pointed out earlier, I think it is difficult to simply compare Japan's share and those of other western countries and say that Japan's level is too high. This is because Japan's GDP has remained almost unchanged while GDP of western nations has been growing. So-called "collusive bidding practices or *dango*" is very shameful. For this, I would like to apologize to people in this country. I will seek to completely eliminate *dango*. It is important that local authorities should select road construction projects and public investment projects that are really necessary at their own discretion, but we have to design roadway networks as a part of National Spatial Strategies because some road networks cover more than one prefecture. Anyway I would like to listen to what local people say on this matter. Regarding the expert members' recommendation that the Government annually publish estimated life cycle costs including maintenance costs of existing stocks, I think it is rather difficult to annually release the estimate

because one has to estimate costs for 30 years to compute life cycle costs. Yet I would like to carefully deliberate over the expert members' precious recommendation.

I summed up the discussions as follows:

Considering current situations concerning public investment, we have to address a number of problems such as wasteful spending and collusive bidding practices in the face of price hikes in materials, and at the same time, we have to give careful consideration to the shifting of the earmarked revenues for road construction to general revenues.

I would like to continuously discuss the issue at the CEF, too, with these situations in mind, in preparation for development of expenditure ceilings for the next fiscal year's budget request this summer and for development of the state budget at the end of the year.

The Prime Minister made the following statements:

When reexamining the earmarked revenues for road construction, it is one of key issues for the Government to review how these revenues are being spent from the viewpoint of people and allocate them to important measures that are really required by people as well as to construct roads essential to regional development.

To change the budget allocation to address important issues that are really necessary for people and to satisfy public demand for enhanced social security for responding to the national shortage of physicians and the lack of emergency medical services, I would like to make an inventory of policy measures and seek for the realization of a "zero futility" government, for example by reexamining the earmarked revenues for road construction from the viewpoint of people.

Then again I would like to explain how the Fukuda Cabinet intends to enhance people's safety and security, by emphasizing fiscal consolidation and social security systems.

First of all, the Government will continuously seek reduction in existing expenditures which have been based on past schemes, by thoroughly streamlining governmental duties, in consistent with "Basic Policies 2006."

The Fukuda Cabinet will cope with the cost of important measures centered on social security, including the national shortage of physicians and the improvement of emergency medical services on which the Government is now taking corrective actions, by thoroughly streamlining governmental duties in the following manner:

First, the Government will take strong action on an unprecedented scale to realize a "zero futility" government. Second, the Government will make an inventory of policies, for example, by reviewing the earmarked revenues for road construction from the viewpoint of people. Then to make up for shortfalls that may arise eventually, people will have to select and prioritize costs and benefits of government services.

In preparation for development of the budget for fiscal year 2009, we will cope with the cost for the Fukuda Cabinet's important issues that are really necessary for people, including social security issues, first by realizing a "zero futility" government and by making an inventory of policies.

Accordingly, I would like to ask expert members' assistance in making recommendations on how to realize a "zero futility" government and how to make an inventory of policies, because we have to keep a close watch on special accounts as a whole, including those concerning public investment.

Regarding "Basic Policies 2008," the draft was presented. In response, discussions proceeded as follows:

Mr. Taniguchi, Vice Minister of Internal Affairs and Communications: "Urban and rural exchange program for children" is an important measure.

Member Amari (Minister of Economy, Trade and Industry): I am fine with the draft which properly incorporates the Economic Growth Strategy. It is important to clearly demonstrate to the public how these policies are implemented. In addition, we have to focus on priority items in budget formulation, for enhancing productivity in the budget. Speaking of more details, I really feel the importance of roles of ODA, when being engaged in resource diplomacy. In addition, other countries are seeking tax treaties with the Japanese government. The Government should prioritize issues of concern and promptly address them.

Member Nukaga: What is important is to put no financial burdens on future generations and to secure the confidence of the international market. We will adhere to "Basic Policies 2006" and demonstrate the Fukuda administration's commitment. We have to share common awareness concerning this issue. In addition, I would like to actively and promptly respond to issues of international tax treaties.

Expert member: Effective housing policies are important for the Economic Growth Strategy. Improvement of dwelling environment in Japan is essential partly because of its transmitted effect on affiliated industries. In addition, EPAs are essential, too. In particular, the Government should give a top priority to negotiations of EPA with the EU, which has a total population of 500 million, a combined GDP of 170 billion yen and now has a larger population and GDP than the United States. Moreover, the EU's expectations for Japanese investment are high. Recently I visited three Central and Eastern European countries and saw Japan's presence there being dwarfed by that of South Koreans who are finding their way into local markets. South Korea has already started negotiations of FTA with the EU, and Japan has to make accelerated efforts for the conclusion of FTA with the EU so as not to lag behind its competitors. In addition, ODA is still very important for a country with little natural resource.

Expert member: The integrated reform of expenditures and revenues is a 5-year-long program, but

some have already argued that the program should be discarded though the program is still in its second year. Discarding the integrated reform could cost the international community's confidence for the Japanese government. Of course, the Government needs to address new problems including a nationwide shortage of physicians, yet it should remain faithful to the basic framework of the integrated reform of expenditures and revenues until fiscal year 2011. I would like the Prime Minister to continuously demonstrate strong leadership. In addition, the reform of local branches of governmental organizations is very important. In line with the classification standards of government duties specified in the draft of "Basic Policies," the CEFP should also properly discuss this issue and support the Committee for the Promotion of Decentralization Reform.

Expert member: It is extremely important that the "Fukuda Vision" initiative has already drawn a road map for building a "low carbon society." The road map should be approved in a Cabinet meeting and the Government as a whole should accelerate its efforts in this regard. In addition, promotion of global strategies is essential to the country's economic growth and encouraging EPAs participation is very important. Furthermore, vitalization of financial and capital markets in Japan is one of huge challenges. For that purpose, we need to attract qualified international human resources to Tokyo. Effective use of pension funds is also important. In addition, the agricultural reform is vital, too. International price hikes in foods are creating a good opportunity for the country's agricultural reform, and Japan should take this occasion to cut farming costs and to make the country's agricultural sector internationally competitive enough for export.

Expert member: When considering the future of Japan, human resources and qualified education are indispensable, and accordingly, investment in basic science is essential. In addition, competitiveness of the agricultural sector is important, and accordingly, authorities should deregulate the agricultural sector. The recovery of small and medium-sized enterprises is also essential to the country's economy.

Based on the today's discussions, I will present the first draft of "Basic Policies 2008" at the next meeting of the CEFP.

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