

**Basic Policies for Economic and Fiscal Management and Structural Reform 2004  
( Summary )**

**Introduction**

**Current Situation of the Japanese Economy and the Objectives of Structural Reform**

**1. Current Situation and Challenges for the Japanese Economy**

(Japan experiencing a private demand-led economic recovery)

Japan has made a breakthrough from its long-lasting economic downturn and is now entering a stage towards a new leap forward. Although the intensive adjustment period was launched under a severe economic environment of negative growth and large amounts of non-performing loans, in the process of promotion of structural reform, the fundamentals for economic recovery have steadily expanded through private demand-led growth without having to resort to dependence on fiscal stimulus.

The structural reform implemented thus far such as the steady progress in disposal of non-performing loans, broad range of efforts for regulatory reform, reorganization and revitalization of corporations, promotion of expenditure and tax reform and others have together combined to achieve comprehensive results in eliminating the factors that have suppressed the Japanese economy since the burst of the bubble economy. As for the disposal of non-performing loans, the amount of non-performing loans carried by major banks has decreased by over 13 trillion yen in the past two years and the stock prices of banks and real estate industry, etc., have enjoyed steady gains. Further, in addition to tax cut on business capital investment and R&D expenses supporting the recovery, there has been active revitalization and restructuring of corporations as can be seen from drastic increase of over 10,000 new businesses emerging in the past year under the Special Regulations Governing Minimum Capital Requirements.

At the same time, although unemployment rate rose to 5.5% in January 2002, it was followed by a gradual decrease and looking over 2003 as a whole it can be seen that the unemployment rate has marked a decrease for the first time in 13 years. There is definitely a significant difference when compared with the past two economic recoveries following the burst of the bubble economy, during which the unemployment rate rose or hovered at a high rate, which proves that the recovery this time is due to the

achievements of structural reform.

There are signs that these booms in the corporate sector are having a positive impact on households through recovery of employment and together with stabilization of the financial system and increase in stock prices there have been improvements in the consumer confidence. As a result, the average annual growth rate for the economic recovery phase since the beginning of 2002 is 3.0% of which private demand accounts for 2.2%, indicating that private demand-led growth is being realized. However, there are detectable differences in regional recovery trends and it is important to recognize that the situation surrounding small- and medium-sized enterprises (SMEs) is severer than the situation facing large enterprises. In addition, even in the first half of 2004, Japan is still experiencing moderate deflation and efforts to overcome deflation remain an important policy issue requiring attention.

(Expansion of Fruits of the Reforms and Completion of the Intensive Adjustments Period)

In FY2004 the Government will substantially get rid of problems caused by the negative legacy of the post-bubble period. The Government will strengthen the financial system by bringing the non-performing loans (NPLs) problems to an end through steadily implementing the “Financial Revitalization Program,” and reinforce the function of small and medium-sized or regional financial institutions. At the same time, the Government and the Bank of Japan together will make policy efforts aiming to overcome deflation. The Government will steadily implement measures that have been adopted thus far, including the “Basic Policies for Economic and Fiscal Management and Structural Reform 2003”(Cabinet Decision on June 27, 2003) and make further efforts on regional revitalization and employment policies so that fruits of the reforms would be spread all over Japan.

## **2. From the “Intensive Adjustment Period” to the “Concentrated Consolidation Period”**

The task of the Government after FY2005 is to put forth further full-fledged efforts for the implementation of reforms carried out thus far such as the principle of “from Public Sector to Private Sector” and “from the State to the Regions” and to establish a basis for growth under the new circumstances Japan faces such as population decrease and changes in the international environment. Defining the two-year period between

FY2005-FY2006 as the “Concentrated Consolidation Period”, the Government intends to ensure a breakaway from deflation through its policy efforts together with the Bank of Japan, and to focus on consolidating the fundamentals for new growth. As a result of these efforts, the nominal growth rate after FY2006 is projected to be around a level of 2% or more.

The major tasks of the “Concentrated Consolidation Period” are as follows.

The first task is to implement thoroughly the principle of “from Public Sector to Private Sector” and “from the State to the Regions” and to construct a socio-economic system led by the wisdom of the private sector and the regions. To realize this, the system of administrative *ex post facto* checks must be enhanced and efforts made to clarify those areas of work that can only be conducted by the Government as well as to boost the discretionary power of the local government through review of regulations placed on local governments by the central government. Further, the preparations for the privatization of postal services would be completed.

Second, the Government shall implement a full-fledged reform of the government sector (“public sector reform”) to construct an efficient and streamlined government with public accountability. To realize this, the Government shall engage in budgetary system reform such as clarification of achievement goals by budget items and implementation of strict *ex post facto* evaluations as well as to conduct further administrative reforms.

The third task is to conduct a reform to boost growth potential in the private sector (“private sector reform”). In dealing with a drastic change in Japanese socio-economy due to population decrease in the future, a new strategy is to be drawn up for further development of Japan’s socio-economy. Getting out of the NPLs problems, the Government will formulate the “Program for Concentrated Consolidation of Financial System (tentative name),” and will further strengthen and enhance Japanese financial sectors through structural reform and vitalization of financial and securities markets, so that the world’s highest level of financial function would be supplied to users meeting their needs and contributing to further social and economic growth.

The fourth task is to make efforts for fundamental enhancement of “human resources,” wherein special emphasis will be placed on elimination of employment mismatches. For this purpose, efforts will be made on intensive capacity building among the younger generation, which currently shows a high rate of unemployment at approximately 10%,

development of employment policies based on the situation of each region, restructuring and introducing one-stop services for employment-related policies from the standpoint of the users.

The fifth task is the establishment of “sustainable safety and reassurance.” Specifically, comprehensive reform will be made of the social security system which would include pension, medical care, nursing care and public assistance, etc. Further, the Government will focus on measures against the decreasing birthrate, promotion of health and nursing preventive care, ensuring security and safety, and construction of a recycling-oriented society and preservation of global environment.

As such, the Japanese socio-economy after the intensive adjustment period will aim to establish a sustainable economic growth track while facing new challenges. However, this does not imply that the objective of the structural reform carried out thus far will change. Simply put, structural reform implies reforms to make full advantage of all the resources (human resources, endowment, technology, etc.) Japan possesses. Fully understanding the implications of structural reform is essential at a time of moving from the intensive adjustment period to the concentrated consolidation period. An outline of the Japanese socio-economy that should be aimed for is detailed below.

### **3. Structural Reform and its Objectives**

The Japanese socio-economy in the 21<sup>st</sup> century is not merely an extension of the socio-economy of the past.

While globalization is proceeding at an accelerating pace, the progress of IT is bringing revolutionary changes to industry, lifestyle and also the labor force. In an environment in which countries that were formally known as developing countries are pursuing startling growth in succession, in order for Japan to maintain its competitiveness in the future and create a richer and more livable society, it is now necessary for the Japanese economy to position itself on a new axis for growth. Such an axis for growth must bring about innovation at the corporate, regional and individual level, in an environment in which issues such as aging society and the environment protection are translated into new societal needs.

For example, in a society in which the population is starting to decrease, if we are to advance the development of new products and new services in areas such as medical

care, long-term care and child-raising that are required to support a high standard of living, the aging of the population will be linked to economic vitality. Technical development for resource conservation, energy conservation and new energy sources can also lead to new growth for business.

In order to assist the challenges that companies and individuals will face, government must be streamlined and efficient. In addition, in order to improve fiscal soundness such as turning primary balance to surplus, through realizing sustainable private-demand led growth and controlling government total outlays by concentrated efforts by the central and local governments, we aim to restrain the size of government, for example, keeping the rate of potential national burden to around fifty percent.

On the other hand, the Government must also respond to the new demands arising from changes of the age. For example, given the increasing severity of the international environment, safety and reassurance are now more important challenges than ever before. Measures to ensure public peace and safety, and counter large-scale disaster must be urgently coupled with governmental measures on ensuring information security and sanitary safety, among other issues. In addition, with the values of society becoming ever more diversified and advanced, universal “one-shoe-fits-all” administrative services are no longer sufficient and there is a growing tendency to demand freedom of choice even in the public sector. The Government should not merely arrange an enabling environment to respond flexibly to changes of the age in companies and individuals, but must also change itself, responding to the new needs of the age and changing flexibly.

Structural reform represents ceaseless efforts to reform various systems, policies and the government, so that corporations, regions, and individuals can flexibly respond to the new socio-economic environment and can harness their capabilities to the maximum extent.

## **Part 1 Major Reforms in the Concentrated Consolidation Period**

1. Thorough implementation of the principles “From Public Sector to Private Sector” and “From the State to the Regions”
  - (1) Steady implementation of the privatization of postal services
  - (2) Active promotion of regulatory reform and opening up to the private sector
  - (3) True self-reliance of the regions
2. Enhancement of “Public Sector Reform”
  - (1) Full-fledged implementation of the budgetary system reform
  - (2) Market stability through enhancement of public debt management
  - (3) Administrative reform
  - (4) Comprehensive and fundamental tax system reform
3. Promotion of “Private Sector Reform”
  - (1) Establishment of a growth strategy under decreasing population
  - (2) Encouragement of creation of new businesses and new business legislation
  - (3) Promotion of further reform of the financial system
4. Fundamental enhancement of “human resources”
  - (1) Consideration of a strategy to enhance “human resources”
  - (2) Restructuring of employment-related policies from the standpoint of the users
  - (3) Revitalization of education scenes, etc.
5. Establishment of “sustainable safety and reassurance”
  - (1) Comprehensive reform of the social security system
  - (2) Enhancement of measures against decreasing birthrate
  - (3) Promotion of health and nursing preventive care
  - (4) Ensuring public peace and safety
  - (5) Construction of a recycling-oriented society and preservation of global environment
  - (6) Securing a sustainable development infrastructure

## **Part 2 Priority policies for economic revitalization**

1. Regional revitalization
  - (1) Active advancement of regional revitalization
  - (2) Comprehensive promotion of urban renaissance
  - (3) Revitalization and strengthening of core industries of the regions, etc.
2. New developments in employment policies and policies on human resources development
  - (1) Enhancement of vocational education and of the “Independence and

- Challenge Plan for Young Workers”
- (2) Regionally-oriented employment policy
- (3) Facilitation of labor movements, etc.
- 3. Promotion of a “Strategy Toward Sustainable and Competitive Industrial Structure” , development of market environment and enhancement of development basis
  - (1) Promotion of a “Strategy Toward Sustainable and Competitive Industrial Structure”
  - (2) Enhancement of rules for fair trade
  - (3) Promotion of economic partnership and acceleration of foreign direct investment in Japan
  - (4) Promotion of IT Strategy
  - (5) Advanced science and technology-oriented nation
  - (6) Creation, protection and utilization of intellectual property
  - (7) Innovation and revitalization of small- and medium-sized enterprises (SMEs)

### **Part 3 Economic and fiscal management and FY2005 budget**

- 1. Principles of economic and fiscal management
  - (1)Future economic trends and for present economic and fiscal management
  - (2)Principles of mid-term economic and fiscal management
- 2. Basic Principles of the FY2005 budget
  - (1) Aims of the FY2005 budget
  - (2) Maintenance of expenditure reform
  - (3) Prioritization and streamlining of budgetary allocation
  - (4) Reform of the main budgetary items