

Basic Policies for Economic and Fiscal Management and Structural Reform 2005
(Summary)

Section 1 —Current Status of the Japanese Economy and Our Next Objectives

1. The Japanese Economy to Break Out of the “Post-Bubble Period”

(Prospect of the 21st century beyond the structural reform)

The Japanese economy and society face significant changes in the environment. Whether we will be able to secure a basis for new growth by responding appropriately to the trends of the age, such as the advent of full-fledged population decline and a super-aging society and the advancement of globalization on a global scale, or follow a path of gradual decline depends solely on the progress of structural reform during the next year or two.

Meanwhile, shifting our attention to the current state of the Japanese economy, we are emerging from the negative legacy of the burst of the bubble and are realizing private demand-led economic growth. This is a result of the progress of the structural reform achieved during the intensive adjustment period up to FY2004.

The two years up to FY2006 (the concentrated consolidation period) are important for three reasons. Firstly, it is the period that should serve as a turning point as to whether or not we will be able to open the door for the new dynamic era to come. Secondly, it is the period in which we must achieve specific targets for the structural reform that we have been working on. Thirdly, it is the period in which we will ensure emergence from deflation and strive to consolidate the foundation for new growth.

(Issues to be addressed during the concentrated consolidation period)

The following three issues require particular emphasis during the two crucial years to come.

The first task is to establish a “small and efficient government.”

The second task is to establish a foundation that will allow Japan to overcome the two most important environmental changes for the Japanese economy in the 21st century, that is, the trend of declining birth rate and aging society and the trend of globalization, with an eye to the new dynamic era.

The third task is to overcome deflation and revitalize our economy to secure private demand-led economic growth.

2. Objectives for the “Basic Policies 2005”

(The realization of a “small and efficient government” upon the completion of structural reform)

In line with the three aforementioned issues, the following issues must be addressed.

(1) Efforts to Achieve a “Small and Efficient Government”

In order to clear the road ahead for a “small and efficient government,” the Government must thoroughly carry out reform involving a shift “from the public to the private sector” and “from the central to the local government.” The aim is to change the three trends listed below. Furthermore, by means of fiscal structural reform the Government will change the flow of funds “from the public to the private sector.”

- 1) Changing Flow of Funds
- 2) Changing Flow of Work
- 3) Changing Personnel and Organization

(2) To Realize a New Dynamic Era—Overcoming Aging and Globalization—

For the Japanese economy to overcome the great changes in the environment, the Government must carry out reform of both expenditure and revenue in an integrated manner, aiming at a surplus in the primary balance in the early 2010s. The Government must also clarify the roadmap for fiscal reform. Another task is to secure safety and reassurance of the nation, as it is one of the fundamental responsibilities of the Government as well as the basis for economic revitalization. On the basis of that, to overcome the unprecedented trend of declining birth rate and aging society, the Government will review the social security network in a comprehensive manner and strive to build a sustainable social security system. Furthermore, the foundation for fostering the next generation must be strengthened, through such measures as reversing the declining birth rate. On the other hand, in order to successfully deal with globalization, Japan’s international competitiveness must be reinforced through means such as innovation. For this, we must strengthen human capability. Also, it is necessary to encourage the development of strong industries and regions, and promote economic partnership agreements (EPAs), among other measures.

(3) To Secure Private Demand-led Economic Growth

To secure private demand-led economic growth, it is necessary to accelerate the four reforms consisting of regulatory reform, financial system reform, tax reform and expenditure reform to revitalize the economy. In order to revitalize the economy, it is important that the Government shift the policy direction to strengthen competitiveness based on the following “Three Principles for Revitalization.”

- i. Shift policy towards “individuals”: The budget emphasis will be shifted from “objects”

to human resources.

- ii. Shift to support front-runners: Instead of a widespread and thinned-out budgetary allocation, the Government will boldly concentrate budget allocations to foster competitiveness.
- iii. Shift to global competition: The Government will foster competitiveness to win the international market.

Furthermore, the Government expects that, considering market trends and expectations, the Bank of Japan (BOJ) will exercise effective monetary policy management, which will be consistent with the Government's efforts for emergence from deflation and the economic perspective in the concentrated consolidation period presented in the "Structural Reform and Medium-term Economic and Fiscal Perspectives - FY2004 Revision".

Based on the four "Basic Policies" formulated since FY2001, the Government has advanced structural reform in four sectors through regulatory reform, financial system reform, tax reform and expenditure reform. The objective of "Basic Policies 2005" is to build on the achievements of the reform while also engaging in new objectives and to nurture the sprout of reform into a big tree.

Section 2—Three Reforms to Achieve "Small and Efficient Government"

1. Changing Flow of Funds

(1) Privatization of Japan Post

To realize the privatization of Japan Post from FY2007, the Government will make efforts towards enactment of related bills that have been submitted to the Diet.

(2) Reform of Policy-based Finance

Following the Council on Economic and Fiscal Policy (CEFP)'s "On the Reform of Policy-based Finance" (December 2002), CEFP will deliberate through autumn of this year, and formulate a basic policy direction to achieve ideal government financial services.

(3) Strengthening Management of Government Assets and Debts—"Comprehensive Review of the Balance Sheet"—

The Government will aim to effectively utilize central Government assets, including its properties, to their fullest potential, and reinforce management of debts such as Government bonds. For this purpose, the Government will strengthen management of government assets and debts and carry out a "comprehensive review of the balance sheet". As the first step, under the coordination of the related ministries and agencies, CEFP will deliberate concerning the

management of assets and debts, aiming to publish a basic policy direction around autumn this year.

2. Changing Flow of Work

(1) Shift from Central to Local Government

To ensure the successful reform package of three issues by FY2006, the following issues must be addressed.

- 1) The Government will steadily realize the reform based on the “Agreement between the Government and the Ruling Parties”¹ on the overall picture of the reform package of three issues up to FY2006 and the four “Basic Policies” formulated since FY2001. In order to do so, the Government will follow up on its progress within the CEFP. Furthermore, on the occasion of the conference between the central and local governments, the Government will listen to the opinions of the local governments in advancing the deliberations.
- 2) The Government will aim for a transfer of tax revenue resources of approximately three trillion yen.
- 3) With regard to the reform of subsidies, the Government will carry out reforms linked to the transfer of tax revenue resources and reforms to increase the discretionary level and largely expand the independence of local governments. To this end, the decision on the remaining issues will be made by autumn 2005. In conjunction, the Government will promote the administration slimming reform for the central and local governments.

Furthermore, the Government will undertake measures to increase the transparency and predictability of the local financial plans. For instance, efforts will be made to correct the disjunction between the local financial plans and the final accounts, for the purpose of moving toward a solution within the concentrated consolidation period.

- (2) The thorough Opening up of Public Services to the Private Sector, through such Means as the Full-scale Introduction of “Market Testing”.

To improve the efficiency of public services, the Government will develop a system aiming towards the full-scale introduction of “Market Testing”.

¹ 「Agreement between the Government and the Ruling Parties」 (26 November, 2004)

For this, based on the “Three year Program for Promoting Regulatory Reform (revision)”², the Government will swiftly prepare a draft proposal of the “Improvement of Public Services Efficiency Bill (or Market Testing Bill) (provisional title)” to submit it to the Diet within FY2005.

(3) Reform of Budget System

(General implementation of Model Projects, etc.)

The reform of the budget system will be settled so as to realize achievement goals (Plan)—efficient execution of budget (Do)—thorough assessments (Check)—reflection of goals in the budget (Action).

In order to do so, the Government will start with issues including the following.

- 1) Shift the “Model Projects” from a trial to a general framework. As the first step, while maintaining the basic outline of the “Model Projects”, the Government will establish from the FY2006 budget “Performance-based Projects” (provisional title) whose association with policy evaluation will be strengthened.
- 2) Review the budget documents and closing statements so that the budgets and accomplishments can be assessed in conjunction with the budget and final account for each policy. Aiming for full implementation by the FY2008 annual budget, the Government will complete practical reviews by FY2006. Furthermore, the Government will carry out the revision of the “Basic Policies Concerning Government Policy Assessments”³ and other tasks by FY2005, in order to steadily advance the review of the policy assessment system such as strengthening the association between the policy assessments and budgets.

(Special accounts reform)

For sustaining and strengthening the special accounts reform, the following are the tasks to be carried out.

- (1) Relevant ministries will steadily implement the reform policies formulated on the basis of the “Basic Policies 2004.” In addition, the Ministry of Finance, together with the relevant ministries, will continue an in-depth review that also considers the possible abolition of some administrative works and projects and the need for division-based accounting with an eye to long-term fiscal health, taking into account the nature of each special account. The result will be periodically reported to the CEFP.
- (2) Comprehensive deliberation will be continued concerning the role of earmarked

² “Three year Program for Promoting Regulatory Reform(revision)” (Cabinet Decision: 25 March 2005)

³ “Basic Policies Concerning Policy Assessment” (Cabinet Decision: 28 December 2001)

revenue sources, including the nature of each revenue source and the appropriate allocation of resources. Basic policy direction will be clarified within the concentrated consolidation period.

3. Changing Personnel and Organization

(1) Thorough Administrative Reform of the Central and Local Governments

Concerning the central government, the following points will be pursued with vigor, among other efforts.

- Concerning local branch offices, the Government will carry out a fundamental review of the necessity of operations. A drastic review will be carried out including commissioning to the private sector, opening up to the private sector by means of market tests, transferring tasks to local governments, conversion to incorporated administrative agencies and some possible abolition and integration. The Ministry of Internal Affairs and Communications will clearly indicate the strategies for FY2006, including the measures to be taken by each ministry.

Furthermore, concerning the local governments, the following points will be pursued with vigor, among other efforts.

- Concerning the “intensive reform plans” to be publicized to the people by local governments based on the “New Local Administrative Reform Guide,” the Ministry of Internal Affairs and Communications will provide information with appropriate indices in a way that allows for the comparison of the progress of the reform among different local governments at glance. Furthermore, with the cooperation of local governments, a public announcement system will be established within FY2005 which will allow comparative analysis of payroll information (such as salary, various bonuses, number of employees for each rank) and financial status.

(2) Reforming Total Personnel Expenses for Public Employees

(Reducing the total expenses for public employees)

Paying attention to the relevant points including those listed below, the Government will establish a basic policy direction for the total personnel expenses reform by the autumn of FY2005, and will reflect it in the budget and local financial plans of FY2006 and thereafter. In so doing, the Government will work to reduce the total personnel expenses in the public sector as a whole.

- Concerning the central government, a personnel reduction plan will be established to promote a drastic relocation of personnel. Meanwhile, a greater net reduction throughout the whole sector must be attained, by measures such as a thorough review of administrative works and projects. Building on the previous achievement of net reduction, the Government will decide on the net reduction target for the next personnel reduction plan period, while also taking into account the administrative demands.
- Concerning the local governments, the task is to make a clear quantitative target for the personnel quota to achieve the net reduction target of the “New Local Administrative Reform Guide.”

(Promotion of public-private interactions of the public employees)

To ensure the effectiveness of the reform of public employees, the Government will work continually on public-private interactions, among others.

Section 3 – To Realize a New Dynamic Era—Overcoming Aging and Globalization

1. Vigorous Implementation of Fiscal Structural Reform— the Reform of Both Expenditure and Revenue in an Integrated Manner

The Government aims to achieve a surplus in the primary balance of the central and local governments combined in the early 2010s.

To achieve this objective, the central and local governments will take concerted action to promote the reform of both expenditure and revenue in an integrated manner and reach a conclusion concerning the medium-term measures to improve the primary balance within the concentrated consolidation period. In this regard, the Government will advance the reform following the three principles mentioned below.

- i. Principle of “small and efficient government”: Under the motto “no tax increase without expenditure cuts,” expenditure cuts and administrative reform will be carried out thoroughly to minimize the necessary increase of the tax burden as much as possible.
- ii. Principle of Vitality: Fiscal soundness will be pursued in balance with Economic vitality.
- iii. Principle of Transparency: Options of reform and future prospects will be presented to the public as deliberations continue.

Within approximately one year, the Government will deliberate on medium-term goals for the central and local governments regarding the scale of government expenditures and the major

areas of expenditure, as well as revenue, in an integrated manner. Moreover, within approximately one year, the Government will clarify options for the direction of the reform and the process of the reform through deliberations within the CEFP and on other occasions.

2. Ensuring Safety and Reassurance of the Nation

While ensuring safety and reassurance of the nation is one of the fundamental responsibilities of the Government, it also serves as the basis for economic revitalization.

The Government will promote disaster prevention investments including measures against large-scale earthquakes such as earthquake-proofing of public facilities and housings, as well as soil conservation and flood control measures. Meanwhile, safety measures for public transportation on land, sea and air will be promoted comprehensively. Furthermore, as the increasing incidence of crimes and their diversification is causing significant anxiety among the people, the Government will promote measures to improve public law and order, and revive “Japan as the safest country in the world.”

3. Building a Sustainable Social Security System

(An integrated review of the social securities)

Building on the “Basic Policies 2004,” the Government will continue advancing the integrated review of the social security.

(Measures to suppress an excessive increase in expenditure to secure sustainability)

In a super-aging society, the sustainability of social security system is essential for the life of the nation. The perspectives of the “reassurance of the nation” and “sustainability” are of primary importance when thinking of social security benefits in the future. To that end, it is necessary to pay attention to Japan’s economic scale and its trends, while concretely and strictly suppressing an excessive or unnecessary increase in expenditure. From this perspective, the Government will work on the following points, among others.

- (1) Concerning the increase of social security benefits, taking note especially of the rapidly increasing medical services, the Government will set a policy objective aiming for a substantive achievement in rationalizing medical expenses. Necessary measures will be taken to achieve this objective after reviewing the achievements periodically from all perspectives. Concerning the abovementioned objective, a conclusion will be reached by the end of 2005, along with concrete measures to achieve it by considering issues such as the burden level that the nation can tolerate, the aging population, local efforts and the characteristics of medical services. On that basis, the Government will boldly implement

the FY2006 medical system reform.

- (2) In order to achieve the abovementioned objective, comprehensive and immediate efforts will be made while assessing the effects of the measures taken so far.

(Social Insurance Agency Reform)

Concerning the Social Insurance Agency reform, the current Social Insurance Agency will not be maintained. As for Government-managed health insurance, its operation will be separated from the central government with the aim of establishing a public corporation run on a national basis. As for public pensions, the measures to be taken include operation by a new governmental system with a drastically reformed organization and function.

(Reform of Central Social Insurance Medical Council)

Concerning the Central Social Insurance Medical Council (CSIMC), considering the deliberations in the “Advisory Council on the Role of the CSIMC,” the Government will work on reforms such as revising the number of members representing public benefits to strengthen the function of public benefits and reflect the opinions of healthcare professionals from various institutions such as hospitals into the deliberations.

4. Fostering the Next Generation

(Measures to reverse the declining birth rate)

With a society of declining population at hand, the role of households, families and community must be emphasized. Through their cooperation, the Government will promote as its basic policy measures to reverse the trend of a declining birth rate in order to build a society in which the people will feel comfortable giving birth to children and bringing them up. Specifically to ensure that individuals can maintain a balance between work and personal life (including childcare) and select various ways of working depending on his or her incentives and abilities, the Government will engage in measures such as the promotion of environmental improvements as a national campaign with public and private participation, while taking into account the needs of small-to-medium-sized enterprises.

Furthermore, to deliberate on comprehensive support measures for women in issues including their reemployment and business promotion, the Government will establish “Conference on support measures for women’s renewed challenges” (provisional title) by related ministers, and within 2005 will formulate the “Support plan for women’s renewed challenges” (provisional title). In addition, to expand the options of various ways of working such as shorter time shifts, the Government will promptly deliberate on the implementation of a shorter time working system for employees of the national government so that it can serve as a model.

(Educational reform)

Concerning compulsory education, a guideline for the implementation of an external assessment and publication of the results will be made within FY2005, and with regard to the freedom of choosing schools, the Government will foster appropriate implementation depending on the local circumstances and facilitate nationwide adoption.

By autumn of FY2005, basic policies for revising the curriculum guidelines will be compiled. Furthermore, to assess and analyze the academic abilities of students and to strive for the improvement and upgrading of teaching methods based on these assessments, appropriate measures will be deliberated, including nationwide academic ability surveys. Along with their implementation, the Government will strive to improve “solid academic prowess” by a variety of education and teaching methods such as small-group guidance differentiated by the level of proficiency.

The Government will emphasize education aimed at improving human capability from an early age, and promote sound fostering of juveniles and their vocational training.

Furthermore, concerning higher education, the Government will promote improvement in the quality of education and research in graduate schools.

5. Strengthening Human Capability

The foundation of Japan is “individuals.” As Japan faces globalization and strives to sustain its growth as well, it is essential to establish a society in which each individual is able to realize his or her capacities to the fullest extent. Measures will be taken to that end.

Especially concerning the young generation with high incidence of unemployment due to employment mismatches, the Government will take the following policies.

- (1) On promoting effective and efficient capacity building, it is important to further utilize the occupational training facilities of the private sector and take other measures to facilitate competition among training facilities. Therefore, from the standpoint of maximizing the individual’s freedom of selection, the Government will deliberate on matters such as the effectiveness and problems of the voucher systems for occupational training for youth and will aim to come to a conclusion within a year, while examining the efforts made overseas and by the local governments.
- (2) While inspiring an incentive to work within young workers, the Government will promote

their vocational independence. To reverse the trend of an increasing number of the NEET⁴ and the “freeters,” the Government will strengthen and promote the “Independence and Challenge Plan for Young Workers.”⁵ For example, the Government will enhance and strengthen the plan to convert 200,000 ‘freeters’ to full-time employees and take measures concerning the NEET such as improving the local consulting systems. The Government also will further promote measures such as career education to cultivate views toward work, etc. among children and students and promote business-university networks in the regions.

In addition, in order to utilize foreign human resources, the Government will facilitate the acceptance of skilled foreign laborers. As for the acceptance of foreign workers in fields that are currently not recognized as specialized or technical, the Government will deliberate in a comprehensive manner, taking into account the possible effects on the livelihood of the nation. Furthermore, in order for foreigners working in Japan to fully exercise their abilities, the Government will facilitate Japanese language education, foster foreign human resources, and promote the improvement of living and working environments.

The Government will also promote practical education such as economic education in areas including finance, alongside with encouraging international education systems in schools.

Furthermore, based on “Food Education Basic Law” the Government will draw up a basic promotion program for Food Education, and will promote food education as a national campaign through the cooperation of related administrative agencies and other institutions.

6. Strengthening Global Strategy

The CEFP will draft “The Global Strategy of Japan” (provisional title) by spring 2006, in order to tackle globalization in a comprehensive and strategic manner through measures including economic diplomacy, domestic structural reform, regional management and an international division of labor.

In addition, the Government will actively pursue the following measures.

- (1) To develop industrial competitiveness indispensable to overcoming the challenges of globalization, the Government is pursuing the “New Industry Promotion Strategy 2005,” along with efforts to establish an efficient international distribution system.

⁴ NEET stands for Not in Education, Employment or Training, referring to young people who are not students, employed, or in vocational training.

⁵ “Independence and Challenge Plan for Young Workers” (24 December, 2004)

- (2) Aiming for objectives such as fostering and strengthening of global cutting-edge technologies and creation of new values, the Government will work to realize Japan as an “Advanced Science and Technology-oriented Nation”, promote information technology (IT) strategies, and promote intellectual property (IP) strategies.
- (3) To foster the development of strong regions that can compete with the world and to disseminate the fruit of private demand-led economic growth to the regions, the Government will support regions making efforts to increase their vitality. As a part of this effort, fostering regions that can transmit their initiatives to the world, the Government will establish highly advanced hubs grounded in the regions’ advanced environmental and recycling technologies, and promote the recycling of resources and the development of human resources in Asia. Along with this, the Government will work on regional revitalization, urban renaissance, expansion of Special Zones for Structural Reform, and the tourism promotion strategy, promotion of culture, art and sports.
- (4) In order to foster strong agriculture, forestry and fishery industries, the Government will advance structural reform based on policies such as the “Basic Plan for Food, Agriculture and Rural Areas”⁶. Furthermore, efforts to expand the export of agricultural, forest and marine products will be accelerated.
- (5) The Government will accelerate the international partnership by promoting EPAs and by strengthening and accelerating the Program for the Promotion of Foreign Direct Investment in Japan.

Also, the Government will continue its efforts towards the goal of providing official development assistance (ODA) of 0.7% of our gross national income in order to contribute to the Millennium Development Goals.

- (6) While maintaining a balance between environmental and economic goals, measures for global environmental issues will be strengthened. Aiming for the achievement of the reduction pledged in the Kyoto Protocol and the development of a society that emerges from global warming, strategies to effectively utilize the Kyoto Mechanism will be carried out based on the “Kyoto Protocol Target Achievement Plan,”⁷ such as reductions of greenhouse gas emissions and carbon dioxide sinks by forests, which will be promoted by the maintenance and conservation of forests. Along with this, the Government will promote national campaigns and advance technological developments. Furthermore, the Government will work to establish a Sound Material-Cycle society and, in this regard, will respond to environmental and energy issues in a comprehensive manner.

⁶ “Basic Plan for Food, Agriculture and Rural Areas” (Cabinet Approval: 25 March 2005)

⁷ “Kyoto Protocol Target Attainment Plan”(Cabinet Approval: 28 April 2005)

Section 4: Economic and Fiscal Management and FY2006 Budget

1. Future Economic Trends and Concepts regarding the Present Economic and Fiscal Management

- The Japanese economy in FY2005 as well as FY2006 is expected to continue a moderate recovery led by private demand.
- Emphasizing private sector demand and expanding job opportunities, the Government will engage in a more full-fledged and comprehensive promotion of the four areas of structural reform: regulatory reform, financial system reform, tax reform and expenditure reform.
- To secure the emergence from deflation within the concentrated consolidation period, the Government, together with the Bank of Japan, will further strengthen and expand policy efforts. The Government will further accelerate and expand structural reform, with improvement of the gap between demand and supply as one of the aims. The Government expects that, considering market trends and expectations, the BOJ will exercise effective monetary policy management, which will be consistent with the Government's efforts for emergence from deflation and the economic perspective in the concentrated consolidation period presented in the "Structural Reform and Medium-term Economic and Fiscal Perspectives - FY2004 Revision".

2. Securing a Private Demand-led Economic Growth—Policy Shift for Revitalization

- (1) Regulatory reform and opening up to the private sector (such as the active promotion of transfer of public operations to the private sector)
- (2) Finance system reform (such as efforts to swiftly legislate the “Investment Service Law” [provisional title])
- (3) Tax reform (such as concluding the comprehensive tax reform within the concentrated consolidation period)
- (4) Reviews of expenditure aimed at revitalization: (For instance, prioritization and streamlining of public investment; science and technology policies to strengthen selection and concentration, as well as examination of outcome goals and ex post verification; review of the direction of support to education; and promotion of developing statistics.)

As for public investment, the Government is coming very close to achieving the target of the “level before substantial additions were made for the sake of counter-cyclical measures.” The Government will continue to steadily promote efforts to achieve the target.

3. Basic Direction of FY2006 Budget

(Maintaining and strengthening expenditure reform without exception)

The FY2006 budget is significant as it is the very last budget of the concentrated consolidation period. Toward the “completion of reform,” the central and local governments must keep in line with each other to continue the stance of FY2005 to adhere to and strengthen the expenditure reform.

(Concerning prioritization and restraint)

- The Government will concentrate its measures in alliance with the goals set forth in “Basic Policies 2002,” and will promote the efforts outlined in Section 2, Section 3, and strategy 2 of Section 4. In so doing, bearing in mind the “Three Principles for Revitalization,” the Government will prioritize and streamline its budgetary allocation.
- Concerning the budget as a whole, the Government will make efforts to streamline the budget by utilizing private sector vitality such as consignments to the private sector and private finance initiative (PFI).
- Total personnel expenses for public employees will be reduced within the FY2006 budget.
- For special accounts, measures such as system reform and review of administrative work and projects will be carried out, depending on the nature of each special account. The Government will promote the streamlining and rationalization of expenditure and reduce special account expenditures as well as transfers from the general account and loans from other sources including the private sector.
- Incorporated administrative agencies that have been converted from Government-affiliated institutions will be strictly reviewed in terms of the necessity of the organization and its activities, and measures such as abolishment, downsizing and prioritization will be carried out.
- From the standpoint of the taxpayers, the content of the deliberations at the “Liaison Conference of Related Ministries on the Streamlining of the Government” will be reflected in the budget request, the organization, the number of personnel, and the disbursement of the budget.