

## **Direction and Strategy for the Japanese Economy<sup>1</sup>** **- Path to New “Innovative Growth” -**

### **Introduction**

(Emergence of Japanese economy from a long tunnel of stagnation)

Japanese economy has at last left a long tunnel of stagnation.

After the burst of the bubble economy, companies adjusted their excesses in employment, capital stock and debt, banks were forced to write off a huge amount of non-performing loans, and SMEs faced liquidity difficulties. Also, in this process, people confronted employment difficulties and uncertainty. The “Reform and Perspectives”<sup>2</sup> formulated five years ago had returning the economy to close to normal state as its greatest target. Under a medium-term policy of promoting structural reform without relying on public spending, reforms including disposal of non-performing loans was promoted across the whole economic society.

Although it took more than 10 years to deal with the “negative legacy” of the bubble economy, the maximum efforts of the people normalized the non-performing loans problem of the major banks, and the “Three excesses” problems of industry were largely resolved. The economy started improving after bottoming out at the start of 2002, and even though there is imbalance between local economies, a sustained recovery is continuing. Bright prospects are opening before the Japanese economy in the process of emerging from deflation.

Now is the time to set new goals and implement a strategy that will allow us to achieve them. What must be tackled from here on is not reform in order to eliminate the negative legacy of Japanese economy, but reform in order to open the way to new possibilities. At the same time, these reforms must be meaningful to Japanese people in a variety of environments, such as “NEETs” (those Not in Education, Employment or Training) and “freeters” (job-hopping part timers) who have increased in number during the long period of deflation, and the SMEs in the local economies that still face severe conditions.

(Creation of “a beautiful country” through “Innovative Growth”)

From here on, Japan’s goal is to create “a beautiful country”, and realize “Innovative Growth” in the economic society.

Reflecting back on the past 10 years or more, various lifestyle changes have occurred. Japan as a society continues to age with fewer children, and the baby-boomer generation is reaching retirement age. Types of employment and ways of working have also changed. The IT revolution has changed communications, and exchanges with Asia and other countries have been made much closer to the people.

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<sup>1</sup> Hereafter referred to as “Direction and Strategy”.

<sup>2</sup> “Structural Reform and Medium-Term Economic and Fiscal Perspectives” (Cabinet Decision of January 25, 2002). Hereafter referred to as “Reform and Perspectives”.

The core of this strategy is to respond to these changes, create new lifestyles for the people and a new economic society, and realize growth through these efforts.

Japan, overcoming its aging and low-birthrate society, and building a economic and social model that maintains a high quality of life for its citizens, will contribute in the future to other societies confronting the same type of problems.

(The shape of “New Growth Economy”)

It is necessary to build a economic society that realizes such “Innovative Growth”; in other words, “New Growth Economy”. This is a economic society with vitality, opportunity and compassion as described below.

- The spirit of self-discipline will be respected, and private efforts will be maximized in a free and disciplined market. The potential power of Japanese economy will be drawn out by the power of innovation<sup>3</sup> and a system open to the world. Local society would also develop individuality and demonstrate potential energy.
- People’s efforts will be rewarded, inequalities will not be entrenched, and there will be diversity in ways of working, learning and living, with multi-tracked life possible. The power of “human resources”, which is the wellspring of growth power, will be exerted to the full.
- A good environment and a safe and healthy society will be maintained as the foundation for each individual to flourish, and with a reliable safety net people will be able to feel peace of mind about employment, elderly life and child-raising.
- The Government will respond flexibly to economic and social changes, and fulfill its role with efficiency. The administrative and financial system will be realized as the foundation of the economic society with vitality, opportunity and compassion.

(The role of “Direction and Strategy”)

“Direction and Strategy” indicates the shape of economic society that Japan should aim at, and the medium-term policy of economic and financial management from here on in order to realize it, fulfilling the role to provide unified direction to overall government policy and ensure its consistency. It also achieves the accountability of the Government to the people, and is expected to provide information for economic decision making to the private sector. In adopting “Direction and Strategy”, “Reform and Perspectives” have been abolished.

(Applicable period for “Direction and Strategy”)

The applicable period for “Direction and Strategy” is the next five years (FY2007–FY2011). However, for the fiscal consolidations, a longer period applies.

(Revision of “Direction and Strategy”)

In order to respond appropriately to economic and financial situation changes and the need for new policy responses, “Direction and Strategy” will be revised every fiscal year,

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<sup>3</sup> Innovation means not simply “Technical improvement”, but initiating strong economic and social change incorporating new technology or ways of thinking into broad social systems and people’s livelihoods to create new values.

including objectives, policy responses and perspectives. In particular, from the standpoint of strengthening the PDCA Cycle (Plan-Do-Check-Action), analysis of the situational change in economics and finance of the previous fiscal year and its impact will be made and reflected to the revisions.

(Link with various government plans)

It is necessary that medium-term government plans (public work related plans such as “National Land Sustainability Plan” and “Priority Plan for Social Infrastructure Development”, “Plan for the Promotion of Decentralization Reform”, “vision of a regional government (*doshu-sei*)”, “Innovation 25”, etc.) to be formulated are particularly consistent with “Direction and Strategy”.

## Chapter 1. Issues Facing Japanese Economy and New Possibilities

To realize the “New Growth Economy”, it is necessary to overcome issues facing Japan, and strongly nurture the possibilities that are being newly created.

### (1) Three Issues Facing Japanese Economy

Considering the current state of Japanese economy, there are points that need to be noticed, such as the recent weakening of the ripple effect from the robust corporate sector to the household sector.

Among the issues facing Japan, particularly important from a medium to long-term perspective are the following issues.

#### ① Restriction on growth resulting from factors such as a declining-population

From 2005, overall population of Japan started to decline and the society with a declining population has become a reality. Furthermore, in several years onward from 2007, the “Direction and Strategy” target years, the so-called “Baby-Boomer Generation” is to reach 60 years of age. If no particular measures are taken, a sharp decline in the labour population is expected. First of all, it is important to make an effort to reverse the downward trend in the birthrate as basic national policy, and with the labour population declining, the most important issue is to increase productivity. If this is not achieved, the potential growth rate will decline.

Also, solving environmental problems such as global warming is an urgent issue on a global scale, and they will become factors limiting long-term economic growth if they are not aggressively tackled.

#### ② Concerns over imbalance between areas and entrenchment of inequalities

Japanese economy has been continuing its sustained recovery, but there are imbalances in the recovery between urban and rural areas and between enterprises according to the scale. After the recent years of employment difficulties, the number of non-regular employees, including the youth segment such as freeters, as well as that of NEETs, has increased. There is concern that the society will become stratified into the groups of so-called winners and losers, if this situation continues in the long-term.

#### ③ Extremely severe fiscal situation

It is expected that the deficit in the primary balance of the central and local governments combined improve from the high level of 5.7% of GDP ratio in FY2002 to about 0.6% of GDP ratio in FY2007, but the situation still remains extremely severe. Furthermore, when the stock is considered, outstanding government debt<sup>4</sup> as a ratio of GDP is expected to be about 141.1% in FY2007, a particularly severe situation amongst the major advanced countries.

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<sup>4</sup> Here this refers to the sum of general bonds, local government bonds, and the borrowing by the special account for the local allocation and local transfer tax. However, this includes the borrowing allocated to the general account from the special account for the local allocation and local transfer tax in FY2007.

The current fiscal situation is that future generations bear the burden structurally, and if this situation is left unchanged, it will have a negative impact on medium to long-term growth through slow capital accumulation of industry.

## (2) Opportunity to Carve Out New Possibilities

Although Japan confronted such issues, if we calmly survey the environment surrounding Japan, we can find that buds of new growth as shown below are plentiful, and new possibilities have opened up. We must nurture these buds so that they blossom and lead to continued growth. Furthermore, despite the environmental limitations described above, by promoting technological innovation that overcomes these obstacles, we can instead strengthen our international competitiveness and link it to national growth. By maintaining economic growth, solutions are easily found to the above-mentioned issues. Conversely, if economic stagnation continues, problems will become more severe. For this reason, it is important to maintain the energy to grow.

### (Possibility of growth through innovation)

For depopulating Japan, innovation is a key to realizing economic growth. Particularly, in the fields of IT, environment science, nanotechnology and biotechnology, various innovations are occurring, so strong increases in productivity are expected through promoting their applications in a wide range of fields and changing the economic and social system to meet the needs of the times.

### (Mechanism of growth with Asia)

The growth power of Asia, the world's growth center, can provide a strong stimulus to increase Japan's vitality. It is necessary for Japan to strengthen mechanisms for growing together with Asia, and lead the formation of an integrated market based on an international business cooperation network and its cultural strength as a core nation of Asia.

### (The consumer market that produces new goods and services)

Japanese consumer market seeking sophistication and high quality produces new goods and services through rigorous competition between companies. From here on, with the number of mature consumers increasing as Japanese population ages, it is expected that the sophisticated and diversified consumer needs and the development efforts of companies responding to those needs will produce a favourable cycle. Particularly, in the field of health and medical treatment, education and industrial training, and housework and child-raising support, consumer demand is expected to increase for services directly connected with people's lives. The key to realization of such consumer market producing new goods and services lies in the reform of non-manufacturing industry, which currently cannot adequately respond to potential demand due to regulatory restrictions and so forth.

## (3) Acceleration and Deepening of Reform

In order to seize such opportunities, it is indispensable to escape from the bureaucracy-led economic and social system that has supported the "post-war regimes", and switch to a economic and social system supported by freedom and discipline. Under the economic and social system that has been preserved despite institutional fatigue and

its mismatch with current realities, the potential of Japanese economy is not fully realized. However, the various necessary reforms have faced obstacles which are even more persistent than before, and become more difficult. Considering the increasing severity of global competitiveness and declining population, this could be the last chance for Japan to build a system for sustainable growth. It is necessary to accelerate and deepen our efforts at reform with new strategies.

## **Chapter 2. Shape of the Target Economic Society** **-Society Full of Vitality of the “New Growth Economy” -**

This chapter will more specifically depict the shape of the “New Growth Economy”. This will be built upon the following four pillars: ①Strengthening Growth Potential. ②A Society that Guarantees a Chance to Challenge Again and Again. ③A Healthy and Safe Society. ④An Administrative and Financial System That Befits this 21<sup>st</sup> Century.

### **(1) Strengthening Growth Potential**

To strengthen growth potential, it is necessary to build a mechanism for growing together with the world in the global market, and to build an economic system that develops innovation by enhancing human resources that hold the key to growth. Instead of a nationally-led economy, local economies will be developed that are supported by supra-regional economies full of individuality and vitality.

#### **(Acceleration of growth)**

For Japanese economy to sustain stable growth as its population decreases, productivity of the overall economy must increase substantially. By tackling this issue in accordance with the “Direction and Strategy” policy, Japanese economy will be elevated to a new stage for economic growth over the medium to long-term, and the aim is to switch to the “New Growth Economy” during the next five years. Through these efforts in the next five years, the real growth rate of about 2% or even considerably higher can be expected.

#### **(Increase productivity through the strength of innovation)**

A economic society where innovation is easily incubated through a mix of technology, products, services, business models and social system will be aimed for. The applications of the IT sector, which contributes strongly to growth, will be expanded and deepened across a wide range of fields, and infrastructural sophistication will be achieved<sup>5</sup> to raise the productivity of the overall economy.

In order to do this, it is necessary to convert to a economic and social system that is appropriate, and make overall reforms across the labour market and consumer market. In the labour market, it is necessary to train human resources skilled in new technology and to strengthen skills so that labour transfer to higher productivity fields is facilitated. In the consumer market, besides eliminating regulations and practices hindering full application of the benefits from the IT revolution centered around service industries, it is important to promote the entry of new participants through regulatory reform, such as the field of the so-called government-driven markets.

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<sup>5</sup> Elimination of broadband-zero areas by FY2010, and complete transition to digital terrestrial broadcasting in 2011, etc.

At the same time, it is important to promote start-up enterprises and capital stock spending by building up the institutional infrastructure as well as promoting research and development, and system reform that returns to society the fruits of that R&D (See Reference Chart 1: Changes in Vintage of Capital Stock). By tackling these factors, manufacturing industry and non-manufacturing industry will be the “Twin Engines for Economic Growth”, and will strongly increase the productivity increase rate of the overall economy (See Reference Chart 2: Changes in the Growth Rate of Total Factor Productivity (TFP)).

(Building an open economic system)

Japanese economy still remains a major presence among the rapidly growing economies of Asia (by GDP share, about 47% in 2005). In order for Japan to link up with Asia and other regions of the world, grow together and lead their development, Japan will promote “Proactive Economic Diplomacy”.

In multilateral negotiations such as through the WTO, Japan will exercise its leadership and aim for an early conclusion of the WTO Doha Round negotiations. Japan will strengthen the efforts to conclude EPAs (Economic Partnership Agreements) while giving appropriate consideration to their impact on Japanese agriculture, forestry and fishery industries and to the progress of the structural reform in these industries. As a result, it is expected that the number of countries concluding EPAs with Japan will be increased at least triple (12 or more) in the next two years (See Reference Chart 3: Status of concerning EPA (Economic Partnership Agreement) negotiations).

As international mobility of people, goods, capital, culture and information increases, Japan will proceed to build up institutional infrastructure to attract these factors, double stock of inward foreign direct investment as a ratio of GDP to about 5% by 2010 (See Reference Chart 4: Changes in Outward and Inward Foreign Direct Investments (GDP ratio)) as a first step to increase it to almost the same level as other countries, and promote domestic and foreign people, goods, capital, culture and information accumulation. Furthermore, the Government will promote various measures toward making Japan a country built on tourism, with the number of foreign visitors to be increased to 10 million people by 2010, and expand the number of major international conferences held in Japan by at least 50% within five years.

(Building regional societies full of individuality and vitality)

A nation will not be vitalized unless its regions are vitalized. Building regional society in which citizens can have pride is the foundation of “a beautiful country”. In order to build regional societies full of individuality and vitality, decentralization and regional administrative and financial reforms will be advanced, regional resources, including the natural environment, will be utilized, and regional industry will be promoted. Furthermore, it is necessary to proceed with the formation of supra-regional economies and seriously investigate into a regional government (*doshu-sei*).

It is also important to rebuild regions under private leadership and form “a wealth of public service” providers such as non-profit organizations(NPOs), charitable organizations, social entrepreneurs and regional residents’ associations by improving the environment for their activities and networking (See Reference Chart 5: Changes in the Number of NPO Authorizations (cumulative total values)).

## (2) A Society That Guarantees a Chance to Challenge Again and Again

(Society in which ways of working, studying and living are diverse and multi-tracked)

The Government will aim for a economic society in which a variety of choices and a multi-tracked lifestyle choice is possible in respect to ways of working, learning and living at each stage of life. Furthermore, the Government aims to achieve a fair society in which each citizen can fully demonstrate their abilities and characteristics, and be rewarded for their efforts. Hereby, the Government will ensure that there will be no stratification into winners and losers, and even if people fails at their job or business, they will be able to try again in accordance with their eagerness and capability.

(Society in which anyone can work according to their eagerness and capability)

In response to the age of the “80-year lifespan”, the Government will aim for a society that offers elderly people with the eagerness and capability to have the opportunity, to work irrespective of their age. The Government will build a society in which elderly people can work in a variety of modes and in which it is possible to be actively employed at age 70.

The Government will aim for a society in which it is possible to blend in work and personal life irrespective of gender and promote the development of an environment in which it is also easy for women to work.

The working environment where NEETs and freeters can smoothly have employment opportunities will be built, with the aim of reducing the number of freeters to 80% of their peak level by 2010.

Furthermore, the Government promotes the transition of disabled workers from welfare-type employment to general employment.

Through the wide-ranging measures including above, the Government will endeavour to raise the employment rate for elderly workers, women, youth and the disabled. Accordingly, not only will each individual be able to realize more satisfying lifestyle, but the supporting hand of social security will also be increased.

(Support for a new challenge)

The Government will aim for a economic society vigorous to the challenge of starting new businesses and so on. The entry rate of enterprises for Japan (number of new businesses / total number of businesses) is low by international comparison, and particularly since the 1990s it has been stagnant at the 3% level. (See Reference Chart 6(1): Changes in Entry Rate of Enterprises and Reference Chart 6(2): International Comparison for Entry Rate of Enterprises(1988-1994)). Considering that the normal level is about 10% for Europe and the US, it is necessary to steadily increase the level in Japan. By supporting the prevention and relief of multiple debt, the restart and revitalization of businesses, people who fail once will be easier to recover.

## (3) A Healthy and Safe Society

(Constructing a sustainable and reliable social security systems)

The social security provides a safety net against the risk of life. In order to construct a system that places value on the spirit of self-reliance and is easy to understand as well as compassionate, reliable and sustainable<sup>6</sup>, it is necessary to verify the balance between the benefits and burdens on a constant basis to review both sides of them, and to balance the system with the economy and finance. Accordingly, with roles appropriately being shared among self-help, mutual help and public help, the Government aims to ensure intergenerational equity as well as to curb service supply costs through rationalization efforts while maintaining and improving the service quality.

(“Child-raising friendly society” and rebuilding education)

With the satisfying experience of child-raising and the values of family shared throughout society, the Government will build a society where children can be born in security, the environment is maintained to make it easier to raise children, and both child-raising and work are compatible; in other words, “child-raising friendly society”. Along with local government and corporations, etc., the Government will powerfully and effectively promote measures against the birthrate decline as a national basic policy and in order to reverse the downward trend of the birthrate (See Reference Chart 7(1): Changes in the Total Fertility Rate and Reference Chart 7(2): International Comparison for the Total Fertility Rate) thus society as a whole will support child-raising families.

In order for the Japanese to build up their sound mind and bodies as well as nurture the rich humanity throughout their lifetime, Food Education will be promoted as a national movement.

In order to realize “a beautiful country”, education is regarded as an important foundation. In light of the concepts of the revisions to the Fundamental Law of Education, we will strive to rebuild education to train disciplined individuals equipped with a rich sense of humanity and creativity, who value family, region, country and human life.

(Safe and secure society that will be a global model)

The Government will aim to build a safe and secure country that will be a global model. Ensuring national safety and security is a basic responsibility of government and a basis for stable economic growth.

The Government will actively tackle environmental problems by creating a society which works to remedy global warming and which is active in recycling in order to realize a sustainable society.

(Society where rules function)

Vigorous economic activity is only possible with fair competition among economic discipline which compete with each other in accordance with the rules of a healthy

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<sup>6</sup> It is forecast that social security benefit costs as a ratio of national income will rise from 23.9% in FY2006 to 26.1% in FY2025, and the burden relating to social security (social insurance contributions and public costs) as a ratio of national income will rise from 22.0% to 26.5% (“Prospects for provision and burden of social security” by Ministry of Health, Labour and Welfare (May 2006)).

market society, as well as relationships of trust established between them. Furthermore, only when effort is fairly rewarded can a vigorous society be created. As the foundation for such a society, we will establish a transparent, well-disciplined fair market. To achieve this, we will move from a bureaucracy-regulated society with a view “from regulations to disciplines”.

#### (4) An Administrative and Financial System That Befits this 21<sup>st</sup> Century

(Administrative and financial system and size of government suited to the age)

Aiming at building an administrative and financial system that befits this 21<sup>st</sup> century, the structure of administrative organizations, the budget system and the tax system, etc. will be comprehensively reviewed.

Concerning the size of the Government, it has been stated that “For example, the goal for the potential national burden rate is about 50%, and a rise in scale of government will be restrained”<sup>7</sup>, and during the period of “Direction and Strategy”, the rise will be restrained as much as possible<sup>8</sup> (See Reference Chart 8(1): Changes in Potential National Burden Ratio (National Income ratio) and Reference Chart 8(2): International Comparison for Potential National Burden Ratio (National Income ratio)). The scale of the Government assets and the total personnel expenses for public employees will also be shrunk over the long term.

(Decentralization reform and reform of local public administration and finance)

Real decentralization will be realized, and a system built so that administrative services can be selected through the judgment and responsibility of the residents, taking into account the benefit and burden. To achieve this, decentralization reform will be powerfully promoted, and the autonomy of regions will be advanced in both power and financial aspects, with for example, the number of municipalities that do not need to depend on local allocation tax, by setting a specific target, such as half of cities with a population of 200,000 or more (See Reference Chart 9: The number of cities not entitled to the local allocation tax grant with a population of 200,000 or more). A new fiscal rehabilitation system will be developed and rules will be applied to the finances of local government.

(Fiscal consolidation)

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<sup>7</sup> Stated in “Basic Policies for Economic and Fiscal Management and Structural Reform 2003” (Cabinet decision of June 27, 2003).

<sup>8</sup> The scale of the Government in the economy is falling slightly as a result of progress in administrative and financial reforms. However, social security costs will increase from here on, and, with government debt outstanding accumulating, interest payments on public debt may be sharply increasing depending on interest rate trends. Accordingly, it is possible that the scale of government will expand sharply.

In order to maintain economic growth, fiscal consolidation is indispensable as the other wheel sharing an axel. In accordance with “Basic Policies 2006”<sup>9</sup>, Integrated Reform of Expenditures and Revenues will be steadily promoted, and the Government will definitely achieve a surplus in the primary balance of the central and local governments combined by FY2011 as a first step (See Reference Chart 10: Changes in Primary Balance (GDP ratio)). And the central and local governments will ensure the prevention of a divergence in the ratio of debts of the central and local governments to GDP and the stable reduction of the ratio toward the mid2010s.

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<sup>9</sup> “Basic Policies for Economic and Fiscal Management and Structural Reform 2006” (Cabinet decision of July 7, 2006). Hereafter referred to as “Basic Policies 2006”.

### **Chapter 3. Strategy toward Realizing a “New Growth Economy” - Path to New “Innovative Growth” -**

This chapter outlines the medium-term policy for the strategic promotion of economic and fiscal policy in accordance with the four pillars described above. In particular, designating the first two years (FY2007 and FY2008) out of the next five years as the “take-off period” toward realizing a “New Growth Economy”, the Government will concentrate on reform for it.

#### **(1) Bold Reforms to Enhance the Growth Potential**

Under appropriate macroeconomic management, in accordance with “Basic Policies 2006” and “Economic Growth Initiative”, bold reforms will be implemented to enhance the growth potential. “Economic Growth Initiative” will be rolled over with quantitative revision each fiscal year.

Also, the Government will make efforts such as “Asia Gateway Initiative” to build an open society.

#### **(i) Appropriate macroeconomic management**

##### **(Stable economic and fiscal management)**

The experience of these past five years suggests that considerable confidence can be placed in the autonomous recovery power of Japanese economy. Indicating the medium-term fiscal management policy clearly, the Government will continue efforts toward both economic growth and fiscal consolidations, and stable economic and fiscal management without relying on easy public spending.<sup>10</sup> However, if the economy confronts an unusually extreme severe situation such as an economic crisis from an externally generated shock, the Government will respond boldly and with flexibility.

##### **(Timely and appropriate monetary policy)**

It is necessary to ensure the stable inflation rate compatible with sustainable economic growth led by private-sector demand so that deflation does not return. To achieve this, the Bank of Japan is expected to share the basic perspectives with the government on macroeconomic management, and apply timely and appropriate monetary policies which are consistent with the economic perspectives indicated in “Direction and Strategy”.

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<sup>10</sup> Easy public spending hinders autonomous development of the private sector, and its termination has a minus effect on the economy as a rebound. These effects could amplify economic fluctuations, and could reduce growth potential in the medium to long-term.

(ii) Efforts to increase productivity

(Productivity increase through IT and innovation in service industries)

It is IT that becomes the most important means of increasing productivity across industries. Through IT, the Government will strengthen competitiveness and improve the management capabilities of SMEs, and expand the media contents market. The Government will expand the opportunities for employment using IT, such as aiming to double the number of teleworkers. At the same time, besides aiming to develop new-generation technologies supporting IT innovation, the Government will promote comprehensive policies to strengthen the international competitiveness of the IT industry.

Productivity of the service industries that comprise about 70% of Japanese economy, will be substantially increased by focusing efforts especially on the six service fields of health and welfare, child-raising support, tourism and visitor attraction, media contents, business support and distribution and logistics by developing human resources contributing to innovation in the field and by drastically developing statistics on services.

(Fundamental reform of the labour market<sup>11</sup>)

With realizing multi-tracked, fair ways of working to allow each workers to feel “pride and satisfaction in working”, fundamental system reform of the labour market and environmental development will be tackled from the following angles in order to maintain the economic vitality.

- ①The Government will change the environment and review related systems, such as clarifying the rules relating to labour contracts in response to diversified needs in terms of ways of working, the balance between work and child-raising, white collar working patterns not tied down by time, and the spread of working at home, such as through teleworking.
- ②The Government will improve the environment to enable smooth job-hunting and easy job switching. Under cooperation between private and public sectors, the functions of employment introduction and human resources training and vocational training will be strengthened.
- ③Besides expanding the application of social insurance coverage to part-time workers, the Government will aim to equalize the treatment in wages, etc. for regular and non-regular workers, and realize a fair labour market where workers can be satisfied in their work irrespective of gender, age or employment status. For youth, women and

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<sup>11</sup> “Fundamental reform of the labour market” aims to increase productivity through human resources allocation of the right person at the right place, and it is included in the policy on “Strengthening Growth Potential”, but at the same time, it also belongs in such policies as Challenge Again Support and Constructing a “Child-raising friendly society” to be described later.

elderly workers, the Government will also promote employment support suited to the needs of them.

- ④ The Government will consider the acceptance and methods of appropriate employment management for overseas workers in specialized and technical areas.

(Expansion of the private activities domain and regulatory reform)

Regulatory reform will be promoted in order to realize the “New Growth Economy”.

To make various public services provided to meet public needs appropriately, the Government makes the provision of public services as competitive as possible, by introducing the market testing into the public sectors whose performance might be poor, with the regulatory reform of the market where government controls strongly.

(iii) Enhancing international competitiveness

(Promotion of innovation and the other)

The Government will draw up and promote “Innovation 25”, a long-term strategy initiative with eye on the year 2025. Under the “3rd Science and Technology Basic Plan” and the “Comprehensive Strategy for Creating Innovation”, the Government will strategically promote such measures as an innovation superhighway initiative and try to create new industries leading the world and advance basic national technologies. In order to promote the successive creation of innovation, the Government will advance innovative research and development through industry-academia-government cooperation and further enhance the creation, protection, and exploitation of intellectual property by developing the world’s shortest patent examination system and by strengthening strategic international standardization activities. Furthermore, besides strengthening the competitiveness of domestic industries, tackling the strategic and prioritized development of hard and soft logistics infrastructure, and strategically developing natural resources and energy policies, the Government will advance Asian environmental and energy cooperation.

(Strengthening mechanism of growth with Asia)

The “EPA Timetable” will be revised by the spring of 2007 for the purpose of strategic and effective advancement of EPA negotiations in accordance with the framework of WTO. Also, the Government will continue to engage actively in the maintenance and strengthening of the WTO system. Furthermore, the Government will promote study of broad regional economic partnership in East Asia, make efforts to establish OECD-style international systems, and engage actively in APEC. The Government will support the establishment of institutional infrastructure in each Asian country.

The Government will formulate the “Japanese Cultural Industry Strategy” to reinforce Japan’s international competitiveness and capability to dispatch information to the world in the field of contents, including animation and music, as well as food culture and traditional culture.

Various measures toward making Japan a country built on tourism will be promoted, and the number of people travelling back and forth between Japan and Asia will be increased. Comprehensive measures to support foreign residents in Japan will be promoted to build a society where multiple cultures coexist.

In order to develop a global strategy contributing to the enhancement of national interest, the Government will strengthen its diplomatic capacity through overseas diplomatic establishments to promote economic partnership, implement strategic assistance and secure natural resources and energy.

(Promotion of investment etc. by the improvement of institutional infrastructure)

From the viewpoint of achieving an international equal footing, the Government will promote development of institutional infrastructure such as the tax system and the corporate law system, and make investment environment in Japan more attractive. These measures will promote business start-ups, capital investment and inward foreign direct investment.

At the same time, the financial and capital market will be made more efficient and competitive, and the shift from savings to investments will be secured. Corporate governance will be strengthened.

(iv) Human resources as the key to growth

The Government will establish the society in which each individual can bring out their ability to the maximum, strengthen human resources training through industry-academia collaboration, and strengthen the international competitiveness of human resources in Japan.

Specifically, the quality of education will be improved by strengthening Japanese language capabilities and improving education in science and mathematics, and by 2010 Japan will aim at the global top level in the international surveys of academic ability. Besides promoting human resources mobilization between industry and academia, research and technical human resources will be trained and sound scholarship programs will be expanded, in addition to securing education and research funds for higher education and implementing investment in priority areas identified through third party evaluations.

Besides promoting practical education and training through industry-academia collaboration and science and career education utilizing engineers at local companies, young people's interest in manufacturing will be boosted, in addition to developing global top level research facilities, graduate school education will be fundamentally enhanced.

The foreign student system will be improved while securing high-quality foreign students and interchange between young people in Japan and foreign countries including Asian nations will be promoted. The acceptance of talented experts such as

foreign researchers and technicians<sup>12</sup> will be expanded, training and on-the-job training systems will be revised and residential management strengthened.

(v) Revitalizing local economies and small- and medium-sized enterprises (SMEs)  
(Revitalization of local economies)

Decentralization will be promoted so that the regions can develop their own measures to be reborn as “attractive regions” full of wisdom and ingenuity. At the same time, such efforts as urban renaissance, revitalization of central urban districts, promotion of special zones for structural reform and regional revitalization will be further developed and continued. Policy measures will be strengthened relating to revitalizing the regions, such as providing full information and know-how to the regions, building new networks of regional leaders, and implementing “Program for Helping Striving Regions to Help Themselves”. This is based on the following five viewpoints;①Drawing out and utilizing regional ideas, ②Advancing the development of regional leaders and other human resources, ③Utilizing tangible and intangible unique resources in the region, ④ Promoting international and interregional exchanges, ⑤Providing conditions for the sustainable and independent development of regional communities. In addition, the Government will expand and enhance measures and consider organizing menus of measures that can easily be implemented by communities.

Furthermore, the formation of broad autonomous regional economic zones will be encouraged, and such as setting a “vision of a regional government (*doshu-sei*)” investigation toward the realization of a regional government will be accelerated.

(Revitalization of SMEs)

SMEs are the original source of Japanese economic vitality. By supporting business launches capitalizing on the wisdom and motivation of local SMEs, the Government will promote development and sales of new products and services utilizing local resources, as well as invigorating of SMEs by facilitating fund supply to SMEs owners, supporting R&D, fostering small- and medium-sized retailers and small companies, and revitalizing shopping areas.

(Strengthening of agriculture, forestry and fisheries)

Based on “New Agricultural Administration for the 21<sup>st</sup> Century-2006”, the constitution of agriculture in Japan will be strengthened by promoting management structure reform by concentrating and prioritizing policy measures in principal farmers, establishing systems for food supply and consumption in response to consumer needs, and promoting “Aggressive” agriculture policy, such as promoting exports of agriculture, forestry and fisheries products and food as well as speeding up investment from the

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<sup>12</sup> This refers to particularly outstanding overseas researchers and technicians in the “specialized and technical areas”.

food industry in East Asia. The Government will develop new areas of the agriculture, forestry and fisheries industries such as accelerating the use of biomass.

The Government will promote the management and conservation of forests, revival of the forestry and timber industry, and structural reform to develop an internationally competitive fisheries industry.

## (2) Towards a Society Where Everyone Has a Chance to “Challenge Again”

Based on the “Comprehensive Challenge Again Support Plan”, the following measures will be implemented.

(“Challenge Again” from jobless status or economic hardship due to prolonged deflation)

The Government will promote the permanent worker status of freeters and the vocational self-support of NEETs through comprehensive employment support measures such as career consulting and capability development, the promotion of career education, the revision of the current system of employing new graduates en masse, and the development of employment opportunities. The Government will aim to secure equal treatment for regular and non-regular workers by clarifying the rules applying to overall labour contracts, including fixed-term employment contracts, and expanding application of social insurance to part-time workers.

The Government will prevent people from becoming heavily indebted and provide consulting services and other relief measures for people faced with economic hardship. For challenge-again entrepreneurs and turnaround-seeking SMEs, the Government will support fundraising operations and promote loans that do not heavily depend on real estate collateralized or personal guarantees.

(Equalizing opportunities)

In order to allow people facing various difficulties such as child-raising, long separation from jobs, physical or mental disabilities, economic hardship for guardians, violence from spouses, crime victimization and criminal records to proactively seek jobs or learning opportunities, the Government will provide consulting, recommendation, training, guiding and information services as well as learning opportunities, promote teleworking and enhance cooperation between relevant organizations.

(Realizing multi-tracked society)

In order to diversify ways of working, learning and living at each stage of life, the Government will promote the expansion of working opportunities for elderly people and baby-boomers and relearning opportunities for working adults by establishing a link between universities/special technical schools and local industries, and support for people having residences in both urban and rural areas as well as people pursuing “UJI-turn”, including those seeking agriculture, forestry or fishery jobs in rural regions (“Jinsei Nimousaku”).

### (3) Toward a Healthy and Safe Society

#### (i) Constructing a sustainable and reliable social security system (Comprehensive reform of social security)

With the ageing population and the declining birthrate, social security costs are expected to increase from here on. In order to create the social security system that will be sustainable, the Government will continue to make reform efforts from a medium to long-term perspective, while verifying the effects of institutional reforms to date, and make constant reviews so that this system will be kept within a scope bearable by citizens. The Government will work to increase the employment rate for elderly persons by securing employment and work opportunities and policies supporting “Challenge Again,” and overall efforts will be strengthened to increase the number of people supporting the social security system.

Additionally, the Government will secure stable financial resources for social security in order to avoid leaving its debts to future generations.

From the viewpoint of increasing the convenience of the people, the Government will investigate the introduction of a social security number.

#### (Pensions)

Full information about pension benefits and burdens will be provided by the "Pension Benefits Bulletin Regular Notification Service" system, etc. periodically informing people about how long and how much they have paid in pension premium contributions and how much they will receive in the future, and a system will be established that is friendly and easy to understand. The unification of employee pension schemes and expanded application of social insurance coverage to part-time workers will be realized soon. Based on “the National Pension Law (which revised in 2004)”, the Government share of contributions to the basic pension scheme will be raised to one-half by FY2009, after conducting the necessary fundamental tax reform for securing stable financial resources. Evaluation of pension finances<sup>13</sup> will be started soon, after consideration of population trends, such as new population-projected totals, and future economic trends. The management of the pension system will be rebuilt, and to restore the confidence of the people, the Social Insurance Agency will be eliminated and disbanded, and its functions divided into six sections.<sup>14</sup> While the Government bears the fiscal responsibility and management responsibility for pensions, the management administration will be assigned to a new legal entity with a non-public official nature, and administration will be allocated by third party organizations, with outsourcing to the private sector to be actively encouraged. Furthermore, for particularly bad late payers,

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<sup>13</sup> Creation of current fiscal policy and prospects based on the Employees’ Pension Insurance Law.

<sup>14</sup> The functions will be divided into six areas, between the Ministry of Health, Labour and Welfare; a new public corporation, private consignment, regional bureaus of health and welfare, Association of National Health Insurance, and the National Tax Agency.

the matter will be entrusted to the National Tax Agency to enforce compulsory payment. The members of the government and of the new legal entity will be kept to a minimum, and further rationalization and efficiency will be promoted.

(Medical and nursing care )

The Government will shift the focus of policies to prevention, including lifestyle diseases countermeasures and prevention of the need for nursing care. In addition to increasing the healthy lifespan, the “New Health Frontier Strategy” will be promoted to use innovation so that people with an illness or disability can also employ their abilities to the full.

Regional provision systems for medical and nursing care services will be upgraded, and service quality improved with the online transmission of medical fee bills, etc. and overall measures will be systematically tackled to curb service supply costs through rationalization efforts, etc.

As for medical insurance, further reforms are unavoidable in order that the sustainability of the system will be secured and the burden of the generation still working is not excessive. In the next five years, revision will take place about the contents, range, the method of sharing burdens and benefits, and remuneration for medical services and pharmaceuticals costs. Concerning nursing insurance also, necessary reforms will be tackled, such as revision of the details and extent of public benefits and nursing remuneration, bearing in mind that the start of the next business plan is FY2009, so that the nursing insurance burdens are not excessive.

(Public assistance benefits and policies for the disabled)

As for public assistance benefits, revision of living assistance standards, etc. will be done after study of the consumption situation for low-income households, in addition to strengthening of self-reliance support.

People with disabilities will receive livelihood support toward their self-reliance, and also employment support that has the aim of vocational independence.

(ii) Constructing a “child-raising friendly society” by promoting measures against the birthrate decline

The Government will provide extensive support measures to child-raising families, including support to reduce the economic burden before and after childbirth, and during child-raising periods, upgrade the environment so that childbirth and child-raising can be done with peace of mind due to a comprehensive obstetrics and paediatrics medical system, and enrich local child-raising support such as After school hours Plan for Children and childcare services. Also, child-raising support by industry will be promoted, and previous working habits and styles will be reformed, such as correction of working overly long hours. Reform of social consciousness will be tackled so that the importance of the life of children and the ties of family and local area are shared by all. The tax system will also be tackled to support child-raising.

(iii) Fostering of children supporting the next generation

The Government will provide all children with high quality education and improve academic ability by rebuilding public education, and measures will be implemented to consciousness of standards and sentiment. Educational role of home and community will be strengthened, and society overall will tackle revival of education at the local level.

Measures will be implemented to address bullying as well as to secure the safety of children such as measures to secure safety during the time of commuting to and from school and to prevent child abuse. The Government will promote early childhood education by enhancing measures to reduce preschool education-related burdens on parents and guardians, while, in step with the revenue reform, it will comprehensively consider issues including the financial resources and systems required for making early childhood education free of charge in the future.

(iv) Developing an environment for a safe and secure society

(Restoring Japan to being “the safest country in the world”, etc.)

By advancing measures against malicious incidents in which children are victims and tragic road accidents caused by drunk driving, countermeasures against organized crime and international crime and anti-terrorism measures, the Government will promote efforts to restore “Japan to being the safest country in the world” in cooperation with local society.

In order to ensure peace and safety of Japan, and peace and stability of international society, the Government will promote the build-up of efficient defence systems while taking effective measures against diverse situations as well as new threats including ballistic missiles.

(Disaster control measures, ensuring consumer safety, etc.)

In order to realize a safe and secure society that is a model for the world, as well as strategically and selectively implementing disaster control measures, the Government will implement safety measures for public transport and road traffic, ensuring safety of houses and other familiar facilities and products, promotion of barrier-free environments, and securing of the stable supply and safety of food. The Government will advance justice system reform, such as the introduction of the Saiban-in System.

Furthermore, a transparent, fair market with strong rules will be established and feelings of security in economic activities will be increased by strengthening appropriate information disclosure and market monitoring functions.

(v) Realizing a sustainable society by actively tackling environmental problems

The Government will realize a sustainable society, working toward compatibility between the environment and the economy, by creating a society that exits from inducing global warming, the construction of a Sound Material-Cycle Society, and promotion of harmonious coexistence with nature, together with the creation of new demands through the development of environmental technology. In order to realize

Kyoto Protocol Target Achievement Plan, the whole country must work together to accelerate measures to prevent global warming. The Government will exhibit international leadership in creating future frameworks relating to global warming and conservation of biodiversity, improvement of the water and atmospheric environment, systemic and technical support relating to the 3Rs<sup>15</sup> and energy conservation and new energy sources.

(vi) Promotion of culture, arts and sports

The Government will promote culture and arts, aiming to make Japan a country that values its culture, traditions and history and is open to the world. The Government will promote sports, including through the realization of a lifelong sports society, and the improvement of international competitiveness of sports.

(4) Toward Building an Administrative and Financial System That Befits the 21<sup>st</sup> Century

(i) Promotion of integrated reform of expenditures and revenues  
(Towards FY2011)

Under the principle that there can be no fiscal consolidation without growth, the Government will systematically carry out the expenditure reform indicated in “Basic Policies 2006” during the next five years, while maintaining economic growth and placing top priority on minimizing the financial burden on taxpayers. For the increase in burden caused by social security services and the declining birthrate, the Government will secure a stable supply of revenue source in order to avoid shifting burdens onto the shoulders of future generations. In advancing this process, as a first step, by FY2011 the Government will definitely achieve a surplus in the primary balance of the central and local governments combined.

With the aim of restoring the primary balance of the financially-pressed central government as much as possible, the Government will promote financial reconstruction while securing a central and local balance.

The local governments will maintain a surplus trend by reducing their expenditure while keeping the reduction in pace with that of the central government and, in terms of revenue, securing the total amount of general revenues required.

(Towards the mid-2010s)

Even if the primary balance of the central and local governments combined turns into a surplus, fiscal consolidation is still incomplete, as the fiscal balance including interest payments is expected to be a large deficit, so the fiscal consolidation should be steadily advanced while paying attention to intergenerational equality as one of viewpoints.

Towards the mid-2010s, even after achieving a surplus in the primary balance, the central and local governments will continue their efforts to improve the primary balance, and secure a certain amount of surplus. In doing so, while maintaining steady

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<sup>15</sup> 3Rs: Suppression of waste generation – Reduce, Reuse and Recycle

economic growth, they will ensure the prevention of a divergence in the ratio of debts of the central and local governments to GDP, and stable reduction of the ratio. With respect to the central government alone, the Government will also aim to prevent a divergence in the ratio of debts of the central government to the GDP and reduce the ratio in a stable manner.

(ii) Achieving medium-term targets by “Direction and Strategy”

In order to securely realize the medium-term target toward fiscal consolidation included in “Direction and Strategy”, a scheme to formulate each year’s budget with its consistency toward the steady achievement of the target checked should be adopted for enforceable Integrated Reform of Expenditures and Revenues. Specifically, the Council on Economic and Fiscal Policy will make the following efforts.

- ① Each year’s budget (including its supplementary budget) will be checked to see whether it is consistent with the planned implementation of expenditure reform for the achievement of the medium-term target at pivotal points during budget formulation (for example, when drafting “the Budget Overview”, or when formulating the budget).
- ② Analyses will be provided of “the required amount”<sup>16</sup> necessary to achieve a surplus in the primary balance of the central and local governments combined by FY2011, the execution status of expenditure reduction, and changes in the primary balance of the central and local governments combined.
- ③ In accordance with revisions to “Direction and Strategy”, the fiscal perspective for the future will be calculated and this will also be revised as necessary for “the Budget Overview”, keeping in mind achievement of the medium-term target. Also, every year in the “Basic Policies for Economic and Fiscal Management and Structural Reform”, the necessary verification and revision of the details of expenditure reform will be performed reflecting the updated results.

Through performing this periodic evaluation, the medium-term target will be steadily achieved by avoiding easy expenditure increases and maintaining fiscal discipline.

(iii) Principles of budget formulation

Formulation of the national budget is performed in accordance with the following principles.

Principle 1: Economic growth should be led by the private demand, and policies to augment demand by increasing public spending should not be adopted to bolster an economy.

Principle 2: An increase in tax revenue beyond prior estimation should not be allocated easily to expenditure, but will be allocated to reducing the future financial burden on taxpayers.

Principle 3: In order to achieve both economic growth and fiscal consolidation, weight will be given to a medium-term viewpoint. Namely, fiscal consolidation should be undertaken in a flexible manner: accelerating the pace of fiscal

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<sup>16</sup> In “Basic Policies 2006”, this was about 16.5 trillion yen.

consolidation with rising tax revenue in the period of economic recovery, but slowing the pace with declining tax revenue during recession.

Principle 4: A new expenditure increase should be financed in principle, by an expenditure cut in the other areas.

Principle 5: The accountability to the public should be thoroughly carried out.

(iv) Tax reform

Full-fledged and specific discussions on tax reform will be conducted from autumn 2007, and the Government will work to implement a fundamental tax reform around FY2007. At that time, with the basic concepts of revenue reform indicated in “Basic Policies 2006” and the Outline of Tax Reform of the Ruling Parties in mind, the Government will avoid shifting a burden onto future generations by securing a stable supply of revenue to cover an increase in burden caused by social security services and the declining birthrate that cannot be covered by thorough expenditure cuts.

In order to proceed smoothly with the above measures, basic concepts of tax reform will be steadily considered.

Development of environment for smooth and appropriate tax payment is important, and all means, including the taxpayer identification number system, will be reviewed.

(v) Promoting efficient administration

Based on the “Administrative Reform Promotion Law”, the following measures will be taken to realize a simple yet efficient government.

① Considering the long-term aim of cutting the personnel cost of civil servants in half as a ratio against GDP by within ten years, the Government drastically reduces the total personnel costs of civil servants, for example, the personal quota for central government administrative organizations will be reduced absolutely by about 19,000 personnel in five years. All aspects of the public service system will be reviewed, including human resources management of public servants, and management of re-employment.

② Policy-based finance institutions will be steadily shifted into the new system in FY2008, and the ratio of policy-based financial loans to the GDP at the end of FY2008 will be reduced by half compared to that at the end of 2004.

③ In accordance with basic idea of the Law of the Privatization of Postal Service, postal privatization will be smoothly and steadily implemented in October 2007. Furthermore, public services will be opened wide to the private sector by active application of the market testing based on the Public Service Reform Act and the vigor of the private sector will be utilized to the maximum. The Government will also review the overall operations and organization of incorporated administrative agencies in accordance with the “basic direction of revision of incorporated administrative agencies”<sup>17</sup>.

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<sup>17</sup> “Fundamental direction of revision of incorporated administrative agencies from 2006 onward” (May 23, 2006)

- ④Major revisions of special accounts will be executed, including elimination and consolidation of special accounts, revision of operation differing from that in the general accounts, such as the manner to carry over surplus. Concerning the reform of government assets and debts, based on the “Law on Administrative Reform Promotion”, the Government will reduce its assets by approximately 140 trillion yen with the aim of halving the ratio of government assets to the GDP by the end of FY2015. Concerning tax revenues earmarked for roads projects, reviews will be conducted in accordance with “specific measures for the reviewing of tax revenues earmarked for road projects” (Cabinet decision of December 8, 2006).
- ⑤The budget formulation process in which the PDCA Cycle is strengthened, the public accounting system and the review of budget documents and closing statements will be advanced.
- ⑥A new grand design will be drawn for administrative structure as a whole, such as drastic reform and reorganization of administrative institutions suitable for the 21<sup>st</sup> century, and the formulation of a “vision of a regional government (doshu-sei)” aimed at its full-fledged introduction.

In addition to these reforms, with regard to public works projects while continuing with the reform efforts up to now, truly essential social capital will be improved for promoting the autonomy and vitality of regional communities, strengthening Japan’s growth potential and ensuring safety and security through disaster prevention and reduction measures, while thoroughly pursuing priority and efficiency. In addition, based on clear PDCA Cycles, the evaluation of individual projects will be tightened and reflected to the budget. Efforts are also being made to thoroughly eliminate collusive bidding.

(vi) Decentralization reform and reform of local public administration and finance

Reform of local government expenditures will be continued at the same reduction pace that of the central government and decentralization reform will be advanced under the following policy.

- ①Based on the “Law for the promotion of decentralization reform” (2006 Law No. 111), a “Plan for the Promotion of Decentralization Reform” was drawn up, which defines the necessary legal and fiscal measures, and a “new decentralization package law (as tentatively named)” will be submitted to the Diet within three years. According to this, the central government will focus on fulfilling the roles that the Government originally has a duty to fulfil, and administration close to the people in the regions will be entrusted as much as possible to the local governments.
- ②Considering financial conditions of central and local governments, the Government will comprehensively deliberate for example the reviewed of allocation of tax revenues including a transfer of tax revenue resource, along with reforms of local allocation tax and subsidies.
- ③Considering existing financial power gaps between local governments, the aim will be to narrow such gaps.

- ④A method of computation of local allocation tax under new simple standards will be introduced in FY2007, and its gradual expansion is planned in response to reduced interference from central government.
- ⑤Rules will be applied to fiscal management of the local governments, and to promote fiscal consolidation, a new financial turnaround system will be devoted within two years.
- ⑥Following on from the “Guideline for further promotion of administrative reform at local governments” (August 31, 2006), the central government will encourage local governments to tackle reform of local administration and finance even more.

## **Chapter 4. Future Economic Prospects**

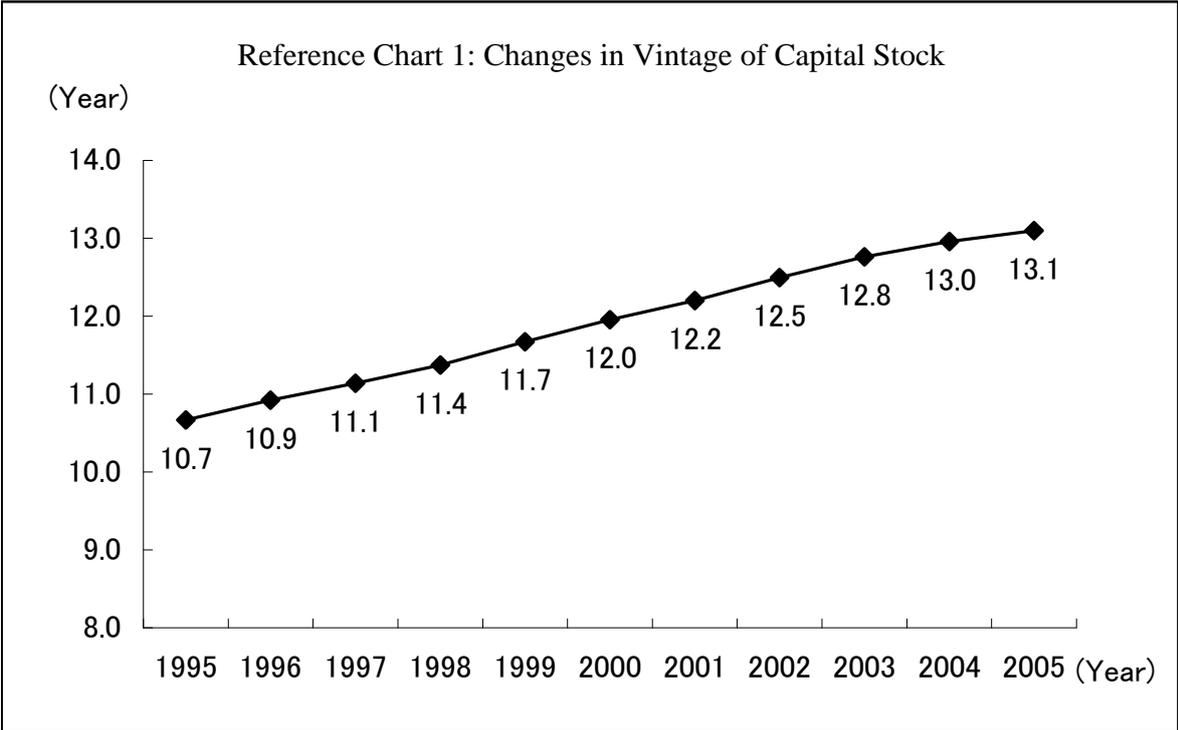
Here, the economic prospects in the upcoming five years under “Direction and Strategy” are reviewed. It should be noted, however, that there exist various risk at this point, including an undeniable risk that Japan will fall back to deflation. Because of such uncertainty, the prospects shown here should be interpreted with a considerable margin.

If the policy incorporated in “Direction and Strategy” is implemented, Japan’s potential growth rate will gradually rise, and the real growth rate of about 2% or even considerably higher can be expected in the next five years. Furthermore, in the next five years, the nominal growth rate at around 3.5% or above can be expected.

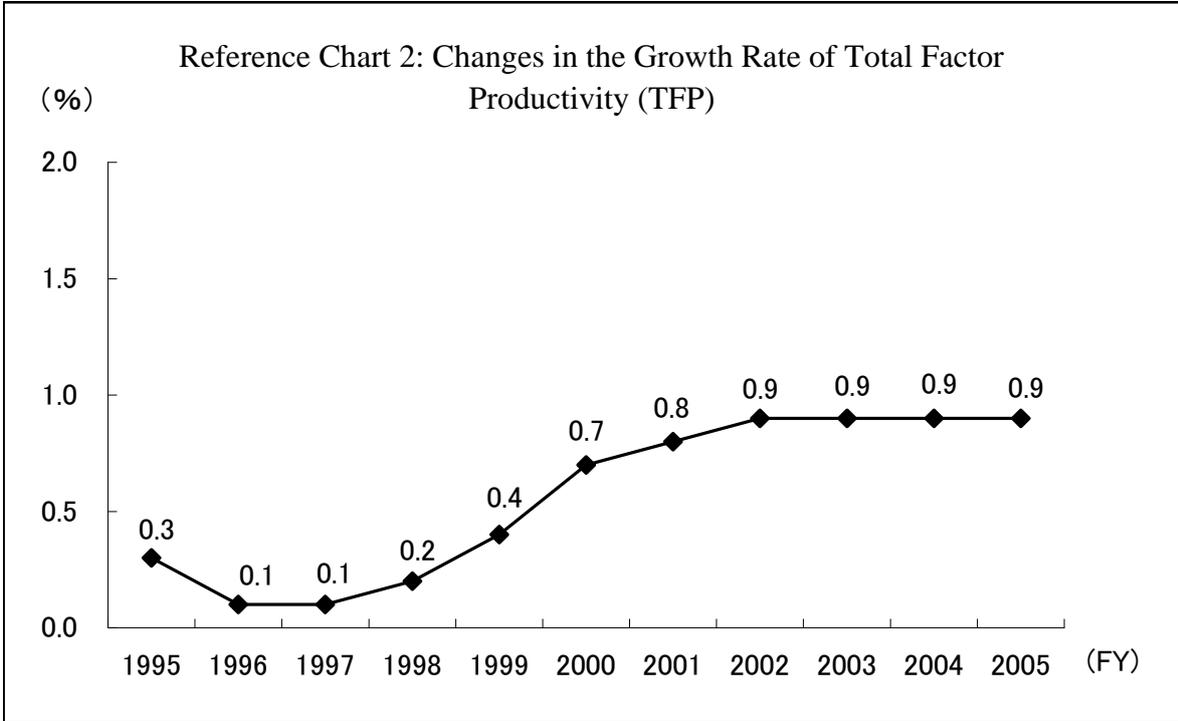
On the other hand, should the risks surface, in other words, under the condition that the labour population decline pushes down the growth rate down by about 0.2 % to 0.3% annually, if the policy effect is not fully exerted, and if the economic environment is severe due to external effects such a slowdown of the global economy, the real growth rate in the medium-term could fall to around just over 1% or even below that. In this scenario, the nominal growth rate would be around just over 2% or below that.

Under the appropriate macroeconomic management indicated in “Direction and Strategy”, it is expected that prices will gradually exhibit a stable positive increase rate, after overcoming deflation, and the increase rate of the consumer price index is expected to approach around 2% in the five years. The GDP deflator increase rate is forecast to rise slightly less than the rate of the consumer price index. On the other hand, if the risk surfaces, the price index increase rate will be somewhat lower than these figures.

[ Reference Charts ]



Notes: 1. Based on the "Gross Capital Stock of Private Enterprises", the Cabinet Office, Government of Japan and "National Wealth Survey".  
 2. A rise in the average elapsed year of capital stock indicates that the capital stock become older.

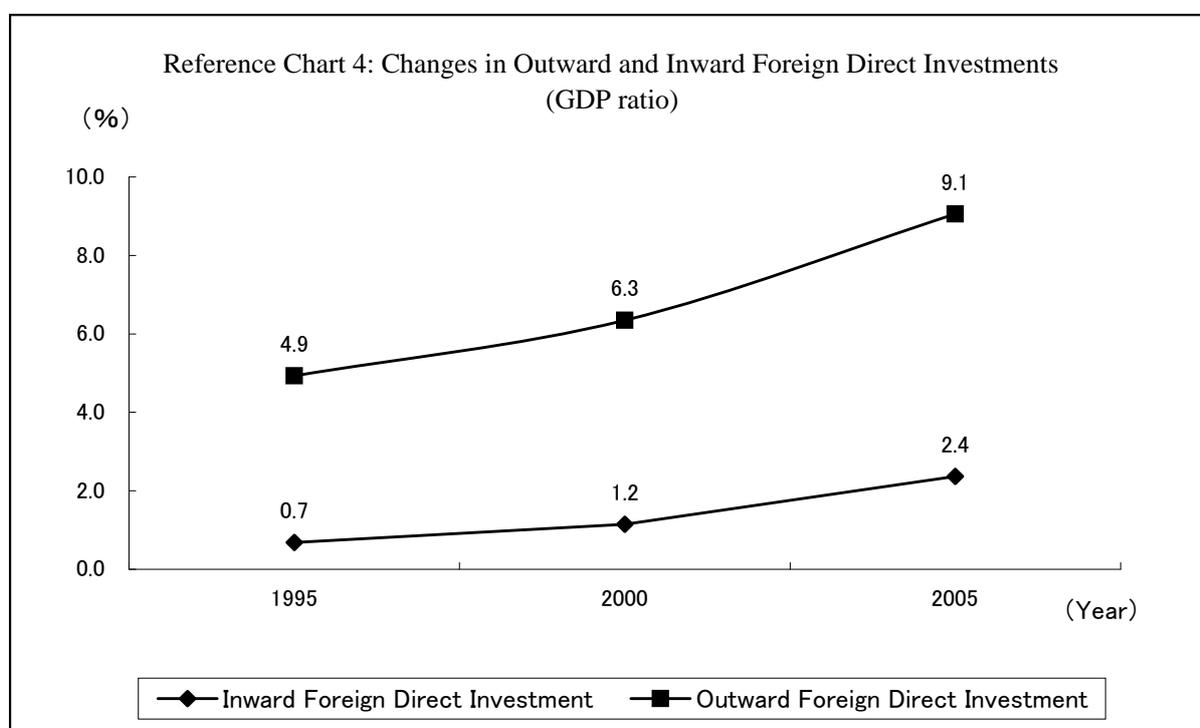


Notes: 1. Estimation method is based on the appended note 1-3 of the "Annual Report on the Japanese Economy and Public Finance 2006", the Cabinet Office, Government of Japan.  
 2. Data is smoothed by HP filter.

Reference Chart 3: Status of concerning EPA (Economic Partnership Agreement) negotiations

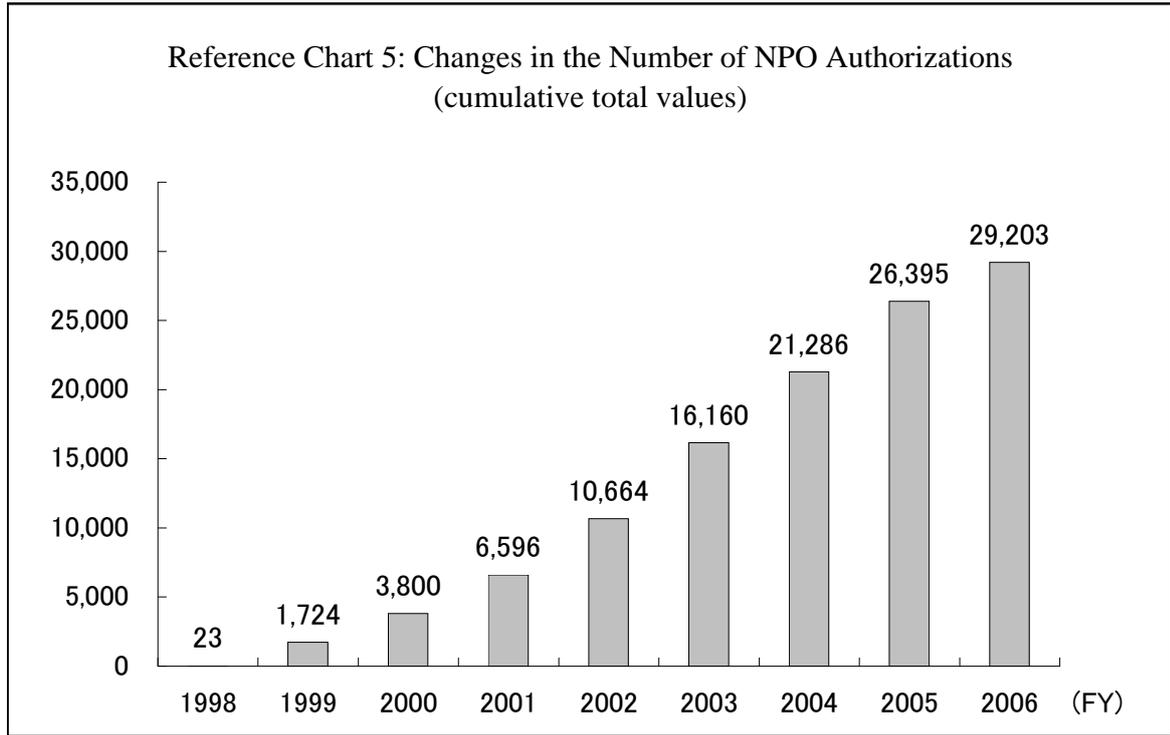
Country/Region	Current Status
Singapore	Concluded. Negotiations for a partial review of the EPA started in April 2006; Agreements reached in principle in January 2007.
Mexico	Concluded.
Malaysia	Concluded.
Philippines	Agreement signed in September 2006.
Thailand	The text of agreement was finalized during the negotiations held in February 2006.
Chile	Agreements in principle reached in September 2006.
Indonesia	Agreements in principle reached in November 2006.
Brunei	Agreements in principle reached in December 2006.
ASEAN (as a whole)	Negotiations began in 2005 and are ongoing.
Republic of Korea	No negotiation has been held since November 2004.
GCC (Bahrain, Oman, Qatar, Saudi Arabia, UAE, Kuwait)	Negotiations began in September 2006 and are ongoing.
Vietnam	Negotiations began in January 2007.
India	Negotiations began in January 2007.
Australia	The two Leaders decided to launch negotiations in December 2006.
Switzerland	Joint Governmental Study was launched at the end of October 2005.

Note: As of January 18, 2007

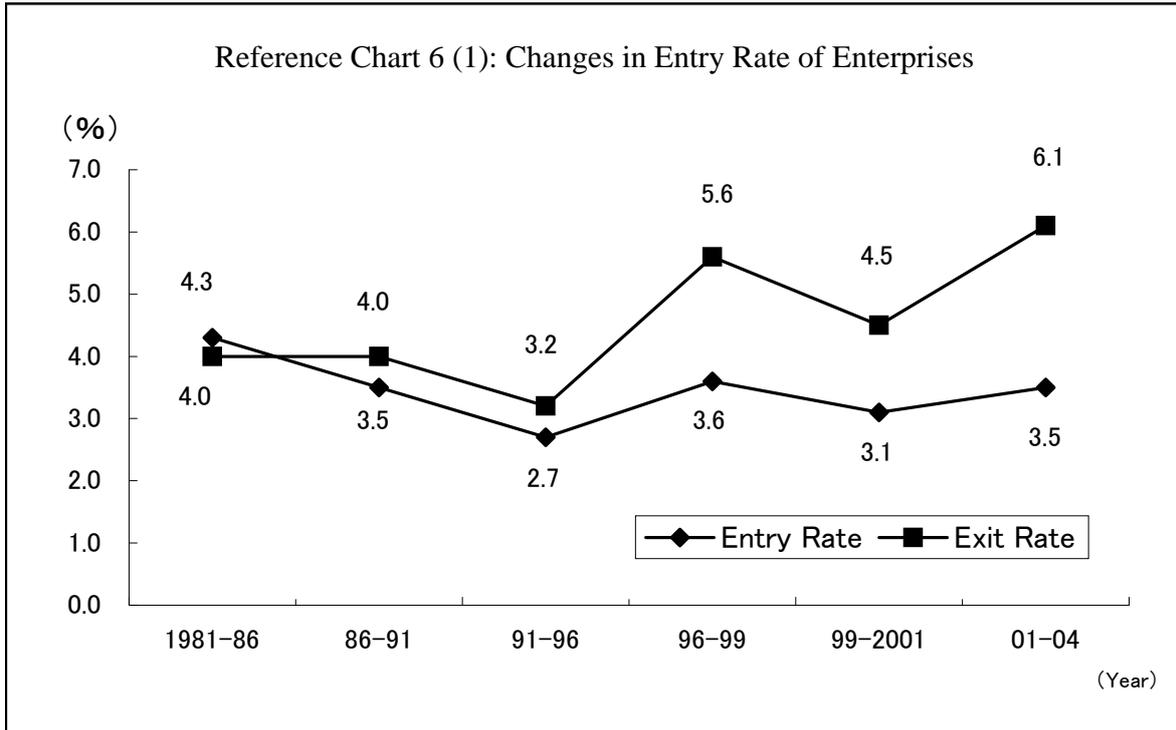


Note: Based on the "National Accounts", the Cabinet Office, Government of Japan and the "International Investment Position", the Ministry of Finance, Government of Japan.

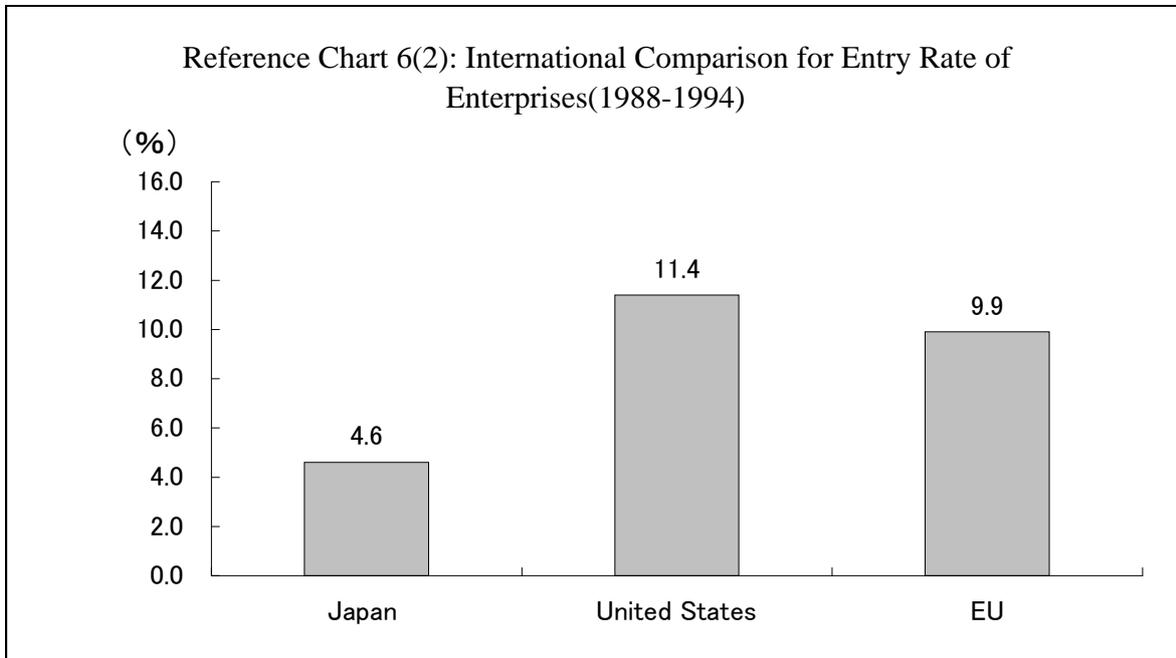
Reference Chart 5: Changes in the Number of NPO Authorizations  
(cumulative total values)



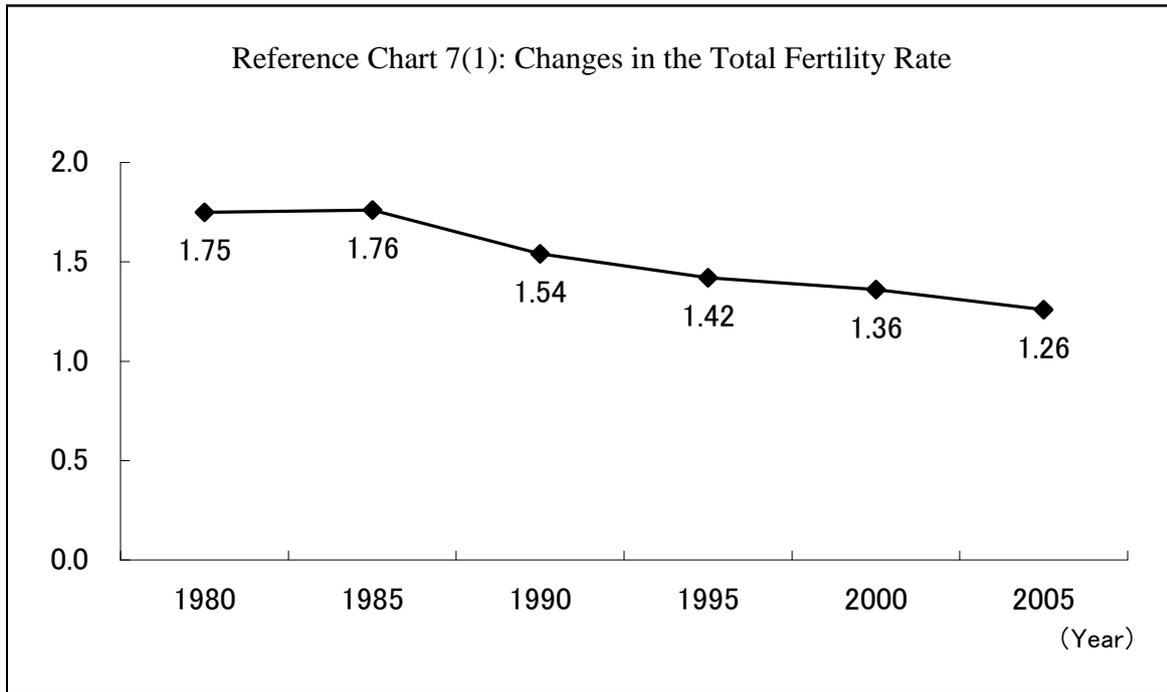
- Notes: 1. Based on the "White Paper on the National Lifestyle" , the Cabinet Office, Government of Japan and surveys by the Cabinet Office.
2. As to FY1998 - FY2005, the numbers of authorizations are as of the end of March; as to FY2006, the number of authorizations is as of October 31.
3. The numbers of authorizations are cummulative total values for each fiscal year.



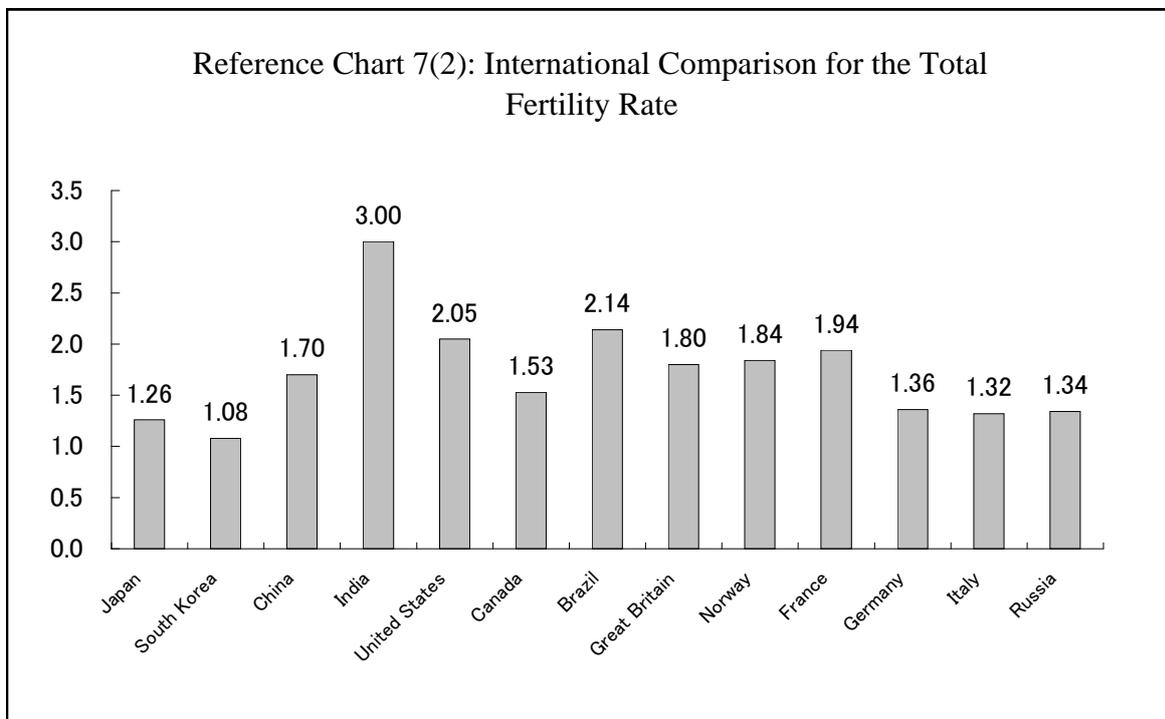
- Notes: 1. Based on "2006 White Paper on Small and Medium Enterprises in Japan", the Small and Medium Enterprise Agency, Government of Japan.
2. The entry rate [exit rate] of enterprises are the number of corporations being established [closed] divided by the number of corporations as of the start of each year (private and public corporations).



- Notes: 1. Based on the "European Observatory for SMEs Fifth Annual Report (1997)", the European Commission Enterprise Directorate General (Translated by Japan Small Business Research Institute).
2. Since different computational methods were used from Reference Chart 6(1) "Changes in Entry Rate of Enterprises" values will not necessarily correspond.



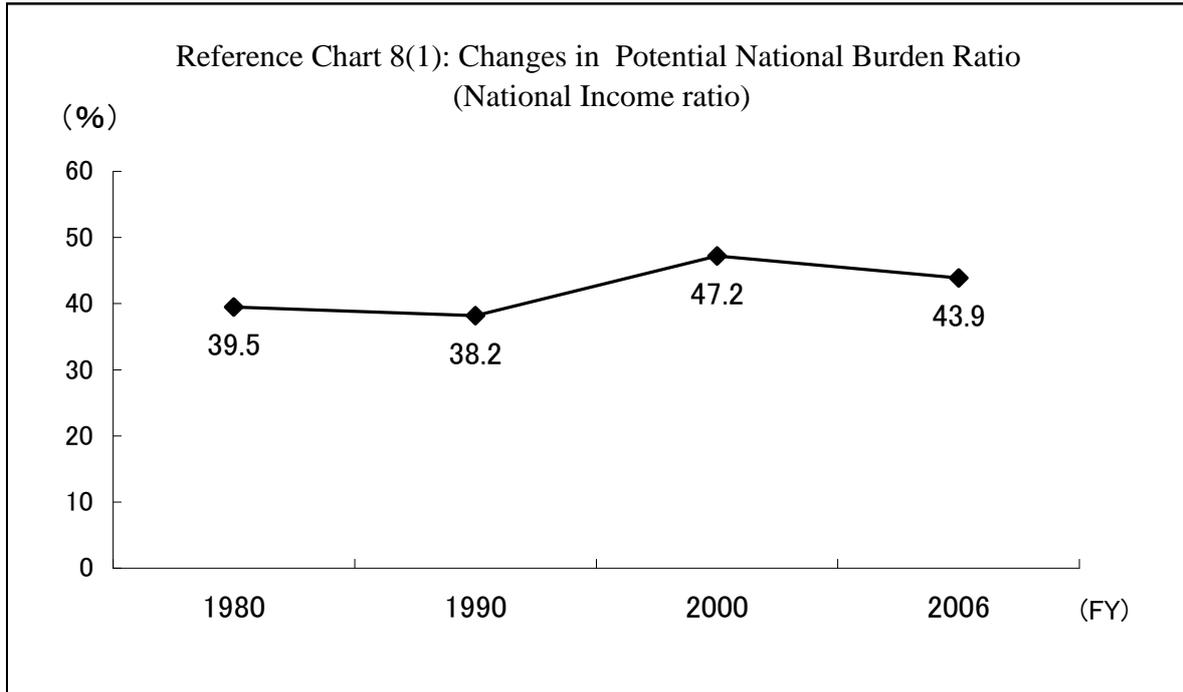
Note: Based on "Vital Statistics of Japan 2005", the Ministry of Health, Labor and Welfare, Government of Japan.



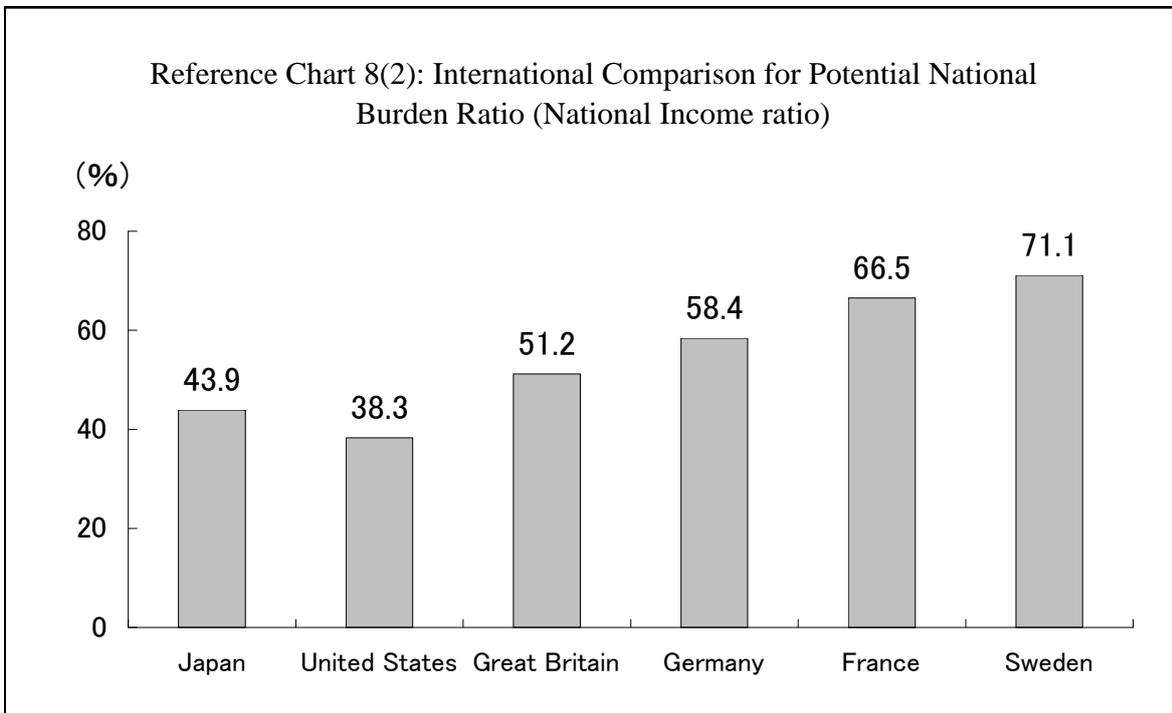
Notes: 1. Based on "Vital Statistics of Japan 2005", the Ministry of Health, Labour and Welfare, Government of Japan, "Eurostat Statistics in Focus: Population and Social Conditions", Eurostat, "Demographic Yearbook", the United Nations, "The World Health Report", the WHO, and corresponding materials of each country.

2. Canada and Brazil's values are of 2003, China, India, US, and Russia's values of 2004, and all others of 2005.

3. US figures are preliminary.

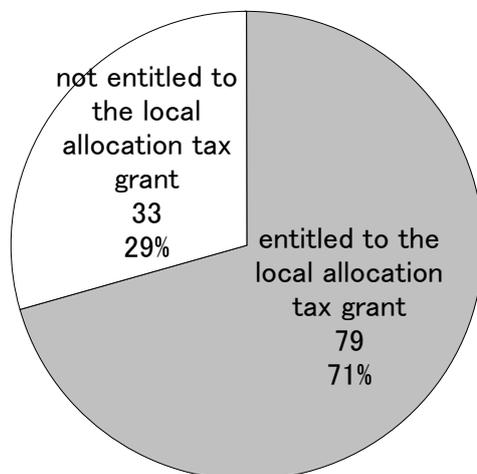


- Notes: 1. Based on "Trend of National Burden Ratio (as a Percentage of National Income)", the Ministry of Finance, Government of Japan.  
 2. Figures obtained in FY1980 are based on the 68SNA, and after FY1990 on the 93SNA.  
 3. FY2006 is used as the initial budget base.



- Notes: 1. Based on "Trend of National Burden Ratio (as a Percentage of National Income)", the Ministry of Finance, Government of Japan.  
 2. FY2006 is used as the initial budget base for Japan, with all other countries using 2003 figures.  
 3. For Japan and the United States, the budget deficit as a percentage of national income based on general government excludes Social Security funds, with all other countries based on general government.

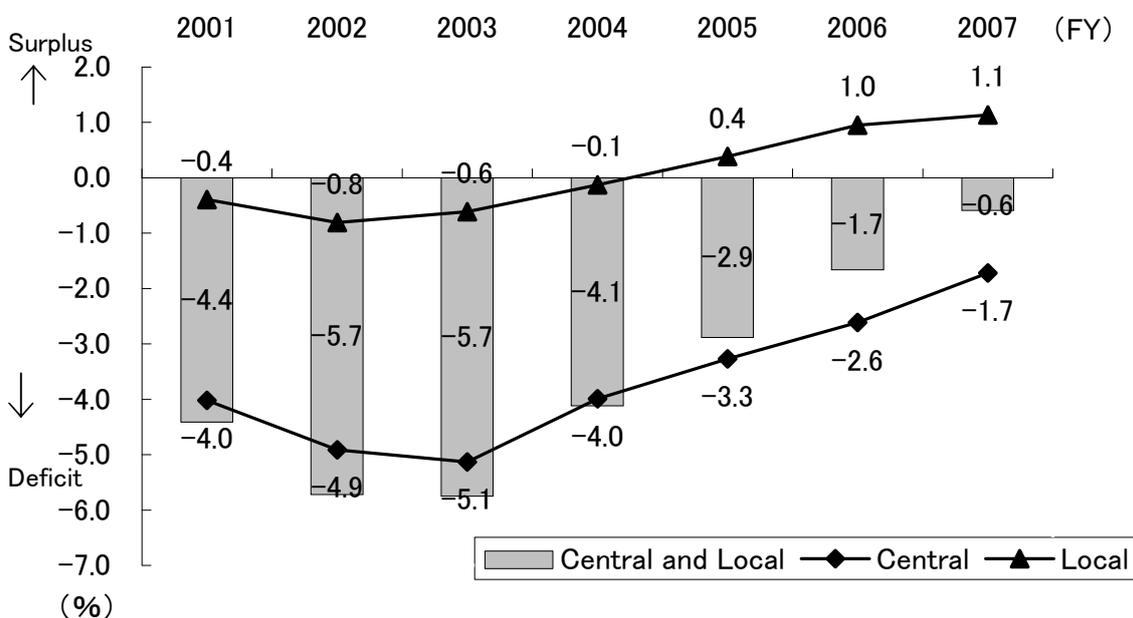
Reference Chart 9: The number of cities not entitled to the local allocation tax grant with a population of 200,000 or more



(In 2006, 112 cities with a population of 200,000 or more)

Note: Based on Mr. Suga's Papers presented to the Council on Economic and Fiscal Policy (CEFP) on October 24, 2006.

Reference Chart 10: Changes in Primary Balances (GDP ratio)



Notes: 1. Estimated from "National Accounts", the Cabinet Office, Government of Japan.  
 2. While the special account for the local allocation tax is classified as central government in SNA, the borrowings and reimbursements by this account are counted separately in central and local governments depending on each share.