

Provisional Translation

Direction and Strategy for the Japanese Economy

-- A Country Open to the World, Growth in Which All Participate, Harmony with the Environment --

January 18, 2008

Cabinet Decision

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Introduction

In recent years, Japan has made efforts at structural reform in all areas of its economy and society. However, in the face of difficult issues such as the arrival of a society with full-fledged population decline, increasing expenses for social security services caused by falling birth rates and the aging of society, structural changes in the domestic and overseas economies, and global environmental issues, Japan has yet to find the solid shape of its new economic growth. Furthermore, new issues have emerged, including widening disparities between urban and rural regions and increasing non-permanent employment.

Based on these points, the Government must now present medium-term economic and fiscal policies under a new concept, while retaining the basic direction of past reforms. In doing so, the Government must, from the standpoint of each and every citizen, clearly demonstrate matters which should be newly considered as well as issues on which deliberations should be sped up in a far-sighted manner.

From the above viewpoint, the current fiscal year's "Direction and Strategy for the Japanese Economy -- A Country Open to the World, Growth in Which All Participate, Harmony with the Environment --"¹ presents the Government's new medium-term policies and perspectives concerning its economic and fiscal management upon the Government's review of Japan's present economic and fiscal situation based on the FY2008 budget formulation, and reconsiders the issues facing Japan also from a medium to long-term standpoint. Of the medium-term policy guideline and so forth to which the Government should continue to commit itself in the future, those that are left out of the "Medium-term Policies" will be implemented under the last fiscal year's "Direction and Strategy."² As for showing policies that are more specific in a comprehensive manner, the Government has been formulating the "Economic and Fiscal Reform"³ in the middle of every fiscal year and will promote reforms in combination with both the "Medium-term Policies" and "Basic Policies."

The "Medium-term Policies" basically covers the years until FY2011, but refers to a longer period when necessary.

¹ Hereinafter referred to as the "Medium-term Policies."

² The "Direction and Strategy for the Japanese Economy" (Cabinet Decision of January 25, 2007). This is hereinafter referred to as the "Direction and Strategy."

³ Hereinafter referred to as the "Basic Policies."

Chapter 1 Shape of Target Economic Society and Basic Policy Concept

(1) Current Situation and Issues of Economy and Finance

(Current economic situation)

The Japanese economy has left a long period of stagnation and a sustained recovery has been continuing after bottoming out at the start of 2002. At the same time, the employment improvement appears to be pausing recently while severe aspects remain. Furthermore, housing construction has declined due to the impact of the implementation of the amended Building Standard Law.⁴ Also, there are imbalances in the recovery between regions, and for many small and medium sized enterprises (SMEs), recovery has yet to be reached.

Given these conditions, economic growth rate is expected to be around 1.3% in real terms and 0.8% in nominal terms in FY2007, and around 2.0% in real terms and around 2.1% in nominal terms in FY2008. Close attention should be given to the effects of fluctuations in financial and capital markets incurred primarily by the subprime mortgage loan problem, economic trends in the United States and soaring crude oil prices on the Japanese economy.

(Issues facing Japanese economy)

Japan is at a critical stage wherein it is emerging from a long period of stagnation following the burst of the bubble economy and is establishing the shape of its new growth. At the same time, Japan is facing difficult issues such as the arrival of a society with full-fledged population decline, increasing expenses for social security services caused by falling birth rates and the aging of society, structural changes in the domestic and overseas economies, and global environmental issues. While Japan is required to convert these issues into new growth chances, their negative effects on people's daily lives have yet to be fully overcome. While Japan has been making efforts to resolve the negative legacy since the burst of the economic bubble, the world economy has undergone huge structural changes, and the Japanese economy has been left out of these changes.

From here on Japan must overcome the following two problem situations in order to restore its economic vigor.

First, there is lingering insecurity and uncertainty about the future Japanese economy and people's lives in the absence of growth in positive, forward-looking developments, despite the fact that the economy is being normalized, with the reversal of deflation coming into sight. For example, a negative spiral of stagnant wages and consumption has emerged while Japan has been waging a long fight against deflation to solve excesses in employment, capital stock and

⁴ "Law for Amending Part of the Building Standard Law to Secure Safety of Buildings" (2006, Law No. 92)

debt. The local regions have fallen into a negative spiral in which the population declines, and as a result, the facilities that support people's daily lives, including schools and hospitals, become less convenient, thereby reducing the attraction of the local regions and contributing to further population decline. Moreover, many of the SMEs that provide the driving force of Japan's economic growth have been left out of the benefits of economic recovery. These conditions have apparently led to a sense of stagnation, making it difficult for citizens to have bright prospects for the future. It is an important challenge to make a breakthrough in the present situation and turn negative spirals, which lead to a sense of stagnation, into positive spirals.

Second, Japan has been left behind by changes in the world economy and is losing its competitiveness under the new world structure. The Japanese economic systems and structure, which are based on the premise of a sustained post-war population increase and a high level of economic growth, have failed to be reformed in ways that address the issues of an aging population, rapid globalization and the world-wide promotion of IT. Furthermore, labor, goods and money have failed to shift to growth areas as people have avoided changes and risks, while investment in cutting-edge areas has been inactive. As a result, Japan was ranked 18th among the OECD member countries in terms of per capita GDP in dollars in 2006, dropping from second place in 1993, due to smooth growth in other countries. Japan's international position has been declining year by year.⁵

(Current situation and issues of administrative and financial systems)

It is expected that the deficit in the primary balance of the central and local governments combined will improve from the high level of 5.7% of GDP ratio in FY2002 to about 0.5% of GDP ratio in FY2008. However, the deficit in the overall fiscal balance when debt service payments are included is expected to post a high level of about 2.4% in FY2008. Furthermore, when the stock is considered, government debt⁶ as a ratio of GDP is expected to remain as high as about 140.2% in FY2008. The Japanese fiscal situation is a particularly severe situation amongst the major advanced countries with a structure that shifts the burden to future generations. If this situation is left unchanged, it will have a negative impact on medium to long-term growth through slow capital accumulation by industry. If population decline continues with the falling birth rates and aging of society, an even heavier burden will be placed on future generations; thus, fiscal consolidation is an urgent task.

⁵ Tokyo, which boasts the highest GDP among the Japanese prefectures, was ranked after Britain in sixth place among the OECD members in terms of GDP in 1993. In 2005, Tokyo followed Spain in eighth place, indicating a setback.

⁶ Here this refers to the sum of government bonds, local bonds, borrowings at the special account for local allocation tax and local transfer tax, and borrowings taken over by the general account from the special account for local allocation tax and local transfer tax.

In the meantime, the pension record problem and other issues have emerged to shake public trust in the executive branch of government. It is an urgent task to remember the principle that civil servants are serving the greater good and recover trust in the administration. The Government is also required to fundamentally reform administrative functions to thoroughly eliminate waste. Over recent years, the falsification of quake-proof data, the falsification of food labels, deception of elderly people and other scandals have emerged one after another to betray the trust of the people and the consumers. It has become an important challenge to shift toward administrative services that are based on the standpoints of the people and the consumers instead of producers.

(2) Shape of Target Economic Society

What Japan will pursue is a country of “hope and reassurance,” where young people have hope for the future and elderly people have a sense of reassurance. To that end, there are three key points: 1) enhancing growth potential, 2) regional independence and revitalization, and 3) establishing secure and trustworthy finance, social security and administration. These three points are not separate, but rather complement each other, and are integrated to achieve a country of “hope and reassurance.”

1) Enhancing growth potential

In order to overcome the problems facing Japan’s economy and achieve a country of “hope and reassurance,” citizens must share the shape of the target economic society and tackle population decline, economic globalization and other great changes courageously and flexibly.

To this end, a new principle of “self-reliance and mutual cooperation” should be adopted to realize future growth. The principle of “mutual cooperation” means that Japan should give priority to “networking,” to develop a system in which urban and rural regions, elderly and young people, large and smaller companies, cooperate with each other and grow together in pursuit of a country with fewer disparity-related economic distortions. Growth potential will be enhanced as skilled human resources are nurtured⁷ and as knowledge and information are exchanged and shared by people of all ages, all regions, all industries and all sizes of company.

In order for “mutual cooperation” to boost growth potential, it is essential for each entity to become independent and demonstrate its strengths. As such, “networking,” rather than mutual interdependence or a predisposition to reliance on outside support, will lead to a synergy effect called “networking ability.” Japan is now required to develop a growth mechanism based on the principle of “self-reliance and mutual cooperation.”

⁷ Education measures will be implemented based on the “Direction and Strategy” for the last fiscal year. Their specifics are given in the “Economic and Fiscal Reform 2007” (Cabinet Decision of June 19, 2007, hereinafter referred to as “Basic Policies 2007”).

2) Regional independence and revitalization

Regional communities are the driving force of economic growth and the settings for the daily lives of citizens. In pursuit of a country of “hope and reassurance,” all regional communities in Japan should become “hopeful and secure.” “Networking ability” should be demonstrated to this end as well.

First, each regional community should promote its own efforts to increase its appeal. To this end, each community must develop public and industrial infrastructure as well as mechanisms and environments to best demonstrate its potential, including its human resources, culture and tourist attractions.

It is also important for residents in each community to promote mutual exchange and cooperation through their daily lives and broader activities. This is expected to allow a relationship wherein the quality of human lives and activities is mutually enhanced to become deep-rooted in regional communities.

Through these efforts, all regional communities should respectively develop human resources, transmit new information and promote culture in order to allow their residents to feel hopeful and secure about their respective regions.

As for local administration to support people’s daily lives, true decentralization should be effected to promote regional independence in both authorities and public finance, to build a system where each local government can choose administrative services based on its own decisions and responsibilities, in consideration of benefits and burdens.

3) Establishing Secure and Trustworthy Finance, Social Security and Administration

Public finance should be structured to prevent burdens from being passed on to future generations. The Government should proceed steadily with efforts to this end and specify a long-term fiscal consolidation path to eliminate people's insecurity about greater future burdens. This should allow Japan to secure overseas confidence in the Japanese system, at a time when all countries are linked together through global and financial markets.

The Government will develop social security systems that should be able to serve as a safety net supporting people's security and stability, should emphasize the spirit of self-reliance and should be easy to understand, kind, reliable and sustainable. Therefore, the Government should always check the balance between benefits and burdens, reform both, and keep the systems in harmony with economic and fiscal conditions.

In a bid to develop an administration system befitting the 21st century, the Government should implement waste-free, efficient administrative services while separating what the government sector should do from what the private sector should do. Furthermore, the Government should base administration on the standpoints of the people and the consumers.

(3) Basic Concept of Economic and Fiscal Policy

1) Appropriate macroeconomic management

The Government will continue stable economic and fiscal policy management without relying on easy public spending. Therefore, the national budget formulation will be based on the principles of budget formulation⁸ specified in the “Direction and Strategy” for the last fiscal year and the “Basic Policies 2007.” If the economy confronts an exceptionally severe situation such as an economic crisis from externally generated shocks, however, the Government will respond boldly and with flexibility measures.

It is necessary to achieve a stable level of inflation rate which will support sustained economic growth led by private-sector demand. For such a reason, the Government expects the Bank of Japan to conduct monetary policy consistent with the economic perspectives indicated in the “Medium-term Policies” in a timely and appropriate manner by sharing basic points of view on macroeconomic management with the government.

2) Further promotion of reforms

In order to overcome present challenges and build a country of “hope and reassurance,” the Government must advance reforms with our eyes fixed on the future of Japan and revise systems and organizations that no longer benefit the present times. The Government also needs to provide solutions to each and every problem in a proper way.

The Government will base the further promotion of reforms on the public's viewpoint, under the broad policy of safeguarding what should be safeguarded, nurturing what should be nurtured and passing on what should be passed on to future generations.

The Government will retain its basic policy of proceeding with reforms to achieve both enhancement of growth potential and fiscal consolidation in an integrated manner as two wheels on the same axle. The enhancement of growth potential should be based on the standpoints of the people and the consumers. At the same time, a new strategy in which all participate and take advantage of Japan's strengths will be adopted to solidify growth policy.

⁸ “Formulation of the national budget is performed in accordance with the following principles:

Principle 1: Economic growth should be led by private demand, and policies to augment demand by increasing public spending should not be adopted to bolster the 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 consolidation with rising tax revenue in periods of economic recovery, but slowing the pace with declining tax revenue during recessions.

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

Principle 5: Accountability to the public should be thoroughly carried out.”

Chapter 2 Toward Enhancing Growth Potential

(1) Growth Strategies based on “Networking Ability and Environmental Prowess”

(Three goals)

In order to overcome the challenges facing the Japanese economy and achieve a country of “hope and reassurance,” it is necessary to share the shape of the Japanese economic society that should be aimed for. The Government now sets the following three goals representing the shape of Japan that should be achieved within 10 years or so, and will intensively implement the relevant reform strategies. Under these goals, a real economic growth rate of 2% or higher can be expected, even with the declining population.

Goal 1: An open country which develops together with the rest of the world

– An attractive country that people can boast about to the world –

Japan will expand the global flow of people, goods, money and information to continue dynamic growth. It will contribute to the development of Asia and become a country that foreign citizens wish to visit and live in. Japan will maintain the world's highest technology standards in such areas as manufacturing, the environment and energy.

Goal 2: A country where people can live without anxiety into their 90s

– High-quality work and lives –

Japan will depart from production-oriented thinking and mass consumption lifestyles and realize high-quality ways of living, working and dwelling. It will establish lifestyles that strike a balance between the environment and the economy and use resources carefully.

Goal 3: A country that sustains economic growth even with a declining population

– Overcoming population decline –

Japan will utilize its strengths in “human resources,” “technology” and “cultures and lifestyles” to the maximum extent possible to achieve a sustainable growth that is led by the consumers and the people, minimizes disparities, is open to the world and is based on a balance between domestic and external demand.

A more advanced society encompassing the three goals should coexist harmoniously with the global environment. It is vital to create an economic society that coexists harmoniously with the environment. As a top-level nation in energy-saving technology and the like, Japan is required to demonstrate its “environmental prowess” by sharing environmental consciousness,

playing a leading role in addressing global environmental issues, and strengthening environmental innovation to build a low-carbon society and the like.

(Shape of economic growth to achieve goals)

The shape of economic growth to achieve the above three goals is described below. The key to economic growth is the “networking ability” of economic entities to cooperate while acting independently and demonstrating their respective strengths.

1) An economy in which all participate

i) Consumers driving growth

Departing from production-oriented thinking and creating a consumer-oriented society. Aiming at a virtuous circle in which excellent goods and services bring affluence to people’s lives and lead to income and employment.

ii) Full use of IT

Making a society that links all people through the full use of IT. Spreading a new method of communication and expanding new services and employment opportunities. Improving the productivity of a wide range of industries and organizations and achieving regional revitalization.

iii) Elderly and working generations supporting each other

Creating a labor market in which elderly and young people are mixed together. Developing health, nursing care, child care and other services that lead to a sense of reassurance in people’s lives as a growth sector for a society with falling birth rates and an aging population.

iv) Bearing responsibility for future generations

Developing a new model of economy that strikes a balance with the environment, to be passed on to future generations. Introducing this economic model in all fields and regions to build a sustainable society.

v) Overcoming boundaries between regular and non-regular workers

Making a society in which people can select diverse and flexible ways of working, with equal treatment secured regardless of one’s form of employment.

vi) Companies in different industries and of different sizes cooperating

Large enterprises and SMEs, and manufacturing and agriculture/services industries will cooperate and grow together by circulating and sharing ideas and information.

vii) Urban and rural areas supporting each other

Through the formation of broader economic zones and cooperation between the urban and rural areas therein, people’s lives and industries in both areas will be mutually supported.

2) An economy that develops its strengths

i) Enhancing international competitiveness by way of utilizing strengths

Pursuing the “only one” value amid globalization and maintaining the world's highest technology standards.

ii) Achieving growth by way of converting risks into opportunities

Not only overcoming challenges related to potential risk factors such as the declining and aging population, the high degree of dependence on overseas energy and foods, and environmental constraints, but using such disadvantages as a key for growth.

iii) Developing high quality of life by proposing a “long-lasting and slow lifestyle,” and spreading this proposal throughout the world.

Turning a society characterized by narrow living spaces and a “throwaway” consumption lifestyle into a stock-oriented society emphasizing slow and long-lasting use of resources with a sense of enjoyment by way of reducing life-cycle cost.

iv) Every person improving and exercising potential at any time

Providing opportunities for development of abilities to ensure that every person has a chance to increase their income. Making a society where efforts are rewarded.

3) An economy that develops together with the rest of the world

i) Expanding the flow of people, goods, money and information by way of establishing an open economy

Expanding Japan’s coordination and cooperation with Europe, the United States and other parts of Asia to actively introduce superior overseas elements and systems and develop them into new growth energy.

ii) Taking a leading role in solving global issues by utilizing Japan’s strengths

Taking a leading role in solving common issues facing developed countries, newly industrialized countries and developing countries, such as environmental conservation – including measures against climate change – and preservation of water resources.

iii) Transmitting information concerning Japan’s appeal to the world

Spreading Japan’s appeal – such as the “soft power” of Japanese culture, content and lifestyles – throughout the world, and making Japan a country that foreign people wish to live in and visit.

iv) Each region enhancing its strengths and linking with the world

Creating diverse links between local communities in Japan and foreign countries.

v) Utilizing Japan’s location in Asia, the strongest growth center in the world

Advancing and harmonizing the economic systems of Asia and enhancing the growth potential and stability of financial and capital markets in order to grow together with the rest

of Asia in the Asian economic zone. Tackling issues such as the global environment together with the rest of Asia to establish a framework for developing together.

vi) Developing international human resources in Japan

Making Japan a center of human resources development in Asia. Developing international human resources and accepting outstanding foreign human resources to make a society where anyone can easily demonstrate their abilities.

(2) Concretization of Growth Strategies

Specifically, the following three strategies will be promoted as those for new growth. All three will share the common basis of “environmental prowess” and will effectively demonstrate “networking ability.”

Strategy 1: Strategy of mutual cooperation (through the participation of all.)

The economy that is driven by large enterprises, cities and working people will be reexamined. SMEs, venture companies, rural areas, consumers and elderly citizens will also take leading roles and develop together. Along with a safety net for sense of reassurance, the broad middle class will be maintained.

Strategy 2: Strategy of independence (through demonstrating strengths)

Individuals, companies and regions will become independent by way of departing from an economy whose weaknesses are both deplored and protected as well as enhancing strengths. Taking on new challenges will break through the sense of stagnation and produce international competitiveness.

Strategy 3: Global strategy

Japan will grow together with the rest of the world while taking full advantage of its national character, as seen in the fact that actively embracing the dynamism of the world economy has brought about the nation’s rapid progress.

In line with the above basic direction and past policies⁹ for enhancing growth potential, the Council on Economic and Fiscal Policy will play a leading role in translating the new growth strategies into concrete measures around this spring and compile the strategies in the “Basic Policies 2008 (tentative name).”

⁹ The policies include the “Third Science and Technology Basic Plan” (Cabinet Decision of March 28, 2006), “Program for Enhancing Growth Potential” (April 25, 2007), “Asia Gateway Initiative” (May 16, 2007), “21st-Century Environment Nation Strategy” (Cabinet Decision of June 1, 2007), “Long-term Strategic Guideline ‘Innovation 25’” (Cabinet Decision of June 1, 2007), “Economic Growth Initiative” (Revised on June 19, 2007) and a basic program aimed at converting Japan to a country built on tourism (Cabinet Decision of June 29, 2007).

Chapter 3 Toward Regional Independence and Revitalization

(1) Supporting regional revitalization

(Promotion of comprehensive support under the Strategy for Regional Revitalization)

Based on the “Strategy for Regional Revitalization,”¹⁰ comprehensive support across the government ministries and policies will be promoted, primarily within the context of the Unified Headquarters for Regional Revitalization in the Cabinet. In conducting such support, the Government will create the Program for Regional Revitalization with the aim of supporting regions in their initiation of unrestricted actions based on their own ingenuity and ideas. In taking this opportunity, support measures by all ministries will be linked in a coordinated manner so as to promote comprehensive support.

Specifically, from an on-the-ground perspective, the Government will classify regional issues into three categories, namely “rural cities,” “farming, forestry and fishing villages” and “villages facing difficult basic conditions,” and focus on the following three main sectors:

i) Protecting the lives of residents (through Medical care, Welfare, Housing, Security, Environmental preservation, Public transport and Information and communication infrastructure)

ii) Developing industries capable of serving as original sources of power that enables regions to maintain economic and social activities (through Utilization of local resources, Creation of new industries, Promotion of establishment of new companies, Cooperation among agricultural, commercial and manufacturing industries and Revitalization of the Agriculture, Forestry, Fisheries and Construction industries and SMEs)

iii) Regional development through intra- and inter-regional exchanges (through Tourism, Provision of opportunities to reside in both urban and rural areas and Arterial traffic)

In addition to these three main sectors, the Government will develop an integrated plan by way of organizing measures for such areas as Employment, Education, Urban functions and Local communities.

(Establishment of the Regional Power Revitalization Corporation)

In coordination with the “Regional Revitalization Strategy,” the Government will revitalize regional economies -- a priority for the Japanese economy -- through establishing the Regional Power Revitalization Corporation, which will support restructuring of medium-sized regional companies and semi-public joint venture companies and promote “areal revitalization,”

¹⁰ “Strategy for Regional Revitalization” (approved at the Meeting of the Unified Headquarters for Regional Revitalization on November 30, 2007)

under the understanding and cooperation of regional financial institutions and local governments.

(2) Decentralization and Local Administration & Finance Reforms

The Government will further transfer power to local governments so that a system is developed to enable local regions to explore ideas and implement them on their own. The Government will also tackle local tax and finance reforms to allow local governments to become financially independent.

The Committee for the Promotion of Decentralization Reform, based on its “Basic Idea” and “Interim Report,” will thoroughly review the division of roles between the central and local governments. It will also consider reforming the obligations and frameworks imposed on local governments under state law and the central government's involvement in local administration, and transferring central government power to local governments and rationalizing administrative services in line with the “Law for the Promotion of Decentralization Reform,”¹¹ toward the development of local tax and finance infrastructure and the thorough reform of local branch offices of the central government. The committee will issue recommendations on these matters this spring and thereafter.

In line with these recommendations, based on the “Law for the Promotion of Decentralization Reform,” the Government will formulate a “plan for the promotion of decentralization reform” that sets out required legislative and fiscal measures, and submit a “new decentralization package law” as early as possible in FY2009. The Headquarters for the Promotion of Decentralization Reform in the Cabinet will vigorously lead the government's united decentralization reform.

In light of the fiscal conditions of the central and local governments, considerations will be made in pursuit of an integrated package to reform state subsidies and contributions, local allocation tax and division of tax sources as well as local government bonds. Measures to reform the division of tax sources between the central and local governments may include transferring some central government tax sources to local governments.

In line with the central government's fiscal consolidation, local governments will tackle expenditure reforms.

The Government will steadily implement decentralization and consider introducing a system of broader regional government (Doshu-sei) through preparation of a “Doshu-sei Vision” in pursuit of local government independence.

¹¹ “The Law for the Promotion of Decentralization Reform” (December 15, 2006, Law No. 111)

Chapter 4 Toward Establishing Secure and Trustworthy Finance, Social Security and Administration

(1) Steady Promotion of Integrated Reform of Expenditures and Revenues

(Definite achievement of a surplus in the primary balance)

Toward advancing fiscal consolidation, the Government will promote stable growth and firmly maintain the “Basic Policies 2006”¹² and “Basic Policies 2007.” The current expenditure reform efforts for expenditure as a whole will not be relaxed, and reductions will be achieved at the central and local governments in line with the “Basic Policies 2006” and “Basic Policies 2007.” Even after implementing expenditure reforms and other reforms, for any possible increases in burden caused by social security services and the declining birthrate, the Government will secure a stable supply of revenue sources, and avoid any shift of the burden 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.¹³

With the aim of restoring the primary balance of the financially-pressed central government as much as possible, the Government will promote fiscal consolidation while securing a balance between central and local governments. Local governments will maintain a surplus trend by reducing their expenditure, keeping the reduction in pace with that of the central government and, in terms of revenue, securing the total amount of general revenues required.

(Toward stable reduction of the ratio of debts to GDP)

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

¹² “Basic Policies for Economic and Fiscal Management and Structural Reforms 2006” (Cabinet Decision of July 7, 2006). Hereinafter referred to as the same.

¹³ The “Basic Policies 2006” set “the required amount” as the amount that is necessary to achieve a surplus in the primary balance of the central and local governments combined in FY2011 and said: “The portion that is still short of the required amount after conducting expenditure reduction will be supplemented in principle by the increased revenue achieved through revenue reform in order to achieve the Integrated Reform of Expenditures and Revenues. By doing so, the Government will secure market confidence in fiscal management.”

secure a certain amount of surplus. In doing so, while maintaining steady 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 GDP and reduce the ratio in a stable manner.

The Council on Economic and Fiscal Policy will consider specifying the above targets.

(Tax reform)

Based on the 2004 amended pension law, the “Basic Policies 2006,” the “Basic Policies 2007” and the “Basic Concept” in the ruling parties' FY2008 tax reform outline, the Government will try to promptly realize a thorough reform of the tax system, including the consumption tax.

(Definite achievement of medium-term targets through regular checkups)

In order to make the Integrated Reform of Expenditures and Revenues effective, in line with the last fiscal year's “Direction and Strategy,” each fiscal year's budget will be checked at pivotal points during budget formulation to see whether it is consistent with the steady achievement of the medium-term target toward fiscal consolidation.

(2) Integrated Reform of Social Security and Tax System

1) Five Principles for Reassurance and Sustainability

Over the period until FY2025 when baby-boomers become old-old, young people's tax and social security premium burdens will have to be increased to maintain social security benefits, or else benefits for elderly people will have to be lowered to prevent burdens from being increased amid falling birth rates and the aging of society.

In recognition of such difficult conditions, the Government must reform social security and tax system in an integrated manner. In doing so, the Government must continue discussions in line with the following “Five Principles for Reassurance and Sustainability”, design the most suitable form of social security system in terms of both benefits and burdens, and secure a stable supply of revenue sources:

Principle 1: Enhancing economic vitality

Growth potential should be enhanced to reduce future burdens as much as possible and achieve both stable economic growth and ample social security. In order to maintain and enhance Japan's competitiveness, the integrated reform of social security and tax system should cover the viewpoints of business activities and employee participation.

Principle 2: Correcting the disparity between generations regarding benefits and burdens

In order to establish a sustainable social security system, benefits and burdens should be reformed to reduce the disparity between generations. For that purpose, the increase of benefits should be restrained through institutional reform by way of prioritization and streamlining. Regarding the indispensable increase of benefits, a stable supply of revenue sources should be secured by broad and equal burdens on all generations and burdens should be prevented from being passed on to future generations.

Principle 3: Integrated and consistent review of social security and tax system

The Government will create a framework which allows individuals to receive the necessary benefits at every stage of their lives efficiently and effectively, regardless of their working styles and so on, and ensure equal sharing of burdens without negatively affecting people's willingness to work. In order to support the people in true need, relevant government ministries and agencies should work together to conduct an integrated and consistent review of the social security and tax systems, which have been separately designed.

Principle 4: Trustworthiness and transparency of the systems

The Government will establish a framework for a social security benefit system as well as for a system operation and premium collection system that can be trusted by the public. The computerization of social security should be promoted so that individuals may grasp and utilize their unified social security information.

Principle 5: Maintaining a balance with medium to long-term fiscal consolidation

The Government will firmly maintain the Integrated Reform of Expenditures and Revenues and definitely achieve a surplus in the primary balance of the central and local governments combined by FY2011. In doing so, the Government will thoroughly eliminate administrative and fiscal waste. Both a sustainable social security system and fiscal consolidation must be realized thereafter.

More specifically, in the immediate future the Government will continue discussions on policy challenges, including the ones mentioned below, based on the latest population estimates, and implement practicable reforms.

2) Medical and Nursing Care

In FY2005, per-capita medical expenses totaled 260,000 yen for the entire people in

Japan and 820,000 yen for old-old people. In order to increase the efficiency of medical care services to cut costs while maintaining and improving the quality of services, the Government will work on the following effective reforms to achieve the targets specified by the “Program for Improving Quality and Promoting Efficiency in the Medical and Nursing Care Services”¹⁴:

i) Reduction of burdens on doctors, and division of roles between hospitals, clinics and nursing care facilities

Reduction of burdens on hospital doctors, specification of roles of hospitals, clinics and nursing care facilities, prioritization of rewards commensurate with their respective roles

ii) Reviewing roles of medical and nursing care service providers and their training systems

A review of division of roles between doctors and nurses, training of doctors with all-round medical care ability

iii) Promoting generic drugs and introduction of IT

Promotion of use of generic drugs, elimination of duplicate medical tests, promotion of the Diagnosis Procedure Combination, promotion of online receipts, introduction of social security cards (tentative name)

iv) Developing regional medical care systems including secured availability of doctors

Solutions to shortages of gynecologists and pediatricians, expansion of emergency medical services including creation of systems to ensure that emergency patients are accepted without fail

v) Reorganization and greater efficiency of public hospitals

Promoting local governments' preparation of public hospital reform plans based on the “Public Hospital Reform Guideline.”¹⁵

3) Pensions

Public pensions form the basis of lives of the elderly, playing an indispensable role in securing reassurance in the daily lives of citizens. Along with building public confidence in the public pension system, the Government should have a long-term perspective to design a system that can secure stable benefits into the future.

To this end, the Government will steadily address the problem of pension records and measures against people failing to pay premiums or join pension plans, reform the relevant organizations and operations, and thus try to solve the various problems involving pensions. Based on the 2004 amended National Pension Law,¹⁶ the Government's share of contributions to the basic pension scheme will be raised to 50% by FY2009, after the necessary fundamental

¹⁴ “Program for Improving Quality and Promoting Efficiency in the Medical and Nursing Care Services” (May 15, 2007)

¹⁵ “Public Hospital Reform Guideline” (December 24, 2007)

¹⁶ “Law to Partially Amend the National Pension Law, etc.” (2004, Law No. 104)

tax reform for securing stable financial resources. Nationwide debate is required on the basic way in which pension systems will function in the medium to long term, including the choice or combination of premium and tax methods.

4) Falling birthrate

In order to make Japan a society where citizens can achieve their aspirations for marriage, childbirth and child-raising, the Government will work based on the “Key Strategies for Japan in Support of Children and Families,”¹⁷ the “Work-Life Balance Charter”¹⁸ and the “Action Guideline for Promotion of Work-Life Balance”¹⁹ to realize a balance between work and personal life for both males and females through changes to their ways of working, and to develop child-raising support infrastructure such as childcare services that responds to diverse ways of working. The two measures will be implemented as “two wheels on the same axle.”

In order to secure the revenue sources required at present and to avoid passing the burden on to future generations, the Government will continue its deliberations together with discussions on tax reform and will promptly begin and speed up considerations on institutional frameworks for the burdens borne by the entire society (central and local governments, enterprises and individuals) so as to support training of the coming generation in a comprehensive manner.

(3) Shifting to a Government Befitting the 21st Century

1) Thorough review of administrative functions

In order to create a government befitting the 21st century, the Government should thoroughly review administrative functions and eliminate waste and inefficiency. To this end, based on the Administrative Reform Promotion Law,²⁰ the Government will promote the review of independent administrative agencies and overall personnel expenditure reform, with a view to expanding the scope for private sector activities and to consolidating and streamlining the administrative system. At the same time, the Government will address: civil service reform; regulatory reform; private finance initiatives and other measures for the utilization of private sector resources; active implementation of market testing; state asset sales and other asset and liability reform measures (including introduction of a bidding system using private sector proposals for state asset sales); public-interest corporation reform (based on the stance that the private sector's voluntary public activities should be promoted further), etc. Government duties should be classified and reviewed from the basic standpoint of ascertaining whether or not such

¹⁷ “Key Strategies for Japan in Support of Children and Families” (December 18, 2007)

¹⁸ “Work-Life Balance Charter” (December 18, 2007)

¹⁹ “Action Guideline for Promotion of Work-Life Balance” (December 18, 2007)

²⁰ “Law Concerning Promotion of Administrative Reform to Realize a Simple yet Efficient Government” (2006, Law No. 47)

duties should be implemented by public sector organizations.

2) Shifting to an administration based on the standpoints of the people and the consumers

In order to allow citizens to live with a sense of security, the Government should review or expand administrative operations related to people's daily lives so as to prevent damage and bring safety and security to citizens.

To this end, the Government will transform the administration into one based on the standpoints of the people and the consumers and thoroughly review the whole range of the administration, including laws, institutions and projects for the basic areas of people's lives: "eating," "working," "producing," "protecting" and "living." Through these efforts, the Government will thoroughly reform the production-oriented administration and establish an administration that puts the people and the consumers first.

Chapter 5 Future Economic Prospects

The economic prospects for the period covered by the “Medium-term Policies” are described below. Since various uncertainties accompany the economic prospects given here, they should be interpreted with a considerable margin.

If the policies incorporated into the “Medium-term Policies” are implemented, Japan's potential growth rate will gradually rise, and a real growth rate of about 2% or even considerably higher can be expected for that period. Furthermore, a nominal growth rate of around 3% or higher can be expected for that period.

On the other hand, if risks arise, in other words, if the policies' effects fail to become fully apparent and if the external economic environment worsens due to a global economic slowdown and the like, the real growth rate is expected to be within a range of 1.0-1.5% or lower over the medium term. The nominal growth rate is projected to be within a range of 1.5-2.0% or lower.

Prices are expected to gradually exhibit a stable positive increase rate after deflation is overcome under the appropriate macroeconomic management indicated in the “Medium-term Policies.” The increase rate in the consumer price index (CPI) is projected to approach around 1.5% within the period covered by the “Medium-term Policies.” If risks arise, however, the price index increase rate is expected to be somewhat lower than these figures.