

(Reference)
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The Economic and Fiscal Policy of the Koizumi Administration
– Achievements of the Council on Economic and Fiscal Policy and Policies Ahead –

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1. Introduction

Eight months have already passed since Prime Minister Koizumi inaugurated his cabinet. Japan's economic and fiscal policy management is changing fundamentally under his strong leadership. Today, in the last day of 2001, I would like to talk about the changes we made during the year, and about policy direction for 2002.

As you are all aware, the Council on Economic and Fiscal Policy was launched as a forum to support the prime minister in exerting his leadership. Since its inaugural meeting on the day of reorganization of central government ministries and agencies (6 January, 2001), 35 meetings have been held. I believe that the Council has successfully made the following achievements through intensive deliberations.

2. Achievements of the Council

(1) Demonstrating a path to structural reform

In June, the "Structural Reform of the Japanese Economy: Basic Policies for Macroeconomic Management" (hereafter called *the Basic Policies*) was compiled. This clarified the basic concept underlying the Koizumi reforms: "No growth without reform." In addition, in September the "Reform Work Schedule" was formulated, giving a clear timetable for the specific contents of *the Basic Policies* and demonstrating a public road map for reform to the people.

(2) Deciding a broad framework and budgeting priorities for the FY2002 budget; aiming at bold reforms

The Basic Policies formed the foundation for formulating the FY2002 budget. Specifically, under a policy of limiting the issuance of government bonds to no more than 30 trillion yen, seven priority areas were identified, and issues for reforms in public investment, social security systems, and local public finances were presented. Based on these, the guidelines for budget requests were compiled in August. It was decided that the FY2002 budget should be drafted based on the principle of “decreasing budget allocation by 5 trillion yen in non-priority fields while increasing by 2 trillion yen in priority ones.” In addition, the Council made a more detailed report to the prime minister as the “Guidelines for Formulation of the FY2002 Budget” early December. This is the basis on which the FY2002 reform-committing-budget has been compiled.

(3) Proposing flexible policy measures

As the economic situation continued to deteriorate, flexible policy measures were proposed by the Council. When the government formulated policies such as the “Emergency Economic Measures” in April, the “Advanced Reform Program” in October, and the “Immediate Action Program for Structural Reform” in December, the Council led discussions to provide direction on the specific contents of those measures. The Council proposed various measures to contribute to the disposal of non-performing loans, the strengthening of safety nets for the unemployed and for small and medium-sized companies, and the acceleration of structural reforms.

(4) Fulfilling accountability by ensuring a transparent policy formulation process

Deliberations at the Council have been disclosed through publicizing documents and discussion summaries soon after the meetings. This procedure ensures the transparency of the policy formulation process. As a result, various policy formulation processes, including those of budget formulation, are changing to become clearer and more easily understandable for the general public.

I think such unyielding efforts have warranted bold and flexible management of economic and fiscal policy for the determined implementation of structural reforms.

Now I would like to turn to the economic issues.

3. Economic assessment and outlook of Japan

(1) The economy continues to deteriorate

The terrorist attacks on September 11 have created heightened risks for a concurrent global recession. Against this background, the Japanese economy continues to deteriorate. In addition to weakened personal consumption, industrial production has declined sharply. Business investment is also decreasing. The unemployment rate has risen to its highest level ever. Furthermore, deflation (continuous decreases in prices) is underway.

As a result, the Japanese economy faces severe conditions throughout the remainder of FY2001. Real GDP is expected to decline by about 1.0 percent in FY2001.

(2) Firm policy stance to prevent the economy from falling into a deflationary spiral

To cope with such developments, the government has formulated the “Immediate Action Program for Structural Reform,” accompanying the second supplementary budget for the current fiscal year. By steadily implementing these initiatives, the government intends to further accelerate structural reforms and to prevent the economy from falling into a so-called “deflationary spiral” wherein economic conditions deteriorate at an accelerating pace through the interplay of falling prices and contracting production.

In particular, the second supplementary budget aims to boost demand by allocating 4.1 trillion yen (US\$34 billion) to social infrastructures that will facilitate structural reforms. Of that amount, the national government will bear 2.5 trillion yen (\$20 billion), of which 1.5 trillion yen (\$12 billion) will be for public works projects, and 1 trillion yen (\$8 billion) for public facilities.

The economic effects of this demand increase are estimated to push GDP by 0.9 percent in real terms, using the Cabinet Office’s Short-run Macroeconometric Model of the Japanese Economy .

As for the economic and fiscal policy management, the first and second supplementary budgets of FY2001 as well as the FY2002 budget shall be implemented in an integrated and ceaseless manner. And due attention shall be paid to possible risks in the process of structural reforms. Furthermore, the government stands ready to take bold and flexible policy actions, and will closely monitor economic conditions.

In line with the structural reforms being promoted by the government, it is hoped that the Bank of Japan will adopt appropriate and flexible monetary policies to prevent deflation. The government and the Bank of Japan can work together toward resolving the problem of deflation. The Bank of Japan decided additional monetary easing measures on December 19. (Increasing the outstanding balance of the current accounts at the Bank at around 10 to 15 trillion yen and increasing its outright purchase of long-term government bonds to 800 billion yen per month.) I highly appreciate this policy decision.

(3) GDP growth rate is projected to be zero percent for FY2002

I will now talk about the economic outlook for FY2002.

As the intensive adjustment period continues in FY2002, it is unavoidable that prolonged severe economic conditions will persist. We need to aim at economic rejuvenation by overcoming economic fragility with bold implementation of structural reforms, and to do so without a heightened sense of anxiety.

Keeping the basic attitude of “no growth without reform,” economic growth led by private demand will be pursued in FY2002 by unfolding the potential through the further acceleration of structural reforms. Economic development during the year could be depicted as follows. Positive consequences of policy efforts such as the second supplementary budget for FY2001 and anti-deflationary measures will steadily be realized. In addition, improvement in the U.S. economy is likely to result. Accordingly, while severe conditions continue, it is expected that the Japanese economy will emerge from its stagnation and begin to move gradually toward recovery, centering on private demand in the second half of the fiscal year.

As a result, the growth rate of real GDP is projected to be about zero percent.

(4) "Reform and Perspectives" will be decided by the Cabinet in January 2002

Medium-term economic and fiscal management will be clearly drawn by compiling the "Structural Reform and the Medium-term Economic and Fiscal Perspectives" (provisional, hereafter called *Reform and Perspectives*). It intends to show desirable economic and social conditions, and the medium-term policy framework focusing on structural reforms for that end. *Reform and Perspectives* is now undergoing intensive discussion at the Council; final approval will occur next month.

The most important task for the government during the intensive adjustment period of the coming two years is to overcome deflation. For this purpose, priorities will be set on the prompt disposal of non-performing loans and the implementation of structural reforms emphasizing the expansion of private demand and employment. These policy efforts will result in the steady economic growth led by private demand, namely 1.5 percent and above in real terms and 2.5 percent and above in nominal terms as an annual GDP growth rate from FY2004.

Furthermore, under the assumption of the consistent efforts of fiscal consolidation and the continuing steady economic growth centering on private demand, it is projected that the primary balance of the government sector will turn into a surplus sometime in early 2010s.

4. Future Tasks of the Council

As the last topic, I would like to introduce the major tasks ahead for the Council, which is the driving force of our policy management.

The activities of the Council this year have made it possible to take a vigorous step forward towards the promotion of structural reforms. However, this is only one step in implementing structural reforms.

To make further progress, in January next year *Reform and Perspectives* will be finalized for approval, thereby drawing a future picture of the economy once structural reforms have been in place. In addition, discussions will be undertaken concerning strategies to revitalize the economy, the taxation system, and the government-affiliated financial institutions.

Although the Japanese economy is likely to face a severe period for a while, overcoming this intensive adjustment period will revitalize the economy. Under the resolution of Prime Minister Koizumi that there can be “no growth without reform,” I believe that we should continue structural reforms without hesitation.

Finally, I commit myself in support of Prime Minister Koizumi’s leadership. I will continue to do my best to enhance the Council’s functions to step up measures for structural reforms in a visible manner to the general public through ensuring the transparency of Japan’s policy processes.