

“Economic Policy and Reform Agenda of the Abe Administration”
Remarks by the Minister of State for Economic and Fiscal Policy,
Hiroko Ota
at the Peter G. Peterson Institute for International Economics
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1. Opening remarks

Ladies and Gentlemen, my name is Hiroko Ota, and I am the Minister of State for Economic and Fiscal Policy. I deeply appreciate to be invited here today and given the opportunity to talk about Japan’s economic and fiscal policy management and structural reform.

The Japanese economy has overcome the long-lasting economic stagnation following the collapse of the bubble economy. However, we are still faced with challenges, such as intensified global competition, the growth constraint brought on by a declining population, and an extremely severe fiscal situation. To address these structural challenges, it is critical to create a new economic regime for the Japanese economy, and this is precisely what the Abe administration is trying to do. Former Prime Minister Junichiro Koizumi attacked the difficult problems of disposing of non-performing loans, the privatization of Japan Post, and deregulation, among others. Now, the Abe administration is continuing these reforms to lead the Japanese economy toward a new phase of medium- to long-term high growth.

Today, I will briefly explain the current economic situation and the reform agenda of the Abe administration.

2. Current Situation and Outlook of Japan’s Economy

Now, I would like to start with the first item, the current situation and the outlook for the Japanese economy.

Since the bottom of the business cycle at the beginning of 2002, the economy has been on a path of continuous recovery led by private demand. This was achieved by the combined effect of private sector restructuring and government structural reforms including non-performing loan disposal.

We believe that Japan has almost overcome deflation because the year-on-year change in CPI has been positive. However, since the change in core CPI, which excludes oil products and other special factors, has

remained around zero, so we still have to pay due attention to the possible risk of falling back into deflation.

With the world economy continuing to recover, both business and household sectors are expected to improve in FY2007. We estimate the real GDP growth rate to be around 2.0% in FY2007, with the nominal GDP growth rate of around 2.2%.

But some risk factors remain. We have to keep our eye on the developments in the global economy, including the US economy, as well as oil prices and the slow transmission of recovery from the business sector to the household sector. Nevertheless, we expect that Japan's economic recovery will be sustained.

3. About the Council on Economic and Fiscal Policy

I would like to move on to the structural reforms of the Abe Cabinet. First, I will briefly touch upon the function of the Council on Economic and Fiscal Policy.

I am in charge of the Council, which will serve as the engine of the reform process.

The Council is chaired by the Prime Minister, Shinzo Abe. The members include the Minister of State for Economic and Fiscal Policy (myself), Minister of Finance (Mr. Koji Omi), Governor of the Bank of Japan (Mr. Toshihiko Fukui), and four private-sector experts in business and academia. Economic policy is now drawn up primarily at this Council. The Council meetings are held almost every week. Each meeting lasts about two hours, during which the members engage in intense debate on various issues of economic and fiscal policy.

The Council was created in January 2001. Under the strong leadership of former Prime Minister Koizumi, the Council played a key role in the structural reform. It has promoted major reforms including those to dispose of non-performing loans, overcome deflation, achieve fiscal consolidation, reform eight government-affiliated financial institutions, and privatize Japan Post.

The meetings are exceptionally transparent. The Council has changed the policy-making process dramatically and replaced a slow-moving bureaucracy with strategic policy management through top-down decisions by the prime minister.

Prime Minister Abe will firmly maintain this function of the Council to further promote reform in Japan.

4 . Reform Agenda of the Abe Administration

Now I would like to talk about structural reform in Japan.

The Japanese economy has seen brighter prospects partly due to structural reforms. The reforms under the Koizumi administration mainly focused on disposing of the negative legacy of the bubble economy. However, the Abe administration reforms seek to explore the new frontier of the Japanese economy. The main purpose of these reforms is to enhance Japan's growth potential in the face of a declining population.

There are two key issues related to enhancing Japan's growth potential. One is to address globalization. The Japanese economy can achieve a high growth rate by creating a seamless interface between Japan and the global economy, especially with other Asian countries. The other is to make maximum use of information and communication technology. Since the latter half of the 1990s, the US economy has increased productivity by leveraging technology. However, the benefits of information and communication technology have been restricted in Japan by obstacles such as regulations, the lack of flexibility in the labor market, and the decision making process at companies.

Firstly, in the reform for globalization, we will further promote EPA, which stands for economic partnership agreements and includes FTA. We will revise the EPA timetable by next spring, with the target of tripling the number of EPA partners from four to twelve in two years. The feasibility of various proposals on Asian multilateral EPAs will be examined as well. Our goal is to incorporate the dynamism and energetic activities of China and other Asian countries to help drive our economic growth, which in turn will contribute to their growth. It will be a win-win relationship. In relation to this, I believe it is also beneficial to explore the idea of the Free Trade Area of the Asia-Pacific, which was noted in the Hanoi declaration of the APEC economic leaders' meeting, as one of the regional multi-layered frameworks in the Asia-Pacific region.

To maximize the benefit from globalization, it is also important to reform our domestic economic system. The Council is now trying to prepare concrete measures to reform our economy for addressing globalization,

which of course includes agricultural reform.

Secondly, in the reform of productivity, we will enhance competitiveness by making maximum use of information and communication technology and raising efficiency in the service sectors. Productivity in the service sectors such as medical care, child care, and labor and education is kept low mainly due to strict regulations. The lack of competition has delayed the adoption of information and communication technology. In the aging society, consumer demand in these sectors is increasing. Therefore, enhancing productivity in these sectors is critical for the Japanese economy. We have to complete regulatory reforms and open up these government-controlled markets to the private sector through “Market Testing” and the creation of a competitive environment.

In addition, we will implement the “Labor Market Big-Bang”—a comprehensive and drastic change in the labor market system, which will include promoting the diversity of working styles and contracts, and facilitating greater mobility in the labor market. It is also important to correct the unfair disparity of treatment between regular workers and non-regular workers.

The government set the goal of accomplishing the transition to a new growth stage in about five years, while maintaining sound macroeconomic management. The Council is now intensively deliberating the key reform areas to achieve this goal. The discussions will be embodied in a new medium-term policy package for economic and fiscal management, which will be decided by the Cabinet within this month.

5. Fiscal Consolidation

Finally, I will comment on fiscal consolidation.

Japan’s primary balance deficit for the central and local government combined is estimated to decline from 5.7% of GDP in FY2002 to 2.4% in FY2006 due to the recent expenditure cuts and revenue increases from the economic recovery. However, Japan still has a severe fiscal situation. The government debts in FY2006 is estimated at around 143.5% of GDP, the worst among major industrial countries.

To tackle this situation, we set the target of achieving a primary balance surplus for the central and local governments by FY2011. After that, we will continue fiscal consolidation to prevent the debt-to-GDP ratio from

mounting up in an explosive way and to reduce it steadily toward the middle of the next decade.

For achieving this medium-term fiscal target, we decided to introduce a new framework for the budget formulation process. The Council will strictly examine the draft budget at several stages of the process to see whether it is consistent with the medium-term fiscal targets.

6. Closing remarks

I believe implementing the structural reforms mentioned earlier should enhance Japan's growth potential, and possibly raise the real GDP growth rate to be around 2% or more in five years, with a nominal GDP growth rate of around 3.5% or more. These structural reforms should boost domestic demand in some areas, notably in the service sectors, and eventually contribute to the prosperity of the world economy, and to the necessary correction of the global imbalance.

I hope today's discussion will help deepen your understanding of the Abe Administration's economic goals.

Thank you very much.