

A closer look at the latest *Basic Policy on Economic and Fiscal Management and Reform*

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On June 9, 2017, the Japanese government issued a Cabinet Decision on the *Basic Policy on Economic and Fiscal Management and Reform 2017* (the “*Basic Policy 2017*”), and the new Growth Strategy 2017. The formulation of these documents is the fifth under the second administration of Prime Minister Shinzo Abe. This Brief takes a closer look at the *Basic Policy 2017* that also incorporates the essential parts of the Growth Strategy and reviews the key points of economic policy and fiscal policy.

The notable feature of economic policy in the *Basic Policy 2017* is its stress upon “work-style reform” and “investment in human resources” as reforms to raise the level of Japan’s potential rate of growth (see **Chart**). Regarding work-style reform, the *Basic Policy 2017* sets forth the direction of systemic reforms related to equal pay for equal jobs and correction of long working hours. With respect to investment in human resources, the *Basic Policy 2017* sets forth a plan to realize free-of-charge infant education and nurseries, underscoring that “the role played by education is extremely large” in realizing a society with “dynamic engagement of all citizens.” Turning to fiscal resources to enable their provision free of charge, which is estimated to be approximately ¥1.2 trillion, the *Basic Policy 2017* laid out a timetable to reach a conclusion by the end of 2017 upon consideration of the “promotion of fiscal efficiency” “taxes” and a “new social insurance formula” such as the “children’s insurance” proposed by LDP Diet Member Shinjiro Koizumi.

A closer look at the contents of the *Basic Policy 2017* related to the Growth Strategy reveals that it revolves around the concept of “Society 5.0” which seeks to solve social challenges through significant progress in advanced technologies (artificial intelligence and robots, etc.). More specifically, the *Basic Policy 2017* lists “extension of health lifespan,” “realization of mobility revolution,” and “FinTech” etc. as strategic fields toward the realization of Society 5.0, and cites initiatives such as “the construction of data utilization infrastructure” and the establishment of a “regulatory sandbox” as cross-sectional initiatives. The “sandbox” is being incorporated in the Growth Strategy for the first time (likened to children playing freely in sandboxes). The measure is designed to create a more liberal environment to let companies conduct demonstration experiments on drones and automatically-driven vehicles, etc. While the government has yet to commence work on institutional design, it is hoped that the sandbox scheme will break through the current situation where governmental or legal regulations present bottlenecks in commercializing advanced technologies.

Next, the first noteworthy point in fiscal policy is the amendment to the fiscal consolidation target. Previously, the government cited only the “primary balance surplus” as the target to be achieved by FY2020. However, the *Basic Policy 2017* cites the “steady reduction in the ratio of government debt to GDP (gross domestic product)” as the target to be achieved simultaneously with the primary balance surplus. This amendment to the fiscal consolidation target is inviting speculation that the government may be putting one foot in the door in order to switch the fiscal consolidation target from the primary balance surplus, widely seen as difficult to achieve, to the ratio of government debt to GDP. Indeed, since Japan’s long-term interest rates have stood at very low levels in recent years, the burden of interest payments on the government has been curbed and the pace of the increase in the ratio of government debt to GDP remains moderate even with a significant primary balance deficit. The government also estimates that under the assumption of high economic growth, the ratio of government debt to GDP will decline for a while after FY2017. For this scenario to be sustainable even after normalization of monetary policy, long-term interest rates would have to stay at levels below the rate of economic growth. While a fair bit of good luck would be necessary for such conditions to continue, the government should stick to the target of achieving “a primary balance surplus” in order to maintain fiscal discipline.

Let us turn to reforms with respect to expenditures. One of the key elements of expenditure reforms is the “drastic reform of the National Health Insurance drug pricing system”. To cite some of the steps taken forward, the *Basic Policy 2017* proposed changes in the revision of drug prices from every two years, thus far, to annual revisions, and the lowering of prices of new drugs lacking innovation. On the other hand, it failed to address specific plans for several reforms related to how to revise the remuneration for medical services (or technical fees for doctors) and the efficiency in medical services.

In addition to social security, the *Basic Policy 2017* addressed the “funds of local governments.” Local governments have established funds for various purposes, including adjustments between fiscal years and redemptions of local government bonds. In FY2015, the combined balance of such funds reached ¥21 trillion, a level that is, in effect, 1.5 times the average balance for the 10 years prior to the Abe administration. Under these circumstances, the *Basic Policy 2017* incorporated a passage that the Ministry of Internal Affairs and Communications (MIC) will shed light upon and analyze the background factors for the accumulation of local government funds.

The MIC is now conducting a fact-finding survey. Depending on its results, the survey might lead to restraints upon fiscal transfers from the central government to local governments (through national tax allocations to local governments, etc.) under a government policy to make use of local government funds. Initiatives for local administrative and fiscal reforms taken by the Abe administration so far did not necessarily lead directly to restraints on expenditures for the whole of the central and local governments. However, the developments related to the funds of local governments might have a considerable impact on the size of expenditures of the central and local governments as well as on the primary balance. Hence, the issue is likely to attract keen attention in fiscal management going forward.

[Chart: Outline of *Basic Policy on Economic and Fiscal Management and Reform 2017*]

- Drive forward the work-style reform for “productivity enhancement by investing in human resources” and promote investment and innovation
- Achieve the primary balance surplus by FY2020, and simultaneously seek the steady reduction in the ratio of government debt to GDP

Economic Policy: Expansion of the Virtuous Cycle of Growth and Distribution and Medium and Long-Term Development

Realization of a society whose citizens remain active throughout their lives through “work-style reform” and “investment in human resources”

- ◆ Work-style reform (equal pay for equal jobs, correction of long working hours)
- ◆ Investment in human resources/education (early realization of free-of-charge infant education and childcare, zero children on waiting lists to get in nurseries)
- ◆ Countermeasures to the falling birth rate/support for childcare (securing of human resources for childcare, utilization of empty classrooms)
- ◆ Promotion of empowerment of women (support for companies positive about women's return to work)

Acceleration of the growth strategy

- ◆ Realization of Society 5.0 (extension of healthy lifespan, mobility revolution, the next-generation supply chain, comfortable infrastructure, FinTech)
- ◆ Productivity enhancement, investment promotion (strengthening of corporate governance, promotion of innovation, promotion of inward direct investment)
- ◆ Regulatory reform (establishment of regulatory sandbox, over 20% cut in administrative procedure costs)
- ◆ New promising growth markets (creation of a nation based on culture and the arts, creation of a sports-oriented nation, clean and attractive Japanese-style integrated resorts (IRs))
- ◆ Cooperation with overseas growth markets (building of the 21st century-style economic structure, promotion of the export strategy for infrastructure system)

Revitalization of consumption

- ◆ Rise of disposable income (increase in minimum wages by around 3%)
- ◆ Expansion of new demand (introduction of staggered school holidays (the Kids' Week))

Others (regional revitalization, support for small and medium enterprises, energy, etc.)

- ◆ Revitalization of regional universities, creation of jobs for young people in regions
- ◆ Intensive support for regional revitalization driven by core companies in regions
- ◆ Strengthen measures to increase farmers' income (reducing input costs, structural reform of distribution/processing)
- ◆ Planned development of infrastructure conducive to productivity enhancement
- ◆ Promotion of local production of energy for local consumption

Fiscal Policy: Integrated Economic and Fiscal Reforms, FY2018 Budget Compilation

- ◆ Seek to realize ¥600 trillion economy as well as the target of fiscal consolidation
- ◆ In FY2018, the final year of the intensive reform period of the Economic and Fiscal Revitalization Action, the government will continue to proceed with efforts on both fronts of expenditure and revenue without loosening the reins
- ◆ Toward the interim assessment in FY2018, the government will strengthen the checkup and assessment of the progress in reform, and the measurement and analysis of the effects of major policies
- ◆ Drastic reform of National Health Insurance drug pricing, structural reform of administrative and fiscal management of local governments with an eye on the 2020s, promotion of various PPP/PFI methods including concession scheme

Source: Made by MHRI based on *Basic Policy on Economic and Fiscal Management and Reform 2017*

(Cabinet Decision on June 9, 2017)

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