

Fiscal Soundness Issues to Be Addressed after Overcoming Deflation

—The Key Will Be Reform of Government Expenditures on Social Security

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The primary balance of Japan's national and local government accounts have been in deficit since the first half of the 1990s, and, since fiscal 2009, the deficits have expanded significantly. Accompanying this, the long-term debt of national and local governments is expanding rapidly, and the ratio of outstanding debt on a government general account basis to GDP, including social security funds, is at the highest level among the industrialized countries.

Amid this severe fiscal situation, the government implemented comprehensive reforms of the social security and tax systems to secure the sustainability of government finances and obtain a stable funding base for social security. It was estimated that, if the consumption tax rate were to be raised from 5% to 10%, tax revenues would rise ¥14.1 trillion annually. However, since a portion of these additional revenues would be allocated to social security, it is believed likely that the decline in the government deficit will be only ¥10.5 trillion at a maximum.

If the economy overcomes deflation going forward, the nominal GDP growth rate would rise, and it is anticipated that the increase in revenues would bring an improvement in the primary balance. However, for revenues to increase, it will be important not only for prices to rise but also for the rate of growth in real GDP to rise. In addition, since increases are expected in government expenditures along with the rise in prices, if tax revenues expand, pressures for increasing government expenditures are expected to rise. After overcoming deflation, it is expected that controlling government expenditures will become considerably more important to achieve fiscal soundness.

The increase in government expenditures in recent years has been largely due to social security related expenditures, and the factor accounting for this has been the deterioration in the finances of the social security fund. Looking ahead, as the population ages demographically, social security expenditures will continue to rise, and this is seen as a factor accounting for the expansion in fiscal deficits. Examination of the average relationships between social security benefits and the burden borne by those who will eventually receive benefits in countries that are members of the OECD indicates that Japan's benefits and burden lack balance and that social security reforms will be indispensable to achieve overall fiscal soundness.

Although Japan has previously set a goal of bringing the primary balance into a surplus position, because of the sudden deterioration in the economy and other factors, the date of reaching this goal has been postponed, and government debt has continued to rise. The more the goal of attaining fiscal soundness is postponed, the more difficult it will be to accomplish. It is for this very reason that measures should be implemented at an early date to reach the goal of a surplus in the primary balance by fiscal 2020.

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*This is an English-language summary of a report originally published on September 24, 2014. The full report is available only in Japanese, but the author will answer questions regarding the topic by e-mail.

*The information and the views contained herein are subject to change without notice.