

**Japan: Report on Observance of Standards and Codes—
Fiscal Transparency Module—Update**

This update to Report on the Observance of Standards and Codes—Fiscal Transparency Module for **Japan** was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on **July 13, 2004**. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of **Japan** or the Executive Board of the IMF.

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JAPAN

**Report on the Observance of Standards and Codes (ROSC)
Fiscal Transparency Module—Update**

Prepared by the Fiscal Affairs Department
(In consultation with the Asia and Pacific Department)

Approved by Wanda Tseng and Teresa Ter-Minassian

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I. INTRODUCTION

1. The original fiscal ROSC was issued in July 2001. During the 2004 Article IV consultation, the IMF staff reviewed developments in the areas pertaining to Japan's observance of the fiscal transparency practices assessed in 2001, with a view to updating, where relevant, changes in current practices, or describing the implementation of the earlier ROSC's recommendations. Unless indicated differently below, the recommendations made in the 2001 ROSC remain relevant.

II. DESCRIPTION OF PROGRESS

2. The original fiscal ROSC identified three key areas where significant progress was needed to improve transparency: (1) clarifying policy with regard to the size of the Fiscal Investment and Loan Program (FILP) and assessing and reporting on the quality of FILP lending; (2) setting fiscal policy in a longer-term context; and (3) reducing the reliance on supplementary budgets and making the macroeconomic model and assumptions available for scrutiny by independent experts (see the original report for more details). The following describes new practices that relate to these specific recommendations in the original ROSC.

Previous recommendation (1) (FILP program):

3. **Under the FILP reform initiated in 2001, the size of FILP has been significantly reduced.** The automatic deposit scheme of postal savings and public pension reserves to the government's Trust Fund Bureau ceased then, and the FILP is being financed through FILP bonds—which are identical to Japanese Government Bonds. The size of the annual FILP program in FY 2004 has been almost halved from the peak in FY1996, with a significant decrease since the implementation of the reform. Some of the government financial institutions have been specifically required to reduce the volume of lending. While Japan Post—the public corporation established following the corporatization of the national postal services in 2003—is in the process of gaining full autonomy in its investment, it continues to invest mainly in low risk securities and, together with public pension funds, underwrites a part of new FILP bonds.

4. **The government is moving toward privatizing four public highway corporations—recipients of large loans from the FILP—and the postal services.** The highway corporations are increasingly relying on issuing government-guaranteed debt in the bond markets for their project financing. The privatization plan of Japan Post is currently being developed.

Previous recommendation (2) (longer-term context for fiscal policy):

5. **Starting in January 2002, the medium-term macroeconomic and fiscal projections have been published by the Cabinet Office with a view to providing a quantitative reference for the government’s economic and fiscal policy program.** Around the time of the cabinet decision of the national budget at the end of the year, the Council on Economic and Fiscal Policy (CEFP)—chaired by the prime minister—elaborates on a medium-term economic and fiscal policy which is subsequently decided by the cabinet, and the projections are attached as reference material provided by the Cabinet Office.¹ These projections cover the main fiscal aggregates, including central and local government primary balance, public debt, and total general government expenditure including social security based on specific assumptions included in the government’s medium-term policy framework.² Separately from this, the Ministry of Finance prepares three-year forward estimates of the national government general account revenues and expenditures—whose coverage is narrower than the general government in SNA—based on the draft budget and an assumption of the continuation of current policies.³

Previous recommendation (3) (reduced reliance on supplementary budgets and making macroeconomic model available for scrutiny):

6. **Efforts to minimize the use of supplementary budgets have been made.** The supplementary budget in FY2003, for instance, was limited to truly urgent and necessary expenditures for policies such as measures for dealing with natural disasters and economic assistance for Iraqi recovery.

7. **The economic and fiscal model underlying the medium-term macroeconomic and fiscal projections has been made available for open scrutiny.** The model was

¹ The paper is titled “Structural Reform and Medium-Term Economic and Fiscal Perspectives.” The English version of the FY2002 and FY2003 revisions are available on the web (<http://www5.cao.go.jp/keizai/index-e.html#efpm>). It is explicitly stated that, while the main text of the framework paper is subject to cabinet decision, the attached projections are not.

² Longer-term projections of social security spending which cover until FY2025 were updated by the Ministry of Health, Labor and Welfare in May 2004.

³ The most recent estimates are published as “Projection of the FY2004 Budget’s Effects on Outlays and Revenues through FY2007.” English version is available on the web (http://www.mof.go.jp/english/budget/brief/2004/2004f_04.htm). The medium-term estimates by the Ministry of Finance are submitted to the Diet soon after the budget submission.

published in November 2001 and has been used to provide inputs to policy discussions at the CEFP.

8. **Other areas where the government is promoting transparency-related budget management reforms include utilization of policy evaluation and rationalization of special accounts.** As required under the Policy Evaluation Law of 2002, the results of policy evaluation at each central government ministry are providing inputs for budget formulation. The number of national government special accounts has been reduced from 38 in 2001 to 31 by April 2004; projects financed by the remaining special accounts are being reduced; and financial statements based on business accounting standards have been introduced to ensure full accountability.⁴

III. IMF STAFF COMMENTARY

9. **The FILP reforms have contributed to clarifying the government's role in financial intermediation.** Regular publication of information on the FILP activities also provides for greater transparency. Continued analysis of the financial implications of the FILP and the quality of FILP lending is recommended.

10. **The medium-term economic and fiscal policy framework is a welcome step toward a more forward-looking approach to managing fiscal policy.** Currently, however, the projections by the Cabinet Office and the estimates by the Ministry of Finance provide only a very broad framework for the budget negotiations in the following years. In order to integrate further the medium-term framework with the annual budget processes, one first step would be to provide more detailed information about revenue and expenditure components and policy assumptions.

11. **The publication of the macroeconomic models and assumptions is an important step toward strengthening the quality of the budget and revenue projections.** The budget preparation process would benefit from further analysis of the fiscal implications of alternative macroeconomic scenarios and other potential fiscal risks.

12. **Limited progress has been made in providing timely information on the consolidated central and general government fiscal balance.** To monitor fiscal developments against the projections, consolidated revenue and expenditure data for central and general governments on an SNA basis should be provided on a higher frequency than is currently available. Timely consolidation of fiscal data, especially for the local governments, would require the standardization of accounting practices and reporting requirements in addition to strengthening staffing and technical capacity of local governments. Furthermore, improvements are needed in coordination among the different agencies responsible for compiling government finance statistics.

13. **The budget documentation could further extend its coverage of contingent liabilities, estimates of tax expenditures, or information on the nature and estimated costs of quasi-fiscal activities related to public policy obligations of government financial institutions and public corporations.** Although the Diet receives information

⁴ In November 2003, Ministry of Finance's Council of Fiscal System issued specific recommendations on restructuring of the special accounts.

on government guarantees, the cost of existing and new special tax measures, and the FILP plan, more comprehensive data and analysis would be required to assess the overall impact of these government activities.