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## Commentary on the Council on Economic and Fiscal Policy (June 25, 2026)

### ~Overview of Basic Principles for Budget Formulation Reform and Medium- to Long-Term Economic and Fiscal Estimates~

Toshihiro Nagahama, Executive Chief Economist  
Economic Research Department, Daiichi Life Research Institute Co., Ltd.

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#### (Executive Summary)

- At the Council on Economic and Fiscal Policy held on June 25, 2026, discussions focused on the basic principles for budget formulation reform and the overview of medium- to long-term economic and fiscal estimates. Accordingly, this article introduces the discussions held during the council meeting along with the author's assertions.
- As the basic principles for budget formulation reform, private-sector members and Minister of Finance Katayama proposed a transition toward operations based on five core principles, breaking away from the conventional era of deflation and low growth (Principle 1: Fiscal Targets, Principle 2: Growth Responsiveness, Principle 3: Creation of an Investment Framework, Principle 4: Supplementary Budgets and Funds, Principle 5: Market Confidence).
- Regarding the direction of local tax and fiscal reforms alongside structural reforms, Minister for Internal Affairs and Communications Hayashi explained local fiscal soundness, regional future strategies, and social security reforms.
- Furthermore, as an estimate of the medium- to long-term economic and fiscal outlook, the Cabinet Office released projection results for three distinct cases based on the efficacy of growth strategies, assuming an annual real additional fiscal expenditure of 10 trillion yen from FY2027 onward up to FY2040 (Growth Strategy Realization Case 1 [Full Effect], Growth Strategy Realization Case 2 [Medium-Term Effect], and Current Projection Case [Demand Increase Only]). Based on these inputs, the author put forward specific recommendations regarding: 1 the market for Japanese Government Bonds (JGBs) for individual investors, 2 budget formulation reform, 3 the operation of the new investment framework, and 4 strengthening the Cabinet Office's medium- to long-term estimation capabilities.

#### 1. Introduction

At the Council on Economic and Fiscal Policy held on June 25, 2026, participants discussed the basic principles for budget formulation reform and the overview of medium- to long-term

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economic and fiscal estimates. This paper outlines the key arguments presented at the council and details the author's own perspective and proposals.

## 2. Fundamental Principles for a Radical Overhaul of Budget Formulation

To break away from traditional budget formulation suited for deflationary, low-growth periods and transition into the concrete systemic operations of "Responsible Proactive Fiscal Policy," five core principles were put forward:

### Principle 1: Shift in the Core Target of Fiscal Management

Instead of mechanically aiming for a primary balance (PB) surplus within a single fiscal year, the core objective of fiscal management will shift to achieving a stable reduction in the debt-to-GDP ratio. The PB will be managed and improved over a multi-year framework, allowing for temporary deteriorations to accommodate growth investments and crisis management.

### Principle 2: Budget Formulation Aligned with Enhancing Growth Capacity

The framework will be revised toward a disciplined allocation of resources commensurate with the expansion of the nominal economic scale, accurately reflecting price and wage increases. The government will inspect and promote thorough price pass-throughs in public procurement as well as adjustments to official prices, such as medical and nursing care fees.

### Principle 3: Creation of the "Strong and Prosperous Japan" Investment Framework

Separate from regular expenditures, a new investment framework will be established to enable predictable execution based on public-private investment roadmaps. Fields of particular significance to economic security will have multi-year financial resources secured and managed under separate categories within special accounts, enabling advanced procurement via "bridging bonds" backed by designated redemption sources.

### Principle 4: Departure from Supplementary Budget Dependency and Overhaul of Fund Rules

Supplementary budgets will be strictly limited to matters of true urgency, while ongoing, permanent measures must be incorporated into the initial budget. Additionally, fund-based projects will undergo rigorous performance management, employing flexible operations and reviews that are not bound by rigid, uniform timeframes.

### Principle 5: Preparing for Uncertainty and Ensuring Market Confidence

The government will eschew mechanical tightening in the face of economic recessions or external shocks.

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Instead, it will maintain market confidence by delivering highly transparent explanations to domestic and international market participants and conducting multi-faceted indicator analyses.

### 3. Opinions and Directions for Recommendations on Local Tax and Fiscal Reforms

An overview of opinions from various councils regarding structural economic shifts and the sustainability of local government administration and finance was presented:

First, concerning the securing of general revenue sources and local fiscal soundness, it was requested that expenses reflecting economic and price trends be appropriately factored into local fiscal plans to secure the total amount of general revenue. Simultaneously, the continuation of zero new issuances of temporary fiscal management bonds was urged alongside a steady reduction of extraordinary debt balances.

Second, regarding regional future strategies and social security reforms, emphasis was placed on supporting the development of regional industries and driving structural transformation via municipal DX (Digital Transformation) and AX (AI Transformation). To address severe labor supply constraints, proposals were advanced to optimize universities and departments in line with the shrinking 18-year-old population, enhance productivity and promote organizational consolidation or scale-expansion in medical and nursing care sectors, and review the cost-burden sharing of the elderly to alleviate the burden on the current working-generation population.

### 4. Estimates of the Medium- to Long-Term Economic and Fiscal Outlook

Assuming comprehensive leveraging of domestic investments, the Cabinet Office simulated the economic outlook up to FY2040 under the condition that an additional real fiscal expenditure of 10 trillion yen is executed every fiscal year starting from FY2027. The results were analyzed across three cases depending on the efficacy of the growth strategy:

#### 1 Impacts on Economic Growth and Potential Growth Rate (Supply Capacity)

The growth strategy is projected to significantly drive up Total Factor Productivity (TFP) compared to the current projection case, thanks to accelerated AI adoption, capital rejuvenation through large-scale capital investments, R&D investments, and optimized allocation of productive resources.

Growth Strategy Realization Case 1 (Effects Fully Manifested):

The TFP growth rate rises to +1.4% in the long term, pushing the potential growth rate into the upper 1% range and nominal GDP growth into the mid-3% range.

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Growth Strategy Realization Case 2 (Effects Manifested in the Medium Term):

The TFP growth rate reaches +1.1% in the medium term and plateaus thereafter. The potential growth rate hovers in the mid-1% range, and nominal GDP growth trends around 3%.

Current Projection Case (Demand Increase Only):

Expected return on investment fails to rise, leaving the TFP growth rate stagnant at around 0.6%. Coupled with an expanding negative drag on labor input due to aging and low birthrates, the potential growth rate drops to the lower 0% range, with nominal GDP growth remaining subdued at around 2%.

## 2 Scale of Private Capital Investment and Nominal GDP

In Realization Case 1, private capital investment rises to over 230 trillion yen by FY2040, bringing nominal GDP close to 1,100 trillion yen. In Realization Case 2, private capital investment reaches approximately 220 trillion yen by FY2040, with nominal GDP increasing to around 1,040 trillion yen. In contrast, under the Current Projection Case, private capital investment stagnates at around 170 trillion yen, and nominal GDP remains low at approximately 900 trillion yen.

## 3 Impact on Fiscal Indicators (Debt Outstanding and Primary Balance)

Ratio of Outstanding Central and Local Government Debt to GDP: Even with the additional fiscal expenditures, this ratio demonstrates a downward trend (declining securely and stably) under Realization Case 1, where robust economic growth is achieved. Conversely, under Realization Case 2 and the Current Projection Case, the ratio turns upward in the 2030s.

Ratio of Central and Local Government PB to GDP: In both Realization Cases 1 and 2, the additional expenditures cause a short-term deficit, which turns into a surplus from FY2028 onward, with the surplus margin expanding until the mid-2030s. In the Current Projection Case, the deficit margin expands steadily.

## 5. Author's Recommendations

In light of the above findings, the author advanced specific recommendations during the council meeting across four areas:

First, regarding the expansion of the JGB market for individual investors, the author pointed out the low proportion of government bond holdings among Japanese households. Drawing on successful precedents from Italy—which introduced loyalty premiums and preferential tax treatments—the author argued that Japan should formalize a highly attractive structural reform package for individual JGBs combining competitive yields, loyalty rewards, and tax incentives.

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Second, concerning budget formulation reform, the author raised concerns over the policy line stating that “essentially no additional government bonds will be issued” in supplementary budgets from autumn onward. This phrase carries the risk of creating a misunderstanding that the government will not respond unless a catastrophic crisis occurs. The author emphasized that to prevent crises before they happen and securely foster seeds of

growth, it is crucial to leave operational leeway that preserves fiscal flexibility when required by changing circumstances.

Third, on the operation and oversight of the new investment framework, the author stated that the “Honebute” Basic Policies must be powerfully linked to the year-end budget formulation. It is vital to establish an operational mechanism that permits “item-requesting” (un-ceilinged itemized requests) for the new investment framework separate from standard spending limits. Concurrently, to prevent reckless budget expansion, the author called for rigorous check functions through a standardized template incorporating clear KPIs, tightly integrated with existing administrative project reviews and Evidence-Based Policy Making (EBPM).

Fourth, regarding the reinforcement of the Cabinet Office’s medium- to long-term simulation and analytical capabilities, the author stressed that these estimates serve as an indispensable foundation for presenting “Responsible Proactive Fiscal Policy” to the public and international markets. The author recommended that the government radically reinforce its internal analytical expertise by appointing high-caliber professionals from both inside and outside the public sector. Enhancing these economic models to accurately and consistently map out a virtuous cycle of investment, economic growth, and fiscal consolidation is paramount to turning these policies into reality.