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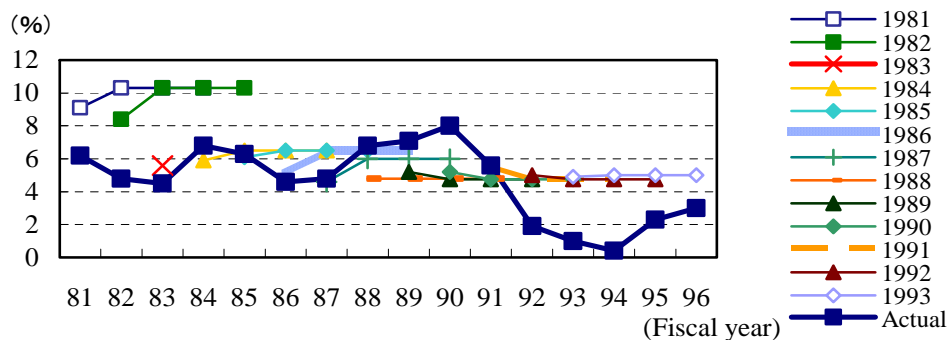
The Need for “Moderate” Projections in Moving Toward Sound Public Finance

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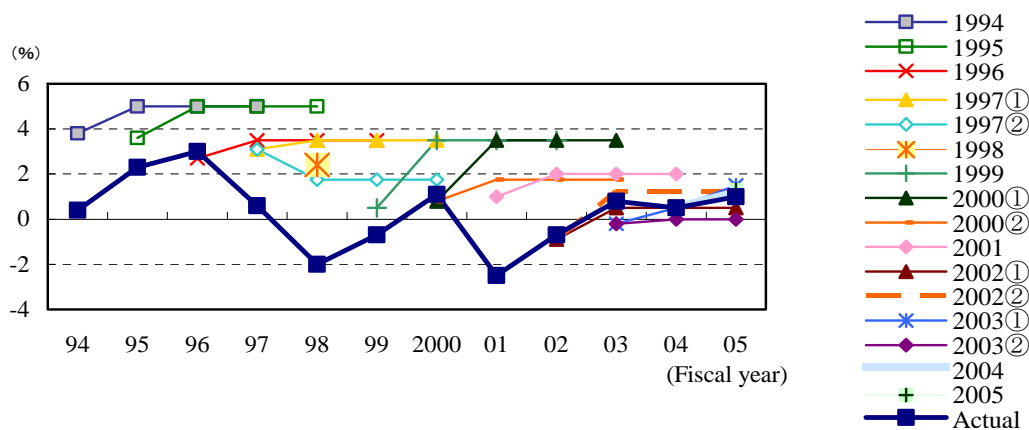
The Ministry of Finance and the Cabinet Office both issue their own respective projections for the medium-term fiscal balance – the former entitled “Trial Calculations of Impact in Later Years” and the latter “Course and Strategy.” Previous research has pointed out that if such government projections are optimistic in their outlooks, they will adopt excessive assumptions of tax revenues, inevitably inviting fiscal deficits.

Graph 1 and Graph 2 present the government projections. We find that the Finance Ministry’s projections for the nominal economic growth rate (using the Cabinet Office’s projections as a reference) are not that far removed from the actual results for the business recoveries and stable periods of the mid-1980s and the years from 2002.

Graph 1 Nominal Economic Growth Projections, 1981~93 (Ministry of Finance)



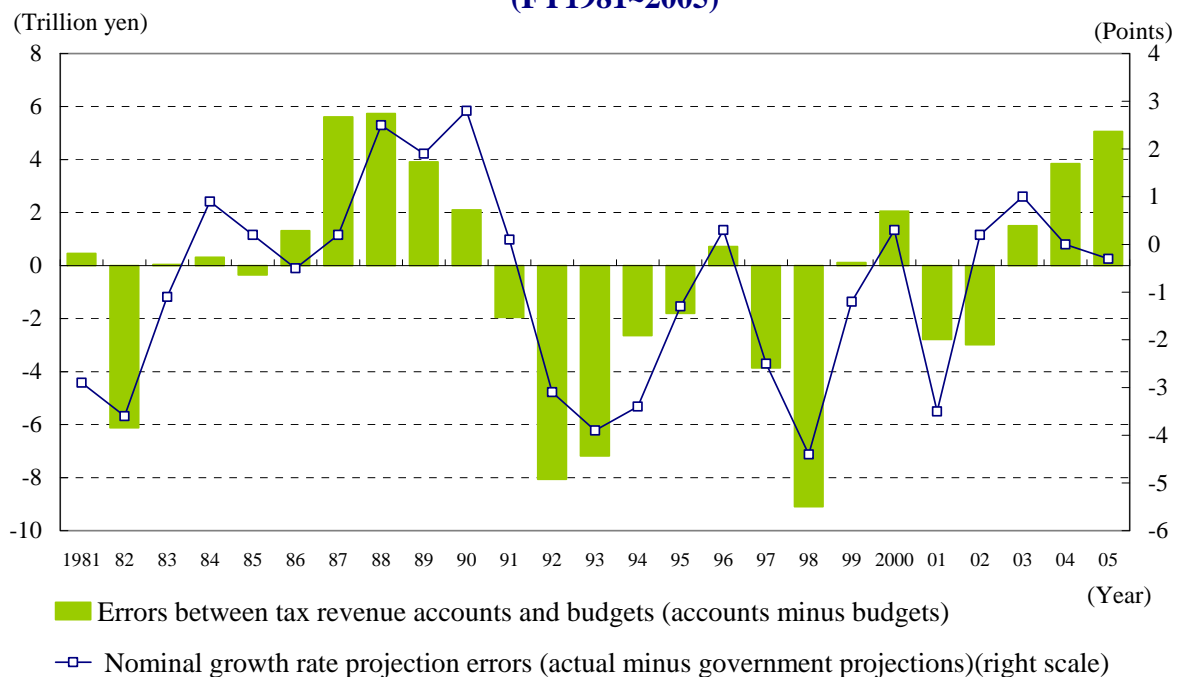
Graph 2 Nominal Economic Growth Projections, 1994~2005 (Ministry of Finance)



Source: Ministry of Finance (*Monthly Finance Review*), etc.

However, from the start of that decade following the collapse of the bubble economy (i.e., the 1990s) projections were overestimated, and it is my view that tax revenues were overestimated. Naturally, there is a need for tax revenue projections to factor in not only the growth rate but also the impact of revisions in the tax system as well. Nevertheless, in years when single year nominal growth rates, the premise for the budget, were projected at levels that turned out to be above the actual results, there was a natural trend for tax revenues to be less than the budgeted targets (Graph 3). Because of this, overestimated projections of tax revenues are based on overestimated projections of growth rate, thereby acting to expand the budget deficit above and beyond expectations. In this report, I wish to introduce the methods used to draw up fiscal projections in other countries, and consider countermeasures for Japan.

Graph 3 Errors Between Nominal Economic Growth Rate and Tax Revenue Projections (FY1981~2005)



Note: General account base tax revenues. Source: Ministry of Finance (*Monthly Finance Review*), etc.

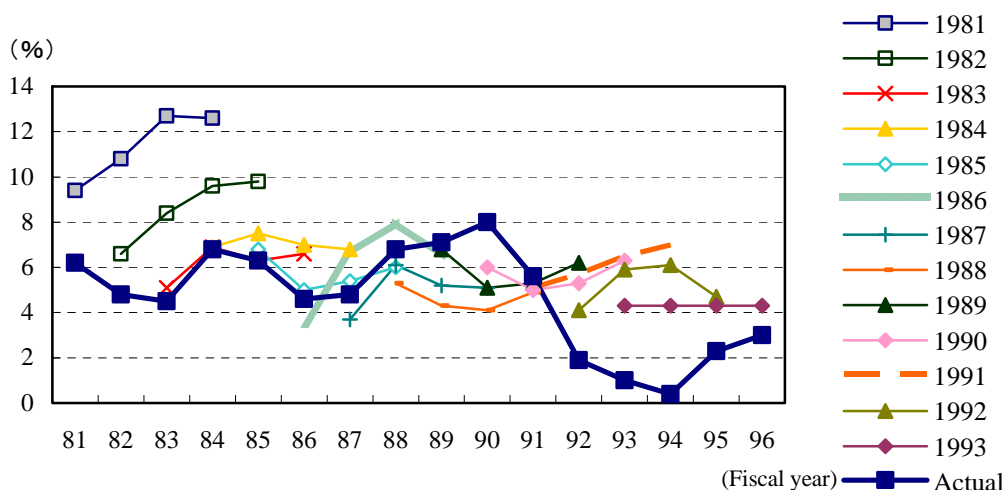
The “Target Figure” Character of Government Forecasts

According to the December 2000 issue of the Toyo Keizai’s “*Tokei Geppo* (statistical monthly report)”, the accuracy rate of government forecasts for the following fiscal year from 1980 to 1999 was found to rank 51st in a listing of 53 agencies (including private research organizations), with government projections generally found to be excessive. This is linked to the need to steer clear of business stagnancy as policy, with the government itself saddled with the fate of finding it difficult to project low growth rates. In this sense, it would appear logical that rather than “projections” as such, the upward bias toward “target figures” exists not only in projections for the following fiscal year, but also in the medium-term forecasts.

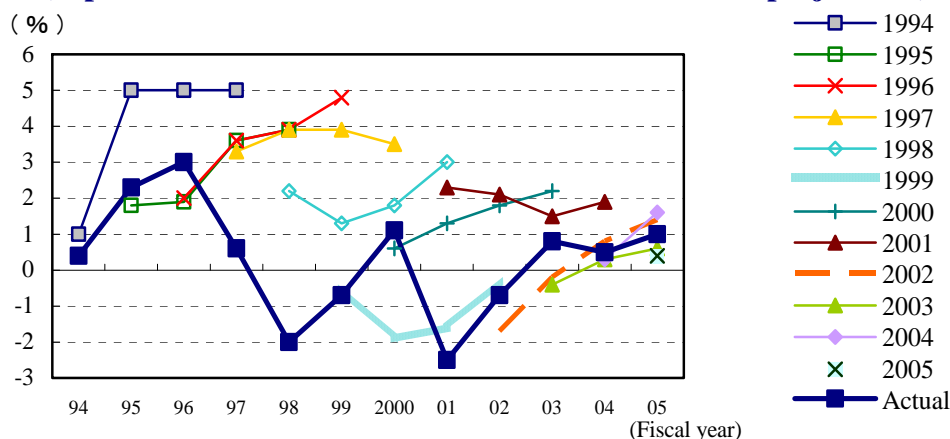
Based on this point, there is the view that the work of drawing up economic forecasts should be consigned to organizations that maintain independent status from the government. In the United States, the United Kingdom and other countries, government materials record that government projections are not considered optimistic if there are no major gaps between them and private sector forecasts.

In Japan, no system exists to officially evaluate the government's medium-term projections. Here, in an attempt to run comparisons with a private research organization, I have used the medium-term projections of the Japan Center for Economic Research (JCER). The reason for using the forecasts of JCER is because, like the government, JCER has continued to issue medium-term projections over the years, thereby facilitating ready comparisons. Examining Graphs 4 and 5, we can see that projections very close to those of the government have been issued. Although we can check whether government projections are optimistic or not by using private sector forecasts, the errors of projections tend to widen during periods of business recession. In other countries as well, previous research confirms that the error of projections expands in business recessions.

**Graph 4 Nominal Economic Growth Projections, 1981~93
(Japan Center for Economic Research medium-term projections)**



**Graph 5 Nominal Economic Growth Projections, 1994~2005
(Japan Center for Economic Research medium-term projections)**



Minimizing Risk

In consideration of the difficulties involved with such projections, the U.K. and other countries present a multiple number of projections, and then use the lowest figures for forming fiscal projections, the premises for budgets. Rather than having the projections be right on target, in other words, the key emphasis is placed on minimizing the risk inherent in having projections become excessive. This is because excessive projections will result in expanding fiscal deficits beyond the level expected. In Japan, while a number of scenarios are presented, it is not clarified which scenario is viewed with the greatest importance.

Because in the past Japan established projections on the basis of high growth rates, reforms in spending and revenues lagged behind, with the size of Japan's fiscal deficit now conspicuously high among the industrialized countries. Therefore, to pursue the goal of using sound fiscal management to prevent any further growth in this red ink, it would appear that the approaches adopted in other countries of advancing discussions on the basis of moderate figures could provide useful references.

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