Regulatory Reform and Demand Creation

December 2003

Japan Center for Economic Research
Japan Center for Economic Research

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The 30th Medium-term Forecast of the Japanese Economy (Fiscal Years 2003-2010)

Regulatory Reform and Demand Creation

(Release Date: December 2, 2003)

1. The Basis of the 30th Medium-Term Forecast

Since the burst of the economic bubble in Japan, Japan has been experiencing stagnant economic growth for over ten years (Figure 1). Although we have seen a relatively high rate of economic growth since the beginning of 2003, the growth has basically been driven by external demand. Even though we see some strength in capital investment, this has not been enough to lead to an autonomous recovery in domestic demand that includes personal consumption. We are not likely at a turning point where the economy will enter into a full-fledged recovery phase.

Figure 1. Real Annual GDP Growth Rates

( Note ) Figures for fiscal 2003 refer to the growth rates in the first and second quarters (year-on-year changes).
( Sources ) "Annual Report on National Accounts", "Quarterly Estimates of GDP", Cabinet Office

Despite several economic stimulus measures and support from monetary policy the Japanese economy has undergone a long period of stagnation from 1990. This is due to the fact that such factors of production as labor, managerial resources and capital have been trapped in areas of low growth, and have not been effectively distributed to higher growth areas. The “structural reform” policies that are to redistribute these resources have been widely promoted, but these high-growth sectors and the strong demand that should support them, are not easily created. In order to realize a virtuous circle in the economy whereby an increase in demand leads to income growth, and this in turn to a further increase in demand, we need to promote “regulatory reforms” geared to creating demand with more enthusiasm.

The other problem in the Japanese economy is the resolution of the “negative legacy”. Equally important as the bad debt problem of the financial institutions is the rebuilding of the central and

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1 Although the term “deregulation” that refers to the relaxing and elimination of existing regulations is heard more frequently, in this report, we refer to “regulatory reforms.” The objective of these reforms is to actively create those sectors that function efficiently in the market and can mean a change or reinforcement of regulations.
the local government coffers that currently have outstanding long-term debt equivalent to 135% of GDP (in fiscal 2001). Although public investment will be reduced, reform will be far from easy, given that expenses associated with social insurance is expected to grow because of an increasingly aged population. Tax increases may be a negative factor to the economy, however, without a clear course to rebuild finances, the anxiety that the population will feel about the ability of the government finances will also have a serious negative effect on the economy as a whole.

Given the above, the two main features of this medium-term forecast follow.

The first is that the demand creating effects of structural reform are clearly factored into this forecast. We estimated the effects of regulatory reform particularly in areas such as healthcare, nursing care, childcare, education and housing construction (the reconstruction and new construction of condominiums) and added these effects into the GDP. Demand in these sectors is expected to grow as the economy and society matures due to the aging population, the declining birthrate and the aging deterioration of older buildings. Regulatory reforms will result in an additional 9.6 trillion yen (on a real basis), and amount to 1.6% of real GDP in fiscal 2010. Also, compared to the case where there are no regulatory reforms, it boosts the average growth rate in fiscal 2006 to 2010 by 0.3 percentage points.

The second feature is that we show a concrete path to fiscal rebuilding. Despite the fact that Prime Minister Koizumi has declared he would not raise consumption taxes during his new term up to fiscal 2006, in our forecast, we supposed that the tax would be hiked by 2% on each of two occasions, once in fiscal 2006, and the second time in fiscal 2008. On a related point, we also presumed the reform in the pension system planned for fiscal 2004, would take a different form from the current scheme of the government. That is, the consumption tax would be appropriated to fund the increase in the government share of contributions to the basic pension. Then the insurance premium rate (insurance premium/annual income) would be kept at current levels, and a “revenue balanced method” would be taken whereby the total benefits paid would be equivalent to the sum of the insurance premiums, the government contributions, and the investment income of the reserve funds. Although the benefits paid would be reduced compared to the government’s scheme, the burden on the people to pay the premiums would be eased. The benefits of this scheme are: the pressure on the national budget would be lessened, since the premium payments of the individual would be reduced, the negative effects to the economy would be reduced and the disparity in the burdens between generations will also be lessened currently the younger generation is contributing a greater amount to the pension compared to the benefits they will receive (Table 1) and the economy will be more lively.

The regulatory reforms we have proposed and the rebuilding of the fiscal coffers are not necessarily easily implemented. However, rebuilding the fiscal finances is an urgent matter, and to reduce the deflationary impact of this, such drastic reform as we are proposing in this forecast is necessary. This medium term forecast for the Japanese economy assumes that regulatory reform and rebuilding the finances will be pursued simultaneously, and results in a picture of the medium-term economy that is more likely to be realized and sustained.
Table 1. Ratio of Net Pension Benefits Received by Year of Birth

<table>
<thead>
<tr>
<th>Year of Birth</th>
<th>Married Couple</th>
<th>Single Person</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1999 Calculation</td>
<td>Revenue Balanced System</td>
</tr>
<tr>
<td>1930</td>
<td>32.9</td>
<td>31.6</td>
</tr>
<tr>
<td>1950</td>
<td>9.8</td>
<td>6.4</td>
</tr>
<tr>
<td>1970</td>
<td>-4.9</td>
<td>-4.2</td>
</tr>
<tr>
<td>1990</td>
<td>-10.8</td>
<td>-4.8</td>
</tr>
<tr>
<td>2010</td>
<td>-14.3</td>
<td>-6.7</td>
</tr>
</tbody>
</table>

(Note) Ratio of Net Pension Benefits Received = Benefits Received over a lifetime less Premiums Paid over a lifetime, as a share of wages earned over a lifetime.

Married couple = Average married couple where Husband works, fitting average wage profile, and Wife is a Housewife two years younger than her husband.

Single person = Single person fitting average wage profile.

For the married couple, the husband becomes a salaried employee from age 20, marries his wife at age 28, and retires at 60. The wife is two years younger than the husband, worked in an office for six years before marrying her husband, and is covered by the Employees’ Pension Insurance. Upon marriage, she becomes a housewife, that is, a Class 3 insured person. Since she is only 58 when her husband retires, she pays premiums on the National Pension Plan for two years. Both husband and wife die at the average age of mortality of the husband at 79, and the wife at 86. Since the wife is two years younger than the husband, she lives alone for 9 years and receives survivor benefits during that time.

Sources: Recalculation of 1999 is from Takashi Oshio’s article entitled “Pension system reform from the viewpoint of the real debt of pension” printed in “Outlook and Policies for the Social Insurance System in the 21st Century”. The balanced revenue method was found by our own calculations using the program provided by Mr. Oshio.

2. Forecast period and forecast method

The forecast period are the eight years between fiscal 2003 to 2010. We have made forecasts for such macro variables as the GDP growth rate, prices, labor and corporate profits, as well as real output amounts, and employment figures up to 2010 of all 31 industries manufacturing and non-manufacturing (including service provided by the public sector) (Appendix Tables 2 and 3). On the assumption that for the medium term, changes in the industrial structure determine economic growth, we first made forecasts for each of the industries, and then forecast the GDP growth rate as the aggregate of all sectors. The effects of regulatory reform were incorporated when the forecasts for the industries were made. With these growth rates, we painted a picture of the macro economy.

3. Summary of forecast results: Standard forecast

In the first half of the forecast period (fiscal years 2002 – 2006), we found that economic growth will be very moderate at about the rate of the 1990s. In the second half (fiscal 2006 – 2010), however, the pace will gradually increase and after fiscal 2009, the economy will expand at a rate above the potential growth rate and at about the 2% level (Appendix Table 1, Figure 2).

Real GDP growth in the first half of the forecast period will be an annual average of 1.5%, and will only slightly outperform the 1.3% recorded in the second half of the 1990s. Although the external demand led economic recovery that began at the start of fiscal 2002 may have ripple effects into domestic private demand, we do not expect a capital investment-led full-fledged autonomous recovery to materialize. Although it would appear that the excess debt and excess employment situation in the corporate sector looks like it has improved quite a bit the situation is
still quite prevalent in the non-manufacturing sector. The bad debts in the financial sector have also made good progress, but are not yet at the point where the financial intermediary function has recovered enough to encourage economic growth. Therefore, while structural factors restricting growth still exist, more time will be needed for the medium-term expected growth rates of the corporate sector to improve, and capital investment will continue to be limited to only very cautious replacement investment in the manufacturing sector. As for the household sector, companies continue to aggressively contain human resource expenses and so there will not be a marked recovery in employee compensation. Thus, growth in personal consumption will be moderate at best. In fiscal 2006, there will be a 2% hike in the consumption tax to fund the increase in government contribution rate to the basic pension and the real economic growth rate will fall to about 0%, partially due to low consumption in response to the rush consumption of the year before.

**Figure 2. Breakdown of Contribution Rates to Real GDP Growth Rate**

![Graph showing contribution rates to real GDP growth rate.]

(Source) "Quarterly Estimates of GDP", Cabinet Office

However, during this period, there will not be an economic slowdown. This will be mainly due to a continued favorable export environment thanks to the fact that the US economy has been successful in recovering quickly and continues to enjoy a stable economy, and to Asia’s continued rapid growth centered on China (Figure 3). As for domestic demand, capital investment will contribute to growth because it fell sharply in fiscal 2001, and there will be some adjustments afterwards.
By the second half of the forecast period, the real economic growth rate will rise to an average 1.9%. The effects of the “regulatory reform” implemented from the first half of the forecast period will gradually become apparent. In personal consumption there will be new demand created in the public service areas of healthcare, nursing care, childcare and education, and in private housing investment, new demand will be created in the area of such urban renewal, such as in condominium reconstruction (Figure 4). In capital investment there will be an increase in IT (information technology) investment in the healthcare sector, and with the active use of PFI (private finance initiatives where private funds are used to fund social overhead capital projects), the provision of social overhead capital can develop as a substitute for public investment. The bad debt problem will have made progress in accordance with the Financial Revitalization Program, and the clean up and reorganization in the corporate sector will have made some headway as well, and the financial intermediary function will be recovered. With this shift to a more favorable environment, corporate profits and the expected growth rates of companies will recover, and capital investment will become active (Figure 5). In fiscal 2008 the consumption tax will be raised again by 2%, and so the real GDP growth will vary in fiscal 2007-2008, but on average, both personal consumption and private housing investment will show a healthy growth. The employment environment will also improve, and the unemployment rate that had been stuck at a high level will fall to 4.4% in fiscal 2010. In this way, the foundation for the revival of the Japanese economy will be laid, and a full-fledged economic recovery led by domestic demand will be on the horizon.
The GDP gap, defined as the difference between the potential GDP and the actual real GDP, will shrink to as small as minus 0.2% in fiscal 2005, but after the effects of consumption tax hike in fiscal 2006, it will be about 1.5% (Figure 6). However, even with GDP gap at this level, it is still possible to break away from deflation, and the consumer price index (General index, excluding fresh food) which has been declining year-over-year since fiscal 1998, will mark a rise in fiscal 2006. This of course will be due largely to the increase in the consumption tax rate, but even in the absence of these effects, the actual CPI will actually rise slightly (Figure 7).
The 30th Medium-term Forecast of the Japanese Economy
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Figure 6. GDP Gap

Notes

1. The potential GDP by finding a potential capital and labor input amount as follows:
   For the capital input, we take the capacity utilization rate where companies feel the economy to be neither overheating nor stagnating and find the capital input under this capacity utilization (potential capital input amount). For labor input, we deduct structural unemployment from the total labor force and multiply this by the hours worked as estimated from the trends in total hours worked to find labor input (potential labor input amount). The potential GDP growth rate can be considered a rate like the cruising speed of the economy.

2. GDP Gap = ((Real GDP - Potential GDP)/Potential GDP) * 100

3. Estimated Function: ln (Y / N H) - α ln (K S / N H) = ln (C) + λ t
   Y = Real Gross Domestic Product, C = constant, KS = Total capital input, K = Net capital stock, S = Capacity Utilization, NH = Total labor input, N = number of workers, H = Total Labor Hours, α = Capital Distribution Rate, λ = TFP parameter, t = time trend

4. Estimation Results: ln (Y / N H) - α ln (K S / N H) = -2.401 + 0.012 t
   (-613.64) (24.19)
   Estimation period: fiscal 1990 – 2002, values in parentheses ( ) are t values.
   Coefficient of Determination adjusted for degrees of freedom = 0.9799 Durbin-Watson statistic = 1.4567

Shaded areas denote contractionary phases of the economy.

Sources
- "Annual Report on National Accounts",
- "Quarterly Estimates of GDP",
- "Private Enterprise Capital Stock Statistics",
- Cabinet Office "Monthly Labour Survey",
- Ministry of Health, Labour and Welfare, etc.

Figure 7. Contribution Rate Breakdown of Goods and Services to Consumer Price Index (General Index excluding Fresh Food)

Notes

1. CPI = Consumer Price Index
2. For fiscal 2006 and 2008, effects of the hike in the consumption tax have been added.

3. Due to rounding of the indices (figures are rounded to two decimal places), the contributions of goods and services may not add up to the rates of change of the Consumer Price Index (Excluding Fresh Food).

Source
For the public sector in this period, we assume some measures for fiscal rebuilding from both the income and expense sides to be implemented. For example an average 3% reduction of public investment (the public fixed capital formation component in the GDP), a cutback in the number of civil servants (to be shaved by 10% in the ten-year period from 2001-2010), and in addition, as we mentioned earlier, there will be two hikes in the consumption tax rate of 2% each in fiscal 2006 and fiscal 2008. We also assumed there would be a pension system reform, where in fiscal 2005; the government contribution to the basic pension will increase from one-third to one-half. Moreover, we assumed that the government would adopt the “revenue balanced method” for the pension system where the total benefits paid would be equal to the sum of the premiums, the contributions of the national government and the investment gains on the reserve fund. As a result of the above, the fiscal balance will show steady signs of recovery, while the deficit of the primary balance (the basic balance of the fiscal budget excluding the issuance income of government bonds, and the interest payments on them) of the central and local governments—an indicator of the fiscal health of the governments—will be reduced to 0.1% of the nominal GDP, and it will be very close to being balanced (Figures 8). The accumulation of the long term debt of the government will finally begin to slow down. However, the level of the outstanding debt will continue to be very high by international standards.

**Figure 8. Primary Balances of Central and Local Governments**

![Diagram showing primary balances of central and local governments]

(Source) "Annual Report on National Accounts", Cabinet Office

The average annual rate of growth estimated for the forecast period of 1.9% does not appear to be greatly improved over the 1.3% growth seen in the latter half of the 1990s. However, this can be seen as being quite a pick-up in pace on a real basis given the severe environment that this is attained under: that is, the downward pressure on the economy from the fiscal rebuilding, the decrease in disposable income resulting from a lower pension benefit, and the stagnation in employment income as a result of the reduction in employment of the companies. The following are some factors in the revival of the economy.

First is the creation of new demand due to regulatory reform. Upon regulatory reform of the
“government markets” that were under the strong control of the government, some latent demand will surface. In the public services areas of healthcare, welfare, nursing care and education, due to the lifting of the ban on “mixed healthcare” (a mix of healthcare covered by insurance and not covered), and the elimination of barriers to entry into the nursing home business, in fiscal 2010, we can expect to see a real increase in final demand of 8.39 trillion yen, and an increase in employment of 856,000. Moreover in the area of urban renewal, with the relaxation of floor area ratio regulations and the resulting increase in condominium reconstruction and new construction, we foresee an increase of 84,000 new units, a real 1.28 trillion yen in final demand, and a 860,000 increase in employment in the same fiscal year.

Second, there will be adjustments made in the industrial and employment structures to adapt to this change in the demand structure. In the private sector during the forecast period, the share of employment in the manufacturing sector will decline and that of the service sector will climb. From the production side, the increase in labor productivity will be relatively higher in the manufacturing sector, and so the decline in their share of production will decline. However, as both employment and labor productivity are expanding in the service sector, the economy will continue to be more and more service-oriented (Figure 9).

Figure 9. Labor Productivity and Labor Input by Manufacturing and Non-manufacturing Industry

(2000 = 1)

Notes
1. The estimates are from actual data up to 2002, and from 2003-2010, forecasted data.
2. Labor productivity = Real Output Amount / (Number of Workers * Total Hours Worked)
3. The broken lines in the figure show the levels of Real Output Amount (Labor Productivity / Labor Input) in 2000 and 2010.

Sources

2 These are such markets and service areas that have had strong public intervention such as with the government restricting the entities in the market. Examples are healthcare, welfare (nursing care, childcare), education, and agriculture. In July of 2003, the Council for Regulatory Reform of the Cabinet Office has selected some “Twelve important items for discussion” to accelerate the pace of regulatory reform, centered on “Total opening of government markets to private sector” and including “renewal of urban centers”, “labor markets”.
Third is the increase, albeit moderate, of the labor force. During the forecast period, the total population will begin to decline, however, the labor force will grow by an average 0.5% annually from the second half of the forecast period. This is a result of more women and older persons joining the labor market because of the provision of more childcare facilities such as daycares, and the declining public pension benefits due to the reform in the pension system (Figure 10). The increase in the labor force will for the medium and long-term reinforce the supply side of the economy, and raise the potential growth rate of the economy. Furthermore as more people are active in production activities, the foundation of the social insurance system is strengthened, and we can expect this to also encourage consumption by alleviating some of the concerns of the people of their future stability.

![Figure 10. Labor Force Participation Rates by Sex](image)

(Source) "Labour Force Survey", Ministry of Public Management, Home Affairs, Posts and Telecommunications

4. Summary of forecast with no regulatory reform

In order to find how great an effect these regulatory reforms will have on the economy as a whole, we also conducted a forecast under the assumption that the regulatory reforms do not take place and compare this with the standard forecast\(^3\) (Appendix Table 4). In the standard forecast, we assumed that the new demand resulting from the regulatory reforms would gradually begin to be realized from fiscal 2005, and in the final year, fiscal 2010, it reaches the final levels that we estimate them to be. Thus, the effects of new demand creation are seen in the latter half of the forecast period. We also assumed in the non-standard forecast that the various policy measures aimed at fiscal rebuilding are implemented in this scenario as well.

Regarding the real GDP growth rate, we do not see the acceleration in the rate that we do in the standard forecast; in the first half of the forecast period it is an annual average of 1.4%, while in the latter half, it is only 1.6%. The main reason for this is that the personal consumption and private housing investment components grow at much slower rates compared to the standard

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\(^3\) To compile the forecast where the regulatory reforms do not take place, we used the medium-term econometric macro model and conducted a simulation where effects of regulatory reform are NOT integrated. Then we took the difference between this and the standard case and applied this to the standard forecast.
forecast where they benefit greatly from the regulatory reforms. The number employed, also goes down to an annual growth rate of 0.7% in the latter half of the forecast period compared to 1.0% with the standard forecast. As domestic demand will be less active, the consumer price index in fiscal 2010 will be 0.4 points lower than the standard forecast, the unemployment rate will be 0.1 percentage point higher, and the trend towards deflation will be stronger. Furthermore, the current account balance as a share of nominal GDP will be 0.3 percentage points higher at 3.5% and at a very high level.

As we have seen, if we go ahead with the fiscal rebuilding without an accompanying regulatory reform program in the current Japanese economy, we forecast that not only will the GDP growth rate fail to show a clear increase, but the external imbalance will also expand.

5. Estimation Methods of Regulatory Reform Effects

As we mentioned earlier, in this medium-term forecast, we have taken the regulatory reform programs currently being deliberated in the Council for Regulatory Reform, we quantitatively estimate their demand expanding effects, and integrate this into the forecast results. The following seven items below are where we estimated the effects of regulatory reform. In all cases, we assumed that the final effects would be seen in 2010, and that the effects would gradually be seen beginning from fiscal 2005. On the left of the brackets [ ] , we note what industry we would expect to have effects, and on the right are the final demand components that would expand as a result.

The measure allowing private companies to enter into the “government markets” is touted with great importance at this Council, we do not integrate these effects into the forecast because although we can anticipate that there would be positive effects in increasing productivity, it is unclear at this point in time how this would directly lead to increase in demand for services and employment.

(1) Effects of Lifting of Ban on “Mixed” Healthcare

【Health, Healthcare → Personal Consumption】

Change in Real Output Amount: + 6.8 trillion yen
Change in Number Employed: + 589 thousand

Estimation Method:

In Japan, there are two ways to pay for healthcare expenses. One is insured healthcare and the other is “free” healthcare (i.e., uninsured healthcare), and it is currently prohibited to use both (“Mixed” healthcare) at the same time. Here, we take the US healthcare service market as a standard (as the US has the most developed market for uninsured healthcare), and assume that when the ban on mixed healthcare is lifted, the market for uninsured healthcare develops to that of the US in order to estimate the market size for Japan (Figure 11). First we control factors such as the aging population and the strength

4 Regarding the effects of private companies entering the market, we should like to consider this on another occasion upon finding the results of the designated structural reform district exercise etc. that began in fiscal 2003.
of public intervention to the average of the OECD countries, and then from the per capita income level, we found a per capita forecasted expense on healthcare for the US. Then, (after the same corrections), we look at the actual per capita expenditure on healthcare in the US, and considered the difference between this and the forecast figure as the additional demand under a system where mixed healthcare is permitted. Assuming that there is no significant difference between the US and Japan in their demand structures for healthcare services, we apply the demand effect that we found for the US and apply it to Japan to find the per capita healthcare expense and the macro healthcare expense of the Japanese. We found that this had the effect of increasing the demand for healthcare by about 20% over the current healthcare expenditure.

Figure 11. Relationship Between Per Capita Healthcare Expenses and GDP for OECD countries (2000)

\[ y = 0.1082x - 540.06 \]
\[ R^2 = 0.7371 \]

( Source ) "OECD Health Data 2003", OECD

( 2 ) Effects of a Zero Waiting List for Special Nursing Homes for the Aged

【 Health, Healthcare → Personal Consumption, Government Consumption 】

Change in Real Output Amount: + 635 billion yen
Change in Number Employed: + 140 thousand

Estimation Method:

Regarding the nursing care facilities area of nursing care services (such as homes for the aged), even after the nursing care insurance system was implemented, barriers to entry continue to exist, and the supply is far behind the demand which continues to grow. According to various surveys, there are about 200,000 persons waiting for a spot in the special nursing homes for the aged. Furthermore, according to research conducted by the Ministry of Health, Labour and Welfare, the cost of nursing services including the contribution of the individual is estimated to be 4.4 million yen per person. If we assume that these persons are currently using nursing care services at their homes, then we can
deduct the at-home service fees and find the net increase of 2.6 million yen per person. Thus, we estimated the effects on demand to be the number of those on the waiting list multiplied by the net increase in nursing service costs.

(3) Effects of a Zero Waiting List for Daycare Spaces

[Public service • other → personal consumption, government consumption]

Change in Real Output Amount: + 859 billion yen
Change in number employed: + 127 thousand

Estimation Method:
Demand for daycare has been on a growing trend due to such factors as the advancement of women into the workplace, and the number of children in daycare centers has been increasing for the past eight years since its trough in 1994. We have estimated the number of those demanding daycare services based on a survey conducted by the Cabinet Office, and according to this there is a latent demand of about 260,000 children waiting for spaces in the Tokyo Metropolitan area (three prefectures and Tokyo). We applied this figure to find an estimate for the country, and found the effect on demand by multiplying the number of children (by age), by the standardized fees as per the “Nursing Charge Table” as determined by the government.

(4) Effects of establishment of (Graduate Level) Law Schools

[Education • Research → Personal Consumption]

Change in Real Output Amount: + 13.9 billion yen

Estimation Method:
As part of the reform of the Japanese judicial system, law schools at the graduate level will be newly established in Japan. Currently there are set to be 72 schools with total enrollment of about 6,000. We took the entrance fee and tuition into these programs as the increase in demand for education and research, and estimated their effects. It will be in 2010 and beyond this that these students earn their qualifications to offer legal services and to increase the supply, and so we did not consider the expected expansion in the market for legal services in this forecast.

(5) Effects on Condominium Reconstruction of Relaxation of Floor Area Ratio Requirements

[Construction • Real Estate → Private Housing Investment]

Change in Number of New Housing Start Units: + 80,3000 units
Change in Real Final Demand : + 1.28 trillion yen (Includes next item (6))
Change in Number Employed: + 86 thousand (includes next item (6))

Estimation Method:
First, we estimated for each ward in central Tokyo, the number of new condominiums
that might be reconstructed with the easing of floor area ratio requirements. Our basis concept was as follows: If the condominium reconstruction association could reconstruct the condominium into a new building with the current floor area ratio, and sell the new units (those above and beyond the rebuilt units) without additional burden on the existing residents, then we judged this as justification for reconstructing the condominium. If the income from the sale of additional condominiums is greater than the construction costs of rebuilt building, then the existing residents can rebuild at no cost to them. We defined the wards that met this condition to be “wards where reconstruction is possible from economic conditions alone”. If we allow the floor area ratio to be increased over the 1.5 times of the current Building Standards Code to 2.0 times for the 10 wards in central Tokyo, then we find the wards where reconstruction is possible would be a total 12 wards. The number of units that could be reconstructed would, of the 51,595 buildings that were over 30 years old (as of 2000), be about 30,700, and about 43,500 units could be sold.

Next, we applied the reform that allows the floor area ratio to be increased to 2.0 times in the ten wards in central Tokyo to the rest of the country. We found the number of units that could be reconstructed, and the number that could be sold for each of the fiscal years using the following method: we find the ratio of the units that can be reconstructed and units that can be sold as a share of all condominium units of over 30 years old in the Tokyo ward area (0.595 and 0.845 respectively). Then we multiply this ratio by the estimated number of condominiums that will be over thirty years of age in 2005-2010 (according to the 1998 Housing and Land Survey conducted by the Ministry of Public Management, Home Affairs, Posts and Telecommunications). We estimated the new demand generated as the units that may be rebuilt and sold that would be made available at the rate of 10% over ten years and used this as the units rebuilt and new units sold in each fiscal year.

Effects on New Condominium Construction of Relaxation of Floor Area Ratio Requirements

【Construction • Real Estate → Private Housing Investment】

Change in Number of New Housing Start Units: 4,000 Units

Estimation Method:

The relaxation of the restrictions regarding floor area space should raise the value of real estate by allowing a higher revenue be earned from the same land. However at the same time, if this results in an increase in the floor area provided, the value of the land per floor area may decline. Using cross sectional data of the 23 wards of Tokyo and taking such explanatory variables as contracted rent per floor area for rental condominiums, the designated floor area ratio, and the building to land ratio to run a regression on price per floor area of residential land, we were able to confirm that this is indeed the case. According to this estimation, we find that if the floor area ratio requirement were to be relaxed to 2.0 times in the ten wards in central Tokyo, then the price of land per floor area would decline by 46.4%, and the price of the condominiums would also decline by 21.8% in the same area. If this is applied using the average price in all of Tokyo, then it translates into a 5.8% decline (weighted average based on the total floor space starts for houses by ward and city in Tokyo for fiscal 2001). Furthermore, if we apply the same
change relaxing of regulation to all the major cities in Japan, the price of condominiums would fall by 4.2%. The effect on new demand was found by taking this price decline and substituting this into the demand function for owned housing.

(7) Effects of Regulatory Reform on Employment in the Temporary Employment Sector

【Business Services → GDP】

Change in Number Employed: + 306 thousand

Estimation Method:

The temporary employment sector has grown rapidly in terms of both sales and number of employees dispatched through the 1990s. This has been due in large part to the fact that there has been some regulatory reform in that there has been a successive expansion of the sectors that this kind of employment dispatch is allowed. However, as we can see from the fact that the total employment figure is growing at a very low rate, temporary workers are often substitutes for the conventional permanent employees. That is, the increase in number of temporary staff does not necessarily translate into the net increase of employees. Thus, in order to find the effects on employment of a regulatory reform in this sector, we first find the demand function for temporary labor. Of the increase in temporary employees, we find the share that is generated because of their lower relative cost (sales per temporary worker / total cash earnings per temporary worker). In other words the newly created demand is the part of the increase in temporary workers that was created due to the fact that temporary employment is a cheaper factor of production, and lowers the production cost of goods and services. We assumed that the relative cost of temporary workers in the forecast period would be on a declining trend due to the increased market competition as developments are made in regulatory reform. The new employment created was added on according to the current distribution of labor among the industries.
## Appendix Table 1. Major Economic Indicators

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**Note:** Growth rates are over previous fiscal year, unless otherwise noted (%)

### Appendix Table 2. Real Output Amount by Industry

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<td>(millions of yen, %)</td>
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<td>1995</td>
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**Notes:**
- Primary Industries = Agriculture, Forestry and Fishery
- Secondary Industries = From Mining to Construction Industries
- Tertiary Industries = Electric Power, Gas and Heat Supply to Personal Services
- Manufacturing Industries = Food to Other Manufacturing Industries
- Of the Manufacturing Industries: Basic Materials Suppliers = Pulp and Paper to Metal Products
- Processing and Assembly = General Machinery to Precision Machinery
- Products and Services for Daily Life = Food, Textiles and other manufacturing industries

**Source:** SNA Input-Output Table (Base Year 1995), Cabinet Office
## Appendix Table 3. Employment by Industry

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Notes:
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Sources:
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<td>89.4</td>
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<td>89.8</td>
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<td>Employment (10s of thousands)</td>
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<td>5,347.0</td>
<td>5,392.0</td>
<td>5,353.0</td>
<td>5,325.0</td>
<td>5,372.0</td>
<td>5,354.0</td>
<td>5,328.0</td>
<td>5,324.8</td>
<td>5,336.7</td>
<td>5,361.0</td>
<td>5,377.4</td>
<td>5,404.6</td>
<td>5,431.1</td>
<td>5,477.3</td>
<td>5,533.5</td>
</tr>
<tr>
<td>Unemployment Rate</td>
<td>3.2</td>
<td>3.3</td>
<td>3.5</td>
<td>4.3</td>
<td>4.7</td>
<td>4.7</td>
<td>5.2</td>
<td>5.4</td>
<td>5.4</td>
<td>5.4</td>
<td>5.4</td>
<td>5.4</td>
<td>5.2</td>
<td>5.0</td>
<td>4.6</td>
<td>4.5</td>
</tr>
<tr>
<td>Consumer Price Index (2000=100)</td>
<td>98.4</td>
<td>98.8</td>
<td>100.8</td>
<td>101.0</td>
<td>100.5</td>
<td>99.9</td>
<td>98.9</td>
<td>98.3</td>
<td>98.2</td>
<td>97.9</td>
<td>97.6</td>
<td>99.0</td>
<td>99.2</td>
<td>101.0</td>
<td>101.4</td>
<td>101.6</td>
</tr>
<tr>
<td>Current Account to Nominal GDP</td>
<td>1.9</td>
<td>1.4</td>
<td>2.5</td>
<td>3.0</td>
<td>2.6</td>
<td>2.4</td>
<td>2.4</td>
<td>2.7</td>
<td>2.5</td>
<td>2.6</td>
<td>2.7</td>
<td>3.1</td>
<td>3.2</td>
<td>3.4</td>
<td>3.4</td>
<td>3.5</td>
</tr>
</tbody>
</table>

Note: Lower rows are year-on-year changes.