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Key Takeaways from the Basic Policy on Economic and Fiscal Management and Reform, Part 2: The 2030s Will Be the Litmus Test for "Responsible Active Fiscal Policy"

Fiscal management must look beyond the post–"fiscal bonus period" and should not be predicated on growth materializing

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Summary

- The draft FY2026 Basic Policy on Economic and Fiscal Management and Reform ("Basic Policy 2026") states that the Sanae Takaichi administration will formulate a Medium- to Long-Term Economic and Fiscal Plan (FY2027–FY2040) based on "responsible active fiscal policy." It positions "a steady decline in the ratio of total central and local government debt outstanding to GDP" as the core fiscal management objective, and redefines the primary balance (PB) of the central and local governments as an "indicator to be checked toward reducing the debt-to-GDP ratio." It also indicates that, depending on the business cycle and the need for crisis management investments and growth investments, a temporary deterioration in the PB may be tolerated.

- In the Cabinet Office's Estimates on the "Medium- to Long-Term Economic and Fiscal Projections under Japan's Growth Strategy" (Cabinet Office; 24 June 2026), only one of the three scenarios—"Growth Strategy Achieved Case I"—shows the ratio of outstanding government bonds and other liabilities to GDP continuing to decline. This scenario assumes additional fiscal spending of 10 tril yen in real terms each fiscal year, along with a sharp expansion in capital investment and productivity growth outpacing that of the United States; under this scenario, the PB remains broadly in surplus. However, realizing this would require a major transformation of Japan's economic and fiscal structure, as well as securing funding sources for measures managed under separate accounts/frameworks. Securing a permanent funding

source for income-linked benefits scheduled for full-scale introduction in FY2029 is also a challenge.

- In all three scenarios, from the early to mid-2030s the effective interest rate on debt is projected to exceed nominal GDP growth (i.e., the “Domar condition” no longer holds), which would act to push up the debt-to-GDP ratio. During the 2020s—when the “fiscal bonus period,” in which the debt-to-GDP ratio can decline even with a PB deficit, is expected to continue—it will be necessary to move the underlying PB trend toward balance or surplus to prepare for the 2030s. Rather than predicating fiscal policy on growth materializing, fiscal management should remain flexible with various contingencies in mind and be conducted so that the debt-to-GDP ratio declines steadily over time.