

Fiscal Policy and Social Security Reform under High Debt

Challenges in improving fiscal sustainability and the role of refundable tax credits

MIZUHO

Summary

Developed countries are facing upward pressure on long-term interest rates, and Japan is no exception. Impacted by policy decisions and elections in various countries, government debt-to-GDP ratios remain stubbornly high.

As fiscal policy tends to be less effective under high debt levels, the formulation of targeted policies is essential. On the other hand, Japan's fiscal targets lack a strong legal basis, so transparency and monitoring must be ensured when setting target indicators.

Structural reforms are necessary on both revenue and expenditure sides, and the review of social insurance premiums (contributions) and tax burdens is an urgent priority to reduce the burden on the working-age population. Introducing refundable tax credits to alleviate their burden is the cornerstone of the growth strategy.

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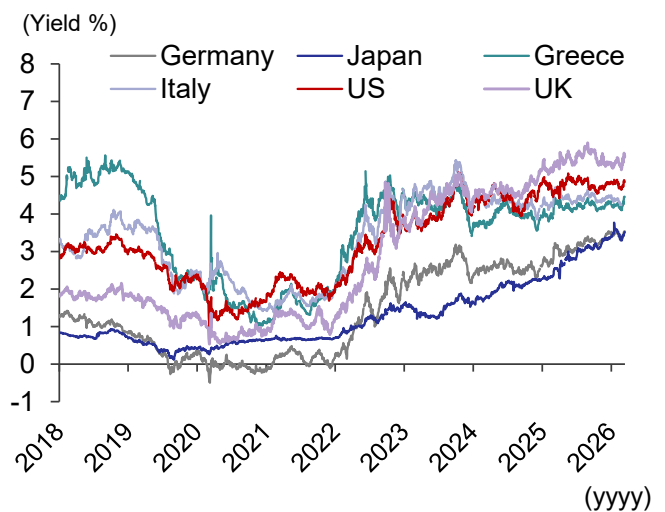
1. Long-term interest rates are under rising pressure amid growing concerns about the fiscal deterioration of developed nations. Japan is no exception

Persistent upward pressure on long-term interest rates is building in major developed economies, driven by deteriorating fiscal conditions over the medium to long term. Looking at the trend in 30-year bond yields since 2018, yields on US and UK 30-year bonds surpassed those of Greece by mid-2023, and since 2024, yields have remained higher than those of Italy, a country long plagued by fiscal concerns (Figure 1). Turning to Japan, while long-term interest rates remain low compared with those in other countries, the pace of increase in ultra-long-term bond yields has accelerated since March of last year. Many may recall that weak auction demand for ultra-long-term bonds attracted significant market attention at the time. Currently, yields across the ultra-long-term to long-term segments, including 10-year bonds, continue to rise, and yields on 30-year bonds have reached levels comparable with those in Germany.

Against this backdrop, the Ministry of Finance decided last June to shift toward shorter-term government bonds while scaling back the issuance of ultra-long-term bonds in the initial FY2026 budget (Figure 2). While the rise in long-term interest rates can be attributed to deteriorating supply-and-demand conditions in the market and the Bank of Japan's previous rate hikes, some foreign investors also expressed concerns about the risk of fiscal deterioration over the medium to long term. This upward pressure on interest rates is not a phenomenon unique to Japan, but is a structural challenge common to developed nations facing high levels of debt.

This report builds on this understanding and examines from an international comparative perspective how persistently high levels of government debt impact the effectiveness of fiscal policy. It then turns to Japan's fiscal situation and discusses the challenges facing future policy.

[Figure 1: Comparison of 30-year government bond yields]



Source: Made by Research Department, Mizuho Research Institute based on the CEIC.

2. Countries face fiscal challenges. Elections are fueling fiscal expansion

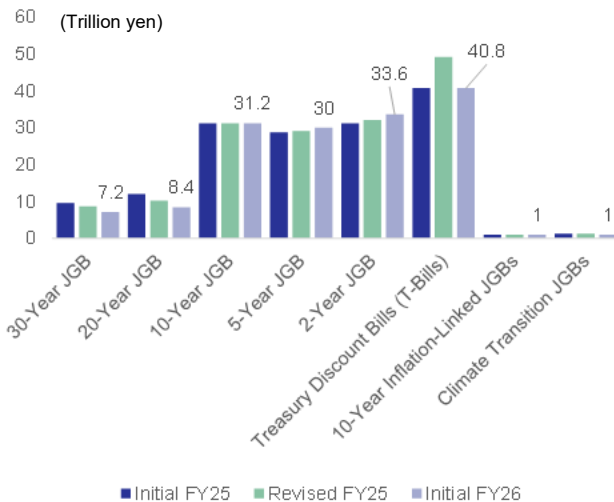
(1) Government debt-to-GDP ratios have not returned to pre-COVID levels

First, this section reviews the status of government debt in terms of stock. Although each country has its own specific circumstances, many developed nations share the common challenge of high debt and deteriorating fiscal conditions. According to IMF data (Figure 3), government debt-to-GDP ratios in many advanced economies have not returned to pre-pandemic levels. In G7 member countries such as the United States, the United Kingdom, and Germany, the government debt-to-GDP ratio worsened in 2025 compared with 2019, while Japan and Italy remained largely flat, with their debt-to-GDP ratios standing at approximately 230% and 130%, respectively, as of 2025—both levels considered high. On the other hand, some countries' debt-to-GDP ratio actually declined, including Greece, where post-financial crisis reforms have borne fruit and the economy is performing well, and Portugal, where recovery of the tourism industry has supported this trend.

Under these circumstances, many countries are likely to increase their fiscal spending in the future. In the United States, as an extension of the Trump administration's tax cuts, the tax reform bill enacted in July 2025 included additional tax cuts for households, such as tax exemptions for tips and overtime pay, and tax cuts for businesses. According to US government projections, the fiscal deficit is expected to rise by \$3.4 trillion over the 10-year period from FY2025 to 2034. In EU member states, defense spending increases were announced in response to the situation in Ukraine, and further expansion of fiscal spending is anticipated. Many EU member states are also members of NATO, which has raised its defense spending target from 2% of GDP to 5%. Following the end of the Cold War, EU country defense spending as a percentage of GDP trended downward, but began to rise after the Crimea crisis in 2014

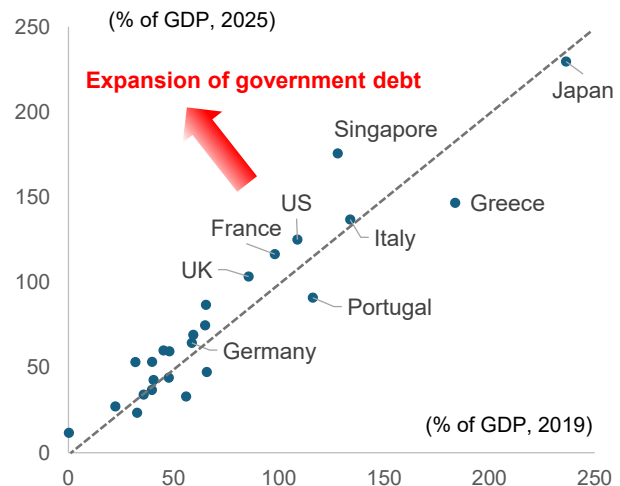
and has accelerated recently. Many countries have already reached the 2% of GDP target, and further defense spending increases are foreseen, including expanded investment in defense infrastructure. In Germany, long-standing fiscal austerity policies have been reversed on the back of an economic downturn and the need to address the situation in Ukraine. A special fund (totaling EUR500 billion over 12 years, or just under 12% of GDP) was established to finance infrastructure investment, and fiscal expansion is expected in the future.

[Figure 2: Japanese government bond issuance by maturity (calendar-year basis)]



Source: Made by Research Department, Mizuho Research Institute based on the Ministry of Finance.

[Figure 3: Government debt balance in developed countries (comparison of 2019 and 2025)]



Source: Made by Research Department, Mizuho Research Institute based on the IMF.

(2) Elections also contribute to growing fiscal deficits

Changes in the political landscape of various countries and regions are also contributing to widening fiscal deficits from a flow-based perspective (annual fiscal spending). While a series of elections took place globally in 2024, existing research points out that elections can have an impact on fiscal health. According to estimates from the IMF's Fiscal Monitor (Figure 4), in election years the fiscal deficit tends to exceed pre-election forecasts by approximately 0.4 percentage points of GDP compared with non-election years. It is also observed that actual fiscal deficits tend to widen in election years compared with the previous year. Recently, following global inflation that intensified in 2022, expansionary fiscal policies have been seen in subsequent elections amid growing dissatisfaction with incumbent governments, particularly among low-income groups. In 2024, elections were held not only in developed nations such as Japan, the United States, the United Kingdom, and France, but also in emerging economies that included Taiwan, Mexico, Brazil, India, and Indonesia. In addition to Taiwan, which shifted slightly toward fiscal expansion ahead of its elections, India took the lead in announcing expanded infrastructure investment in its pre-election budget. Mexico and Indonesia clearly shifted to a fiscal expansionary stance after their elections. Following Japan's 2025 Upper House election, a general election was held after the dissolution of the Lower House in January 2026, and political parties campaigned on reducing the consumption tax.

3. Limits of fiscal policy under high debt and the assurance of fiscal sustainability

(1) The impact of fiscal policy may diminish under high debt

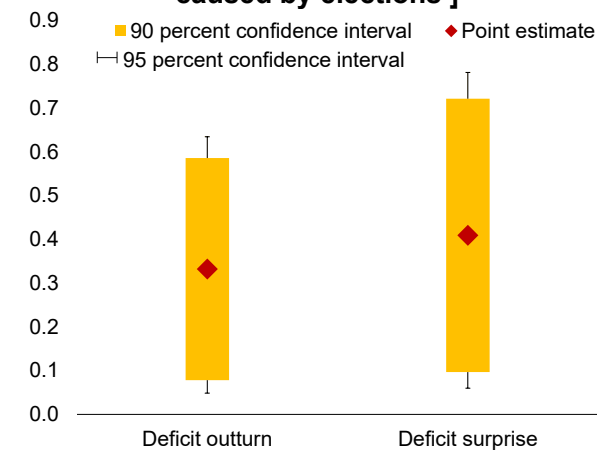
What challenges, then, arise when a country's debt level remains elevated? In essence, high debt can reduce the effectiveness of fiscal policy. Existing research suggests that in countries with high public debt-to-GDP ratios, the economic stimulus effect of fiscal spending—known as the multiplier effect—tends to be weaker. For example, an IMF paper (Honda & Miyamoto, 2020) analyzed data from OECD countries and noted that, as populations age, the GDP-boosting effect of fiscal expansion shocks diminishes, and it is generally observed that the economic stimulus effect of fiscal shocks is weaker in high-debt groups. Accordingly, we attempted to analyze policy effects using country-level time-series data from over 50 countries (Figure 5).

Specifically, data are classified into two categories—high-debt and low-debt—using the median government debt-to-GDP ratio as a threshold, and estimated the GDP-boosting effect (the so-called multiplier effect) of fiscal spending.¹

The result suggests that the effects of fiscal policy may be weaker in a high-debt environment than in a low-debt environment. Thus, based on the premise that high debt levels limit the effectiveness of fiscal policy, it is no longer realistic for Japan, with its high debt level by global standards, to attempt to stimulate the economy through fiscal policies that prioritize scale over targeting. Conversely, there is a need to prioritize budget allocations toward policy measures that contribute to economic growth, while narrowing the scope of policy targets and remaining mindful of the effects described by the Ricardian equivalence theorem—namely, that future fiscal uncertainty can suppress household consumption.

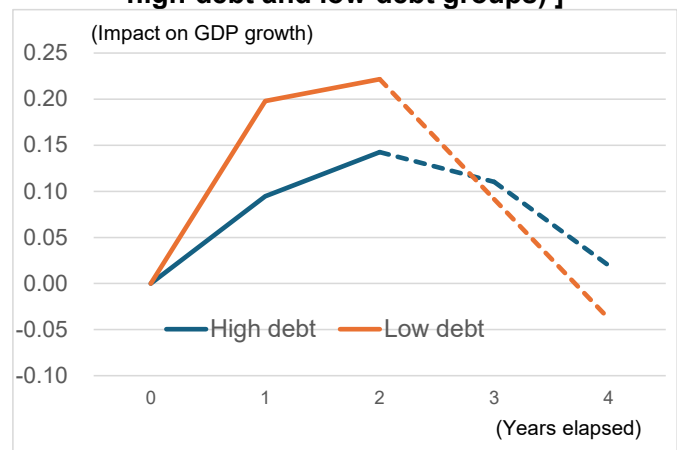
Nevertheless, controlling and choosing fiscal policies is no easy task. In *Democracy in Deficit* (1977), James Buchanan and Richard Wagner argued that deficit financing creates political incentives for governments to expand spending because the benefits are immediate and visible, whereas the costs are deferred and less salient to voters. From this perspective, political incentives tend to favor short-term gains over long-term fiscal discipline, making it easier for fiscal deficits to expand. To serve as a check on such “political failures,” many countries have adopted fiscal rules and fiscal consolidation targets. As discussed later, some countries have also introduced institutional arrangements that constrain the scope of redistribution policies.

[Figure 4: Scale of fiscal deficit expansion caused by elections]



Source: Made by Research Department, Mizuho Research Institute based on the IMF Fiscal Monitor.

[Figure 5: Effects of fiscal policy (comparison of high-debt and low-debt groups)]



Note: Data from 2006 to 2024 using the Local Projection model from Jordà (2005). Dotted lines indicate low statistical significance.

Source: Made by Research Department, Mizuho Research Institute based on IMF and United Nations data.

(2) Japan's fiscal system lacks a strong legal foundation to support fiscal sustainability

From an international comparative perspective, some major economies, including European countries and emerging markets, have legally institutionalized fiscal balance rules and debt rules to ensure fiscal soundness and sustainability. Table 1 compares the rules and systems of various countries.

Germany stipulates a strict “debt brake” in its constitution, and EU member states also operate under numerical standards set forth in treaties. In contrast, Japan’s system is characterized by the government’s commitment, which is not legally binding. While Japan maintains flexibility in response to economic fluctuations, its fiscal discipline fundamentally depends on political judgment. Against this backdrop,

¹ In this report, this report estimates the multiplier effect of fiscal stimulus using the Local Projection (LP) method proposed by Jordà (2005) as a simple way to understand the relationship between fiscal policy and debt levels. The LP method allows for the easy estimation of equations that incorporate nonlinearity and is well-suited for analyzing the impact of debt levels on the effectiveness of fiscal policy. We estimated a fixed-effects model in which the (log) change in GDP served as the dependent variable, and the change in fiscal spending relative to GDP compared with the previous year was treated as the independent variable, with data categorized into high-debt and low-debt groups (using the median of the entire sample as the threshold for these categories). In this model, country and year were treated as fixed effects. The (log) change in GDP was estimated from the point in time when the fiscal expenditure adjustment occurred (set as the baseline) through four years thereafter. The estimation period covered 2006–2024 (since it is necessary to sample the effects of fiscal policy for up to four years, the final estimation sample covered 2020–2024). As indicated in the source, the data used comes from publicly available sources such as the IMF and the United Nations.

Japan has historically focused on achieving a primary balance surplus by a specific target year, but changes are now emerging in this situation.

First, the Takaichi administration has announced a policy of targeting the government debt-to-GDP ratio as a direct indicator of debt sustainability. Despite Japan's high level of government debt, its interest payment burden has remained low thanks to a prolonged period of ultra-low interest rates. Furthermore, these payments are expected to stay manageable for the time being, supported by the lag effect of outstanding low-yield bonds. However, we must be fully aware that in a rising interest rate environment, the risk of fiscal deterioration through increased interest payment burdens, including the rollover of previously issued government bonds, is likely to materialize in the future.

[Table 1: Comparison of rules and systems supporting fiscal sustainability in major countries]

Country/Region	Main Rules	Numerical Targets	Legal Enforceability	Features
Japan	Primary balance (PB) target	Target for achieving a surplus	Low / Weak (government commitment)	No legal rules; soft fiscal targets
Germany	Structural balance rule	Structural federal deficit limited to 0.35% of GDP	High / Strong (Constitution)	Constitutionally based debt brake
France	Fiscal balance (medium term) + debt rule	EU fiscal framework	Medium / Moderate	Domestic implementation of EU rules
Italy	Fiscal balance (medium term) + debt rule	Debt reduction obligations	Medium / Moderate (Constitution)	High-debt country monitoring, Constitution
Greece	Expenditure ceiling + debt rule	Expenditure ceilings	Very High / Very strong (external oversight)	Post-crisis: IMF and EU oversight → Current: Transition to IMF monitoring
UK	Current fiscal balance + debt rule	Fiscal targets set by each government	Low-to-Medium / Moderate to weak	Hybrid of legal and political targets
US	No comprehensive fiscal rule	No permanent fiscal targets	Low / Weak	Debt ceiling defined separately
India	Fiscal balance + debt rule (medium term)	Fiscal deficit and debt-to-GDP targets	Medium / Moderate (laws)	FRBMA Act
Brazil	PB target + expenditure ceiling	Primary balance target	Medium / Moderate (laws and Constitution)	Fiscal Responsibility Law, Constitution
China	Management of fiscal deficits	Targets set by the central government	Medium / Moderate (administration)	Centralized management

Source: Made by Research Department, Mizuho Research Institute based on the IMF, *Fiscal Rules at a Glance (1985–2024)* and *Fiscal Rules and Fiscal Councils: Recent Trends (2025)*.

(3) Developing indicators to comprehensively monitor fiscal sustainability is one option

What should fiscal targets look like to address this situation? Even in cases like Japan's, where statutory constraints on fiscal sustainability are weak, setting highly effective targets could enable domestic and international market participants to monitor the nation's fiscal situation in a transparent and multifaceted manner.

In Japan, fiscal discipline policies have traditionally been established annually through the “Basic Policy on Economic and Fiscal Management and Reform” (Basic Policy), together with special legislation authorizing the issuance of deficit-financing bonds over multiple fiscal years. For example, while the 2024 Basic Policy set the target “of achieving a primary balance surplus of the central and local governments in FY2025,” the 2025 Basic Policy revised the wording and stated, “Over the period from FY2025 to FY2026, we aim to achieve a primary surplus of the central and local governments as early as possible.” The target year was made more flexible in light of uncertain external factors, including U.S. tariff measures. (Table 2).

At the same time, market-oriented language was added, such as “wage hikes rather than tax cuts” and “efforts to further encourage domestic ownership of government bonds to prevent a sharp rise in long-

term interest rates due to a deterioration in the supply-demand balance of government bonds.” Furthermore, the 2025 Basic Policy included a new item for consideration stating that “if a primary balance turns into a surplus and exceeds a certain level, it will be returned to the economy and society by expanding policies that contribute to economic growth and other objectives.” The Takaichi administration, which took office in October 2025, indicated a review of the existing Basic Policy and emphasized a proactive fiscal policy, prioritizing economic growth while clarifying its goal of fiscal consolidation. Specifically, regarding the primary balance surplus target, the administration does not prioritize achieving the target on a single-year basis but instead aims to achieve it over multiple years; the key indicator under consideration is the ratio of government debt to GDP.

From a practical perspective, several issues need to be addressed when selecting indicators for fiscal sustainability. First, with regard to the primary balance target, it is necessary to determine whether a multi-year target should be adopted and, if so, the time frame over which a surplus should be achieved. Second, as in other countries, we need to consider whether to establish a target range for the government debt-to-GDP ratio and a timeline for achieving it. Third, we must consider whether to establish monitoring targets other than the primary balance and the government debt-to-GDP ratio.

Even if the specific primary balance target for a single fiscal year is not explicitly stated, establishing a target over a roughly three-year horizon, taking into account political factors such as election cycles (the average cycle for Lower House elections since 1996 has been 35 months)—could be one option. Second, as for the specific target range of the government debt-to-GDP ratio, the Cabinet Office ratio projections are based on certain economic assumptions, and it is practically feasible to set targets based on these government projections. Furthermore, it would be worth considering having the government discuss specific targets based on forecasts from an independent body, such as an independent fiscal institution proposed by Reiwa Rincho, a private-sector-led council on structural reform. Third, we consider it beneficial to examine interest payment expenses as a monitoring indicator, in addition to the primary balance and the government debt-to-GDP ratio. Since the Ministry of Finance already publishes estimates of the fiscal impact of government debt under alternative scenarios, policymakers could consider monitoring interest payments as a share of GDP or of government revenues and expenditures.

[Table 2: Comparison of recent government fiscal targets and the stance of the Takaichi administration]

	Basic Policy 2024 (Cabinet Decision 2024/6/21)	Basic Policy 2025 (Cabinet Decision 2025/6/13)	Stance of the Takaichi Administration
Fiscal Consolidation Targets	<ul style="list-style-type: none"> Clearly stipulates achieving a PB surplus for national and local governments in FY2025. Emphasizes a steady reduction in the public debt-to-GDP ratio. 	<ul style="list-style-type: none"> Aims for a PB surplus as early as possible throughout FY2025–2026. Explicitly states consideration for external factors (such as Trump tariffs) while paying attention to PB. 	<ul style="list-style-type: none"> Places the highest priority on expanding nominal GDP, putting "fiscal consolidation through growth" at the forefront. Lowers the public debt-to-GDP ratio to ensure fiscal sustainability.
Expenditure Reform Initiatives	<ul style="list-style-type: none"> Continues expenditure reform efforts over a three-year period from FY2025 to FY2027. Restrains expenditures from a medium-term perspective, including social security and defense spending. 	<ul style="list-style-type: none"> Maintains the course set for expenditure reform in Basic Policy 2024. Remains committed to the framework while considering price trends. 	<ul style="list-style-type: none"> Prioritizes "selective expansion into key fields" over broad expenditure cuts. Allocates resources with a priority on defense, economic security, advanced technology, and energy.
Attitude toward Tax Cuts	<ul style="list-style-type: none"> Does not show an explicit tax cut policy. Remains cautious while emphasizing that "the economy is the foundation of public finance." 	<ul style="list-style-type: none"> Clarifies the focus on wage hikes rather than tax cuts. Emphasizes the increase in disposable income through wage growth. 	<ul style="list-style-type: none"> Provides generous support to the middle class by raising the basic exemption.
Response to Government Bonds & Interest Rates	<ul style="list-style-type: none"> Focus on fiscal credibility with monetary policy normalization in mind. Maintains vigilance against the risk of rising interest rates. 	<ul style="list-style-type: none"> Explicitly states avoiding rapid interest rate hikes. Mentions promoting domestic ownership of government bonds. 	<ul style="list-style-type: none"> Emphasizes cooperation with the Bank of Japan to curb rising interest rates. Shows market consideration by restraining the issuance amount of government bonds.
Policy after Achieving a PB Surplus	<ul style="list-style-type: none"> Not stated 	<ul style="list-style-type: none"> Initiates an examination of measures to return the benefits of growth if the PB surplus exceeds a certain level. 	<ul style="list-style-type: none"> Examines the achievement of a PB surplus over a multi-year horizon.

Source: Made by Research Department, Mizuho Research Institute based on various documents released by the government and media resources.

4. Medium- to long-term reforms of social security and the tax system are inevitable

(1) Expenditure-side measures must curb growing social security costs, while revenue-side measures must rebuild the earning power of the working-age population

The third section proposed strengthening the monitoring of fiscal targets, but achieving these targets requires structural reforms from a medium- to long-term perspective on both expenditure and revenue sides. On the expenditure side, we must confront the reality that rising social security costs are limiting flexibility for other policy expenditures. On the revenue side, rather than relying on hasty tax hikes or increased burdens, sustainable tax revenue growth through economic expansion is the most viable approach. To achieve this, the fundamental challenge lies in creating an environment where the working-age population finds it easier to earn income and in expanding the tax base itself. What structural reforms are necessary in this context?² This analysis first examines expenditures. A comparison of the structure of revenue and expenditure in the initial budget proposals for FY1990 and FY2026 (Figure 6) shows that, among expenditure items, social security costs have risen significantly—from 11.6 trillion yen in FY1990 to 39.1 trillion yen in FY2026, an increase of 27.5 trillion yen. There have been no major fluctuations in public works, education, or science and technology-related expenditures, resulting in a structure where the expansion of social security expenditures restricts the flexibility of other spending. Social security costs are expected to rise further as baby boomers turned 75 or older in 2025; since medical and long-term care costs for those aged 75 and older are high per person, these expenses will continue to increase. Pension finances are also under strain due to a lower-than-expected birthrate. In addition to expanding the pool of pension and social insurance subscribers and promoting employment among the elderly and women, fundamental reforms—such as improving efficiency through the use of AI and digital transformation (DX) in medical and long-term care services, and balancing benefits with contributions—are essential to curb rising medical and long-term care costs.

Next, on the revenue side, while corporate tax and other tax revenues have been trending upward in recent years due to inflation, expanding the income tax base and overcoming the slump in domestic demand are urgent priorities for ensuring fiscal sustainability. From the perspective of the income tax base, strengthening households' earning power is also crucial. Due to factors such as an aging population and the expansion of non-regular employment, the income levels of Japanese households have declined year by year; the median income, which stood at 4.62 million yen in 2004, fell to 4.10 million yen in 2024.

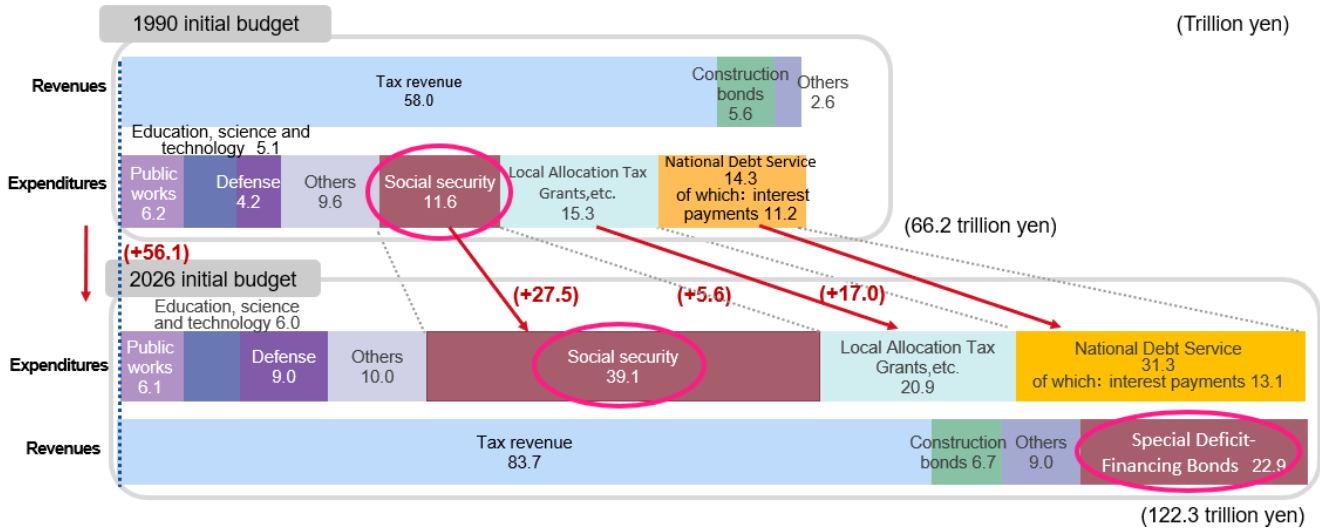
According to the Ministry of Health, Labour and Welfare's Comprehensive Survey of Living Conditions (2024), 36% of households without members aged 65 or older had annual incomes of ¥4.5 million or less, suggesting that a substantial share of the working-age population continues to face financial strain. Furthermore, even as nominal wages rise, real wages are being eroded by inflation, and consumption has remained sluggish for many years. In this context, it is crucial in the medium to long term to review the tax and social security burdens on the working-age population and to address the income thresholds that discourage people from working. In recent years, household tax burdens (including consumption and income taxes) have increased significantly, and social insurance premiums (contributions) for the working-age population have risen substantially. This situation has further reduced disposable income, curbing consumption and acting as a drag on economic growth.

Figure 7 compares the share of social insurance premiums and direct taxes (income tax, resident tax, etc.) as a percentage of household income from employment between 2004 and 2024. The chart shows that the proportion of social insurance premiums is rising. While it is evident that the social insurance burden is increasing for workers in their 60s and older due to the extension of the retirement age and the resulting longer working lives, the chart also suggests that the share of social insurance premiums is growing significantly among households in their 20s to 50s—the working-age population—thereby squeezing their available income. Looking at the actual monthly figures provides a clearer picture of this burden. Figure 8 compares the monthly social security and tax burdens for working households by generation in 2004 and 2024. The actual monthly figures show that social insurance premiums for those in their 40s and 50s have increased by about 20,000 yen, rising from the 50,000-yen range in 2004 to the 70,000-yen range in 2024. On the other hand, the consumption tax burden (estimated figures) shows a

² Various reforms related to government spending and revenue are discussed in detail in "Mizuho Report: Prescriptions for Sustainable and Inclusive Growth in the Japanese Economy (Household Sector)—How to Overcome the Three Structural Challenges Underlying the Long-Term Slump in Consumption" (December 2025).

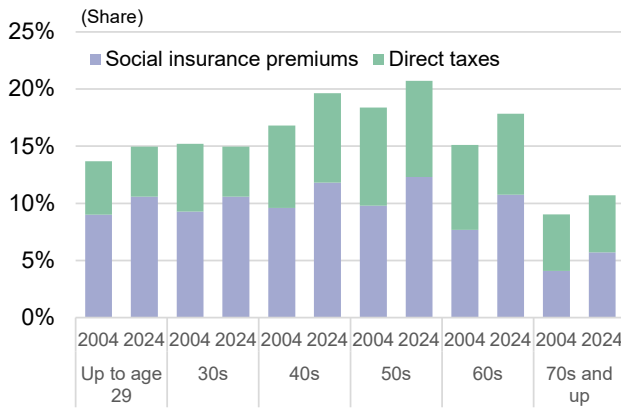
difference of only a few thousand to 10,000 yen between 2004 (5% tax rate) and 2024 (10% tax rate). As such, rising social insurance premiums are the primary factor squeezing disposable income. From the perspective of the consumption life cycle, the heavy burden of social insurance premiums on the working-age population—who are in a stage of rising spending—can also be seen as a factor contributing to restrained consumption.

[Figure 6: Changes in fiscal structure]



Source: Made by Research Department, Mizuho Research Institute based on budget data from the Ministry of Finance.

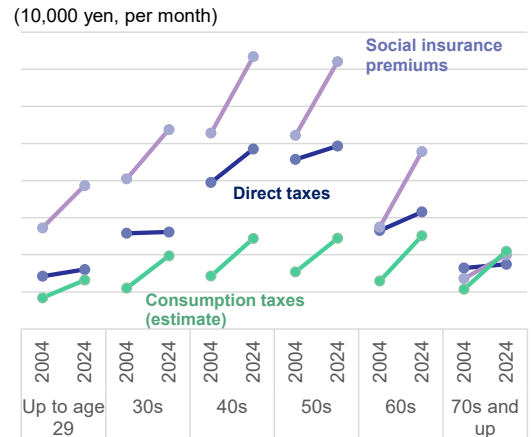
[Figure 7: Trends in the share of income accounted for by direct taxes and social insurance premiums (working households)]



Note: The ratio of direct taxes (including income tax) and social insurance premiums (contributions) (employee share) to household income from employment. For people in their 60s and 70s and older, the ratio to combined total of social insurance benefits (such as pensions) and income from employment.

Source: Made by Research Department, Mizuho Research Institute based on the Ministry of Internal Affairs and Communications, *Family Income and Expenditure Survey* (annual editions).

[Figure 8: Comparison of direct taxes/social insurance premiums and consumption tax (estimated) (working households)]



Note: The estimated consumption tax figures are calculated by applying the consumption tax rate for each fiscal year (FY2004 = 5%, FY2024 = 10%) and setting the tax rates for each category of items subject to reduced rates or tax exemptions; amounts are then aggregated (for items where specific breakdowns are unavailable, calculations are based on broad categories).

Source: Made by Research Department, Mizuho Research Institute based on the Ministry of Internal Affairs and Communications, *Family Income and Expenditure Survey* (annual editions).

(2) Toward the introduction of refundable tax credits, starting with a voluntary filing system is worth considering

As noted above, targeted redistribution policies are becoming increasingly important from the perspective of ensuring fiscal sustainability, and major countries are making progress in this area.³

³ It should be noted that even when benefits or tax deductions are initially designed to serve specific policy objectives, subsequent political pressures may lead to an expansion of eligibility beyond low- and middle-income households, thereby increasing fiscal pressures. Such issues have been

Furthermore, as mentioned earlier, with real wage growth in Japan continuing to stagnate, a refundable tax credit could be one option for a system designed to bolster household disposable income. While discussions regarding the introduction of a refundable tax credit are ongoing between the ruling and opposition parties, discussions are expected to accelerate going forward, centered on the National Council on Social Security, which began its work in February.

Following Morinobu (2025), an examination of international experience with refundable tax credit schemes (Table 3) reveals considerable diversity in program design. Many systems are built around earned income tax credits, while others combine them with child benefits (provided either through tax deductions or cash transfers) and measures to reduce social security contributions. From a medium- to long-term perspective, another option would be to introduce a more comprehensive safety net, such as the United Kingdom's Universal Credit, which integrates child benefits, housing support, unemployment assistance, and employment support into a single system.

However, establishing a comprehensive system from its initial stages of implementation would require system integration across national and local governments as well as different administrative sectors, posing substantial implementation challenges. Furthermore, authorities would need to track not only earned income but also investment income, and determining the value of assets is necessary from the perspective of ability-to-pay in the social security system and tax equity. While efforts to track earned income have gradually expanded through initiatives such as the gradual rollout of the My Number system, challenges remain, including linking financial assets to My Number accounts. With regard to these challenges, drawing on the example of South Korea's self-reporting system (Tajika and Hanai, 2020), one possible approach would be to require taxpayers to voluntarily report the necessary account information when claiming deductions or benefits (with such deductions or benefits not being applied if no information is provided). Furthermore, during the initial stages of introducing a refundable tax credit, securing additional funding for these benefits is one of the challenges that must be addressed. In the early stages, it might be advisable to narrow down the policy objectives and the target population, and then consider such practical measures as expanding the scope of eligibility as the policy's effectiveness is evaluated.

[Table 3: Types of refundable tax credits and similar programs]

Type	Features	Implementation Examples
(1) Earned Income Tax Credit (EITC)	<ul style="list-style-type: none"> ■ Targets individuals with earned income (age restrictions apply depending on country) ■ Supports individuals by improving their ability to live independently through work ■ Provides benefits for excess amounts not covered by tax deductions ■ Combined in the UK with active labor market policies (Universal Credit) 	US: Earned Income Tax Credit (EITC) UK: Working Tax Credit (now merged into Universal Credit) France: Prime d'activité Belgium: In-work tax credit Netherlands: A combination of measures including the Employment Tax Credit (arbeidskorting) Canada: Canada Workers Benefit South Korea: Earned Income Tax Credit (EITC)
(2) Child Tax Credit (CTC)	<ul style="list-style-type: none"> ■ Tax credits and benefits based on household size ■ Measures to address the declining birthrate through poverty alleviation and child-rearing support ■ Applicable up to income levels higher than those covered by the Earned Income Tax Credit (when used in conjunction) 	Child allowances exist in many countries and vary from tax credits to direct cash payments
(3) Tax Credit for Reduced Social Insurance Contributions	<ul style="list-style-type: none"> ■ Reduces the tax and social insurance burden on low-income earners ■ Offset against social insurance premiums; no refunds or benefits 	US: Effectively offsets payroll taxes Canada: Canada Workers Benefit (reduces social insurance contributions) France: Reduction or exemption of social insurance contributions for low-wage workers Belgium and Netherlands: Combination of tax credits and social insurance relief Germany: Reduction of social insurance contributions for low-income earners
(4) Tax Credit to Mitigate the Regressive Nature of the Consumption Tax	<ul style="list-style-type: none"> ■ Introduced as a measure to mitigate the regressive nature of the consumption tax ■ Income tax deduction equivalent to the consumption tax on basic living expenses, paid out as a benefit 	Canada: GST Credit (typical example—full benefit) Australia: GST compensation (adjusted through social security benefits) UK: Indirectly adjusted through Universal Credit

Source: Made by Research Department, Mizuho Research Institute based on Morinobu (2025), Shiraishi (2010), and information from various countries' websites, etc.

identified in the United States, and this point warrants careful consideration. Therefore, timely evaluation of the policy's effectiveness is believed essential.

5. Conclusion

In this report, we examined the direction of Japan's fiscal policy and social security reform against the backdrop of high debt levels and upward pressure on long-term interest rates—challenges shared by major advanced economies.

The first analysis suggests that when government debt is high, the stimulative effect of fiscal spending on the economy may diminish. This implies that in today's Japan, where fiscal discipline is under scrutiny, targeted and effective policy choices are far more important than relying solely on the size of fiscal stimulus. However, Japan's fiscal system lacks legal enforceability and faces structural challenges in ensuring effective policymaking. To enhance the effectiveness of fiscal discipline, we propose strengthening fiscal surveillance through multiple indicators, such as adopting multi-year primary balance targets, setting a target for the government debt-to-GDP ratio, and monitoring interest payment expenses.

Furthermore, structural reforms on both revenue and expenditure sides are essential. In particular, reducing the burden of social insurance premiums is an urgent priority as it continues to squeeze the disposable income of the working-age population, and we believe a refundable tax credit, currently under discussion as a concrete solution, would be effective.

The introduction of a refundable tax credit goes beyond merely supporting low-income earners. It is, in essence, a growth strategy aimed at rebuilding the foundation for sustainable growth in the Japanese economy by increasing the disposable income of the working-age population and stimulating consumption. While challenges such as securing funding and accurately tracking income are substantial, postponing necessary reforms will make it even more difficult to escape the vicious cycle of rising social security burdens and sluggish consumption. Now is the time to address these challenges decisively.

Reference

Refer to the original Japanese report by clicking the URL below for the reference material.

<https://www.mizuhobank.co.jp/corporate/mhri/research/report/2026-0037/index.html>