Basic Framework for Fiscal Consolidation: Medium-term Fiscal Plan

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Approved by the Cabinet

I. Basic Understanding

A strong economy is a source of national strength. Without economic growth, fiscal consolidation and Japan's future prosperity cannot be achieved. Recognizing this, the Japanese government seeks to overcome deflation early and achieve a strong economy through its "three arrows" strategy. The Government seeks to achieve sustainable economic growth led by private demand, nominal GDP growth of around 3% and real GDP growth of around 2% on average over the coming decade (from FY2013 to FY2022) with the impetus resulting from unifying the "three arrows" which strengthen each other.

At present, Japan's fiscal situation has significantly deteriorated in recent years as expenditure continues to increase owing to several factors, including population aging, combined with responses to the economic crisis after the Lehman Shock and to the Great East Japan Earthquake. And it is extremely severe as public debt has cumulatively increased to almost double Japan's GDP. It is therefore essential to construct sustainable public finances, as well as a social security system that allows the Japanese people to live with feeling relieved, even in an aging society with declining birthrates, as well as supporting the growth of Japan's economy.

To achieve sustainable economic growth led by private demand, it is essential to stimulate personal consumption and capital investment through fiscal consolidation which removes unease concerning public finances among households and enterprises, as well as developing an environment in which more private savings can be applied toward private investment. To smoothly advance monetary easing, it is necessary to secure trust in government bonds and keep the long-term interest rate stable; the Government also needs to steadfastly maintain fiscal discipline.

In this way, efforts toward fiscal consolidation are extremely important for making the "three arrows" strategy effective in a sustained way. Recognizing all of the above, as shown in the Basic Policies for Economic and Fiscal Management and Reform (Basic Policies, June 14, 2013, Cabinet Decision), the Government is carrying out the Japan Revitalization Strategy (June 14, 2013, Cabinet Decision) and putting into effect this plan to create a virtuous cycle between sustainable economic growth led by private demand and fiscal consolidation.

At the same time, giving the highest priority to recovery from the Great East Japan Earthquake and accelerated revitalization of Fukushima, the Government will develop concrete measures to accelerate recovery and revitalization by making effective use of the Special Account for Reconstruction from the Great East Japan Earthquake for steady implementation of necessary projects.

II. Fiscal consolidation targets

The Government seeks to create a virtuous cycle, in which economic revitalization promotes fiscal consolidation and progress in fiscal consolidation contributes to further economic revitalization, thereby achieving both sustainable economic growth and fiscal consolidation.

The Government aims to halve the primary deficit of the national and local governments to GDP ratio by FY2015 from the ratio in FY2010 and to achieve a primary surplus by FY2020[1], thereafter the Government will seek to steadily reduce the public debt to GDP ratio.

III. Achieving the target for FY2015.

1. Basic initiatives

For the moment, to achieve the target for FY2015, the Government focuses on improving the primary balance of the national and local governments in FY2014 and FY2015[2,3].

To achieve the target for FY2015, it is necessary to improve the primary balance of the national and local governments by approximately17 trillion yen[4] from FY2013 under the realization of sustainable economic growth led by private demand.

First of all, it is necessary to reduce the primary deficit of the National Government's General Account, which accounts for a large part of the primary deficit of the national and local governments. The utmost effort must be exerted both on the expenditure and revenue sides[5].

For that purpose, until FY2015, following the FY2013 budget, the Government will seek to achieve both economic growth led by private demand and fiscal consolidation targets, review priorities of policy measures from the timing of budget requests, reduce wasteful expenditure to the maximum extent and focus on high priority measures, taking into consideration trend of fiscal revenue.

Through these efforts, the Government aims to improve the primary balance of the General Account at least by approximately 4 trillion yen both in FY2014 and FY2015, and brings down the General Account's primary deficit to around 19 trillion yen in FY2014 and to around 15 trillion yen in FY2015, thereby seeking to achieve the target to halve the primary deficit of the national and local governments. (See Appendix.)

The Government will make its utmost efforts to keep the amount of newly issued National

[1] Based on revised figures of the National Accounts of Japan, a target has been set to reduce the deficit of 6.6 percent in FY2010 by half to a deficit of 3.3 percent in FY2015.

[2] The primary balance of the national and local governments refers to the total balance of the general and special accounts of the state and independent administrative agencies etc., which include additional expenditure and revenues in supplementary budgets, and those of local governments. Among them, almost all of the special accounts of the state and independent administrative agencies etc. keep their budgets virtually balanced, though there are some exceptions, such as the Special Account for Foreign Exchange Funds.

[3] Expenses and funds for policy measures for rehabilitation and restoration after the Great East Japan Earthquake are excluded in referring to financial conditions of the national and local governments, as these measures have a framework established to secure separate financial resources mainly through the Special Reconstruction Tax and accounts are kept for more than one year before settling them. When examining whether and/or to what degree a target for fiscal consolidation is achieved, such expenses and funds are not taken into account.

[4] It should be noted that greater improvement may be required when, for instance, there is a downward swing in the world economy or a delay in recovery of private demand.

[5] The Government will make a decision before implementing each increase of the consumption tax rate to 8 % and 10%, taking into consideration economic conditions and other factors in a comprehensive manner in accordance with Article18 of the Supplementary Provisions of the Act to Amend the Consumption Tax Act, etc., to Make the Comprehensive Reform of the Tax System for Securing (Act No. 68 of 2012).

Government bonds below that of the preceding fiscal year for the FY2014 and FY2015 budgets.

Just as for the General Account, services and policy programs in special accounts and independent administrative agencies, etc. should be thoroughly reviewed, taking into account their content and nature, from the viewpoint of whether they are really necessary.

In terms of local government finances, from the viewpoint of stable management, together with keeping expenses down in line with the efforts of the national government, total general revenues needed for stable fiscal management of local governments in FY2014 and FY2015, including those which receive grants under the Local Allocation Tax Act, should be maintained substantially at the same level as in the FY2013 Fiscal Plan of Local Governments, and not below[6].

The Government will review progress towards the FY2015 fiscal target every six months, taking into account the economic and fiscal outlook.

When significant difficulty is recognized in achieving the targets for fiscal consideration due to a serious economic crisis or any other event, appropriate action should be taken for implementing flexible fiscal policies. In such a case, the Government should present an alternative path to fiscal consolidation without delay.

2. Initiatives on the expenditure and revenue sides

On the expenditure side, the Government will seek to strengthen expenditure prioritization by focusing on each year's pressing issues as well as conducting drastic scrap-and-build measures. The Government will also attach high priority to measures that are highly conducive to private demand and innovation, that warrant urgent attention, and that are to be implemented together with regulatory reforms. The Government will be mindful not to easily allow expenditure increases in spite of higher inflation prospects by promoting cost cutting and enhancing the quality of administrative services.

Initiatives in the major fields mentioned below should be carried out according to the principle of prioritization and efficiency as stated in Chapter 3 of the Basic Policies.

- For social security, the Government seeks to control the overall level of social security expenditure to the extent possible amid an upward trend mainly due to population aging and advances in medical technologies. The Government will also make its utmost efforts to improve its efficiency, by resolving the issue of the exceptionally high levels of public pension benefits, the elimination of which is a pre-requisite for invoking the macroeconomic-slide mechanism, as well as ensuring concrete progress in enhancing efficiency in promoting the use of generic medicine.

- For the infrastructure, to address issues such as strengthening international competitiveness, revitalizing communities, and enhancing national resilience, the Government will apply a "selection and focus" strategy by prioritizing projects with a high return on investment, in combination with non-infrastructure measures.

[6] This paragraph does not apply to general revenues appropriated to policy programs related to the Great East Japan Earthquake.

- For the public finances of local governments, as the economy recovers, there is a need to proceed with normalizing the crisis-response mode following the Lehman Shock, in which measures such as special expenditure allowances have been taken. The Government will promote reforms both on the expenditure and the revenue sides, while supporting local governments in their own initiatives.

- The Government will promote reforms to establish a system in which those (people, companies, and communities) who work hard are rewarded. The Government will support those who need assistance and will develop a system that motivates people to be challenged again.

The Government will continuously review various fiscal measures in each expenditure category mainly in terms of necessity and efficiency, taking into account their content and nature; it will also enhance the effectiveness of the PDCA (Plan, Do, Check and Act) especially for measures that have been in place for more than five years, thereby ensuring elimination of wasteful expenditure.

In the fields of expenditure mentioned in the Basic Policies, which include those stated above, spending will be subjected to prioritizing and streamlining. Also, the Government will make necessary efforts, such as considering an appropriate tax system that takes better account of socio-economic structural changes. In tandem with these efforts on the expenditure and revenue sides, the Government will seek to build an efficient, effective public sector through efforts including the thorough elimination of waste.

IV. Achieving the target for FY2020.

To achieve a primary surplus of the national and local governments by FY2020, a basic measure will be to improve the primary balance of the General Account, just as is the case for efforts to be pursued until FY2015, and turn it into a surplus.

For that purpose the Government will need to steadily reduce primary expenditure, i.e. the General Account expenditure excluding debt repayment and interest payment, to the GDP ratio, while increasing fiscal revenues (taxes and non-tax revenues; the same applies below) to the GDP ratio in each fiscal year’s General Account budget, thereby eliminating the imbalance between them.

Specifically, the Government will draw a more concrete roadmap for five years from FY2016 to FY2020, in addressing efforts toward achieving the target for FY2015, taking into account the economic and fiscal outlook based on the primary expenditure to GDP ratio and fiscal revenues to GDP ratio, etc. in the FY2015 budget.

In this process, on the expenditure side, the Government will gradually reduce the primary expenditure to GDP ratio by controlling the primary expenditure to the extent possible through eliminating wasteful expenditure in each year’s budget, while increasing GDP through economic growth. On the revenue side, the Government will seek to expand tax revenues through economic growth. In the process of making these efforts, the Government will consider securing financial resources for social security spending that has been on the rise mainly due to population aging, through measures both on the expenditure and revenue sides, including any necessary reforms of the systems.

In budget formulations towards the target years, the Government has established a principle to secure stable financial resources by expenditure cuts and/or revenue increases when introducing or extending measures that entail expenditure increases or revenue decreases.

This autumn, the Council on Economic and Fiscal Policy, taking into account the interaction between the economic and fiscal circumstances and the social security system, will examine measures for constructing sustainable public finances and social security.

Appendix: Forecast of the Primary Balance

○ Primary balance of the national and local governments
FY2013: a deficit of 34.0 trillion yen → FY2015: a deficit of around 17.1 trillion yen

○ Targets for the primary balance of the General Account

	FY2013	FY2014	FY2015
Targets for the primary balance of the General Account	a deficit of 23 trillion yen	a deficit of around 19 trillion yen	a deficit of around 15 trillion yen