Provisional Translation
No.2

Toward the Implementation and Establishment of "Responsible and Proactive Public Finances"

—FY2027 Budget Formulation and
Future Economic and Fiscal Management—

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※This document provides a summary of policy proposals submitted for discussion by the expert members to the Council on Economic and Fiscal Policy.

Framework for Budget Formulation and Fiscal Management in the Context of “Responsible and Proactive Public Finances” (Overview)

Based on sound projections of economic conditions, prices, and tax revenues, the FY2027 budget will be formulated as “The First Year of Responsible and Proactive Public Finances”, with a comprehensive approach that integrates responses to major policy priorities and fiscal demands with reviews of both expenditures and revenues, thereby achieving both economic growth and fiscal discipline.

Stance for Economic and Fiscal Management

■ Address the drawbacks of single-year budgeting (utilizing the “investment framework”) and moving away from reliance on supplementary budgets

■ Assess consistency through Economic and Fiscal Projections for Medium to Long Term Analysis (reducing the debt-to-GDP ratio, managing the primary balance over multiple fiscal years)

*A temporary deterioration in the primary balance due to factors such as an economic downturn is acceptable

Major Policy and Fiscal Needs

- “Strong and Prosperous Japan” Investment Framework (Multi-Year Investment Support)
- Reflecting Rising Prices and Wages
- Consumption Tax Reduction on Food and Beverages (for Two Years limited)
- Natural increase and Functional Enhancement of Social Security Expenditures
- Strengthening Defense Capabilities
- Increase in Government Bond Expenses (Interest Payments)

A Review of Both Expenditures and Revenues

■ Enhancing the Review of Special Tax Measures and Subsidies

■ Focusing allocation of the Overall Budget (Prioritizing Initiatives)

■ Efforts to secure additional revenue from special accounts, funds, and other sources (such as curbing the long-term accumulation of funds in endowment funds)

■ Review of Budgets Previously Allocated Through Supplementary Budgets (e.g., Review of Measures to Address Rising Prices)

Presenting the Big Picture of the Macroeconomic Situation

<General account based>

- Total Expenditures
- Total Revenue
- New Government Bond Issuance
- Interest Expense
- Fiscal Stance (Taking the above factors into account)

<SNA-based>

- Primary Balance (PB)
- Fiscal Balance
- Debt-to-GDP Ratio

The Cycle of Economic and Fiscal Management That Supports Market Confidence

(Reviewing economic and fiscal conditions and the effectiveness of policies, and adjusting policies as necessary)

Basic Principles of Budget Formulation
Key Policy Issues and Directions for Reviewing Expenditures and Revenues

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Government’s Draft Budget
Presenting an Overview of Expenditures, Revenues, Government Bond Issuance, and Other Matters

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Medium- to Long-Term Projections
Verification of Consistency with Core Objectives, etc.

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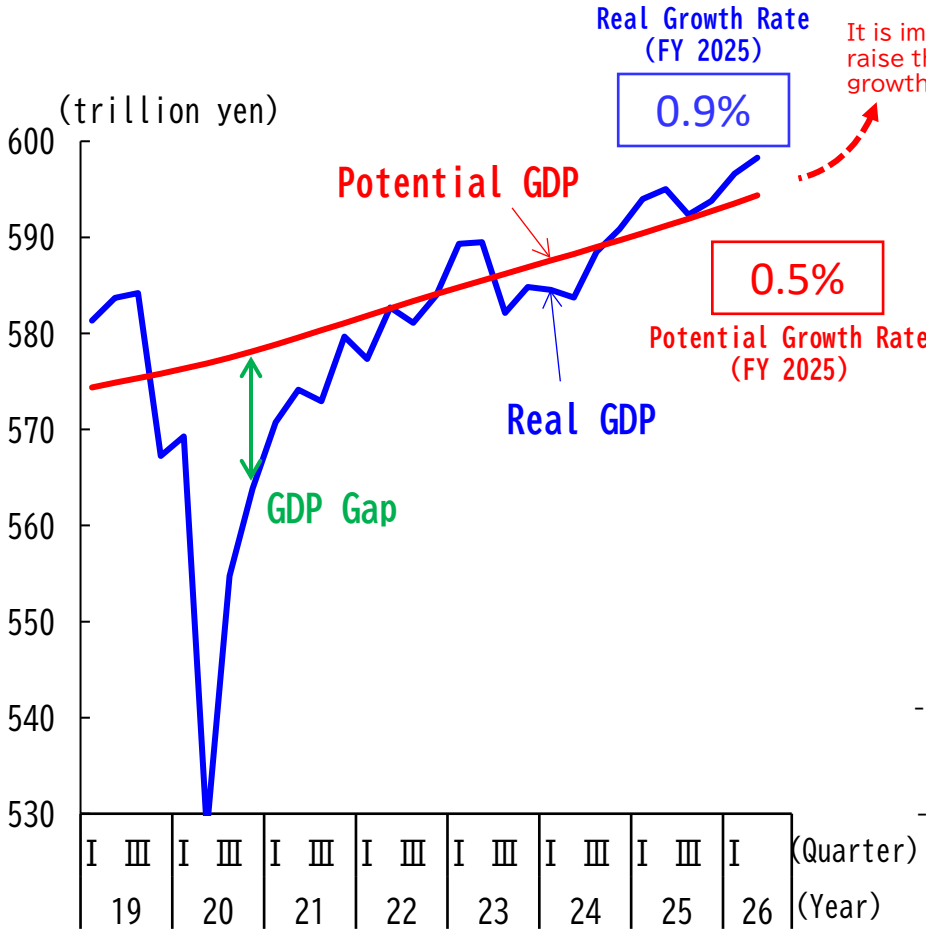
Multifaceted verification
Review the progress and effectiveness of various policies (including risk scenarios)

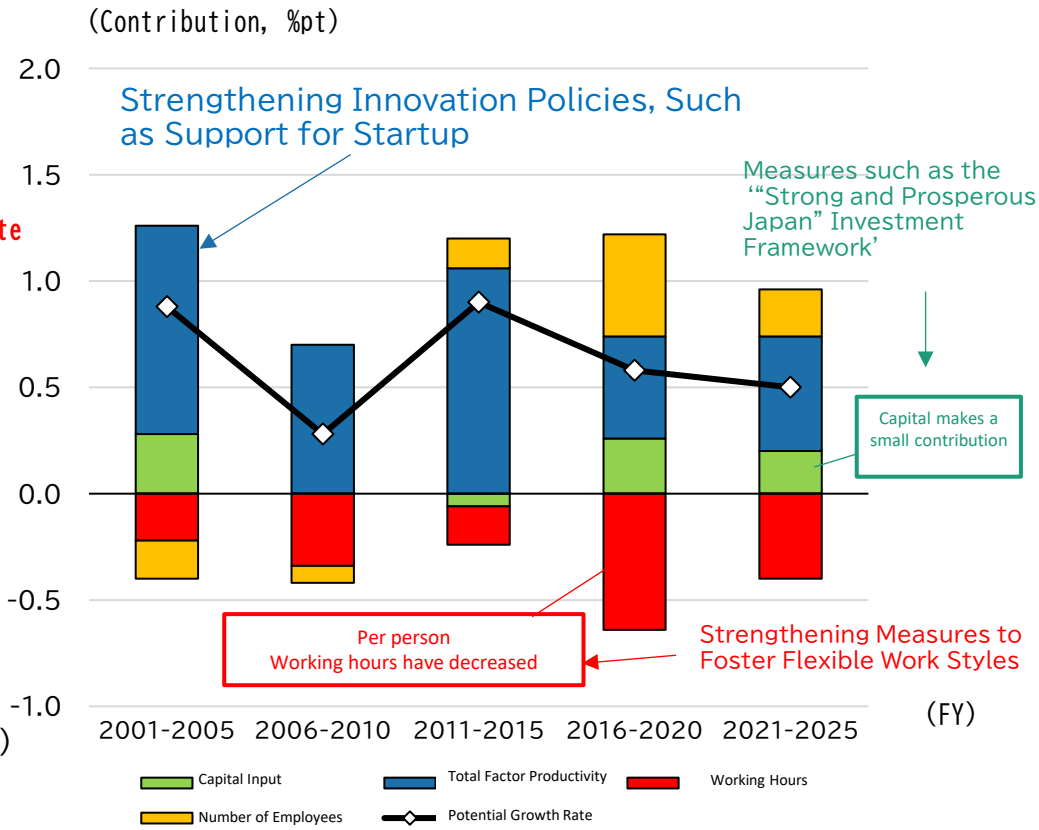
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Revision based on the verification

Strengthening Supply Capacity

○ In fiscal year 2025, the real growth rate exceeds the potential growth rate, and the GDP gap turned positive. As labor shortages and insufficient investment are increasingly becoming constraints on growth, it is important to strengthen supply capacity by expanding domestic investment and improving productivity.



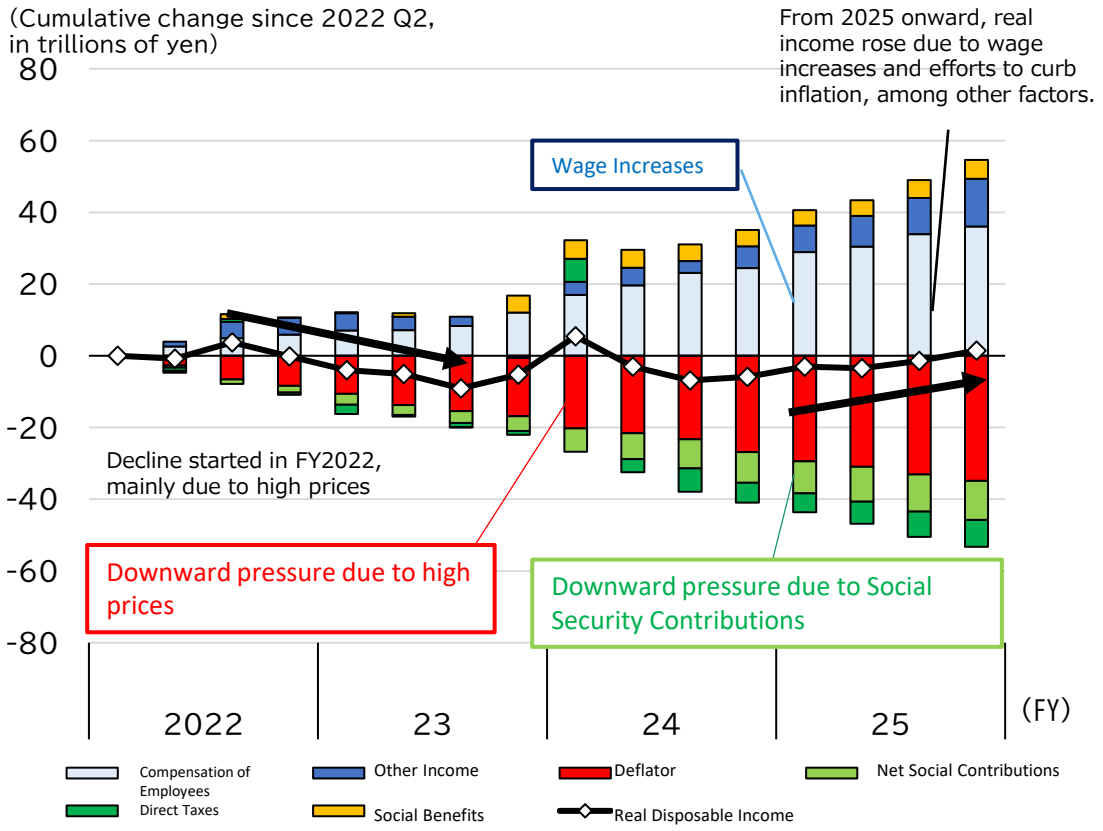


Increasing Households' Real Disposable Income

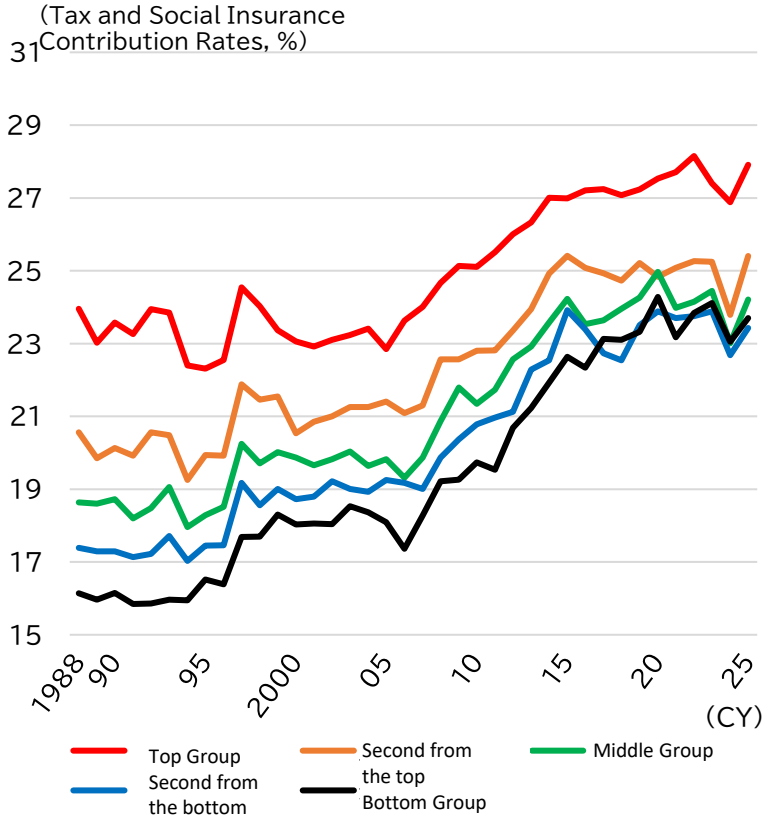
○After real income declined due to rising prices starting in 2022, it began to rise again last year. To stimulate consumer spending, which has been lackluster, we should increase the real disposable income of low- and middle-income earners.

○To this end, it is important to reduce the consumption tax rate on food and beverages, introduce working individuals' burden relief support benefit, and implement social security reforms to alleviate the burden of insurance premiums.

Factors Affecting Changes in Household Disposable Income (Cumulative Change)



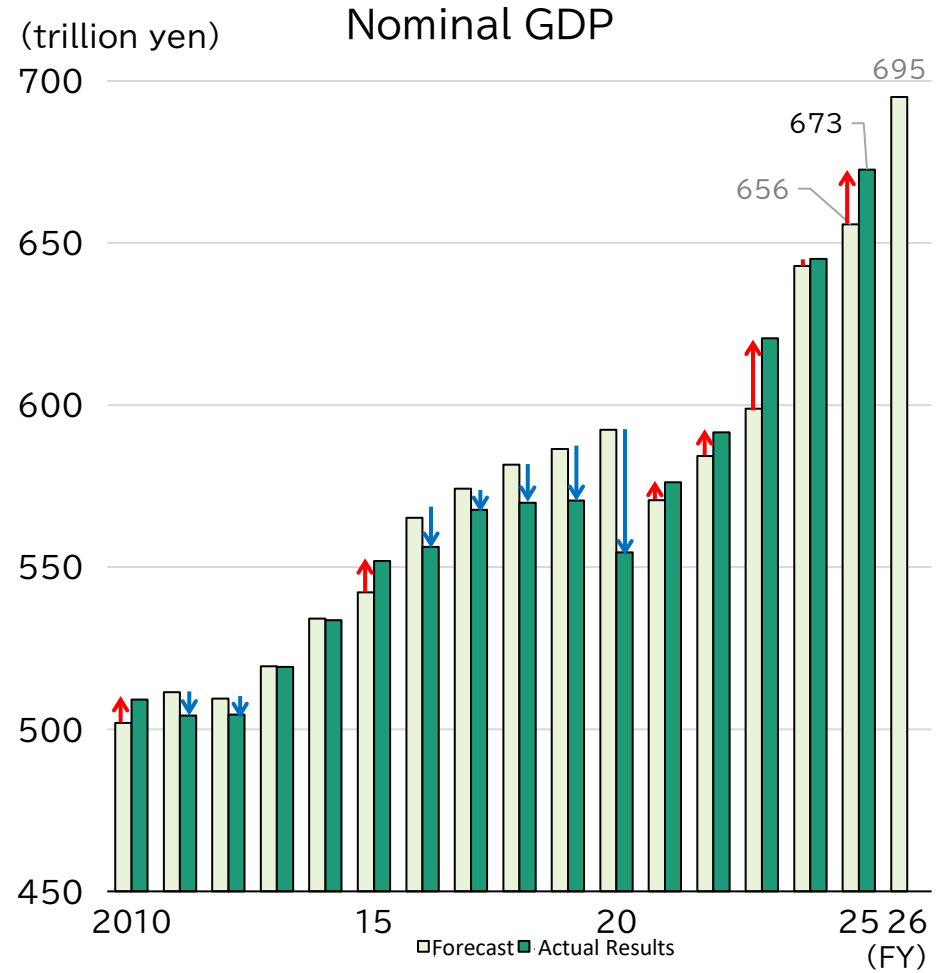
Household Tax and Social Insurance Burden Rate by Income Bracket

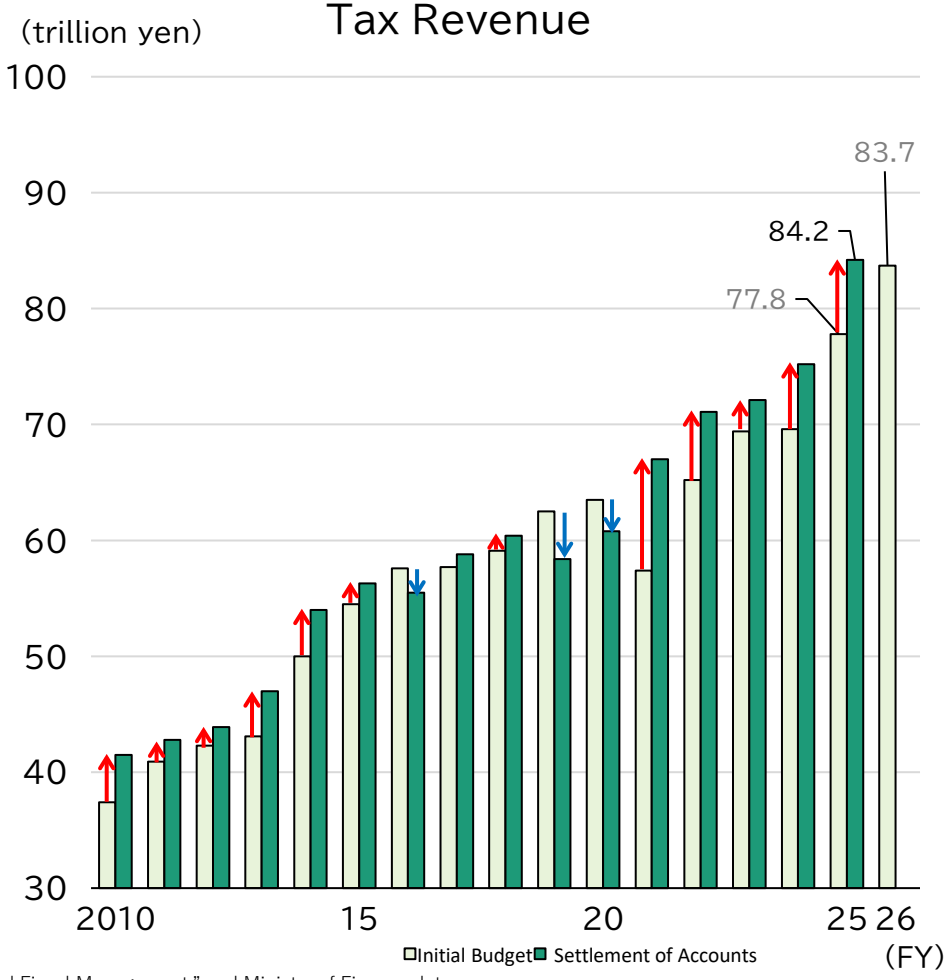


(Note) The figure on the left is based on the Cabinet Office's "Quarterly Estimates of Household Disposable Income and Household Saving Ratio." "Other income" is the sum of "operating surplus and mixed income," "property income, net," and "other current transfers, net."
The chart on the right is based on the Ministry of Internal Affairs and Communications' "Family Income and Expenditure Survey," Uemura (2006), and Koreeda & Hiraishi (2025). Tax and social insurance contribution rate = (direct taxes + indirect taxes + social insurance premiums) / income from employment.
For the income quintile groups, the annual income quintiles, starting from the lowest, are 5.21 million yen, 6.78 million yen, 8.28 million yen, and 10.45 million yen.

Nominal GDP and Tax Revenue

○ To date, nominal GDP projections in the "Government Economic Outlook" as well as tax revenue estimates in the initial budget have shown some divergence from actual outcomes and revenues, and in recent years, actual figures tended to exceed initial forecasts and estimates. It is important to discuss the appropriate structure of the FY2027 budget from a macroeconomic perspective, taking into account current trends and accurate future projections regarding the economy, prices, tax revenue, and other factors.





(Note) Prepared based on the Cabinet Office's "National Accounts," "Economic Outlook and Basic Stance on Economic and Fiscal Management," and Ministry of Finance data.
For the left chart, The figures for the next fiscal year's nominal GDP forecast are calculated as: previous fiscal year's actual figures × projected actual figures for the current fiscal year (year-on-year growth rate) × forecast for the next fiscal year (year-on-year growth rate). The projected actual figures for the current fiscal year and the forecast for the next fiscal year are based on the government's economic outlook.
The "Initial Budget" in the figure on the right refers to the estimated tax revenue (level) in the initial budget.