

Minister's Summary by Minister Ota**26th Meeting (November 24, 2006)**

- (1) On the Basic Principles of FY2007 Budget Formulation (draft)
- (2) Intensive deliberation (4): On the tax system
- (3) On the Asia Gateway Vision
- (4) On regional revitalization
- (5) Others

Hiroko Ota here. Today, the Council on Economic and Fiscal Policy (CEFP) held its 26th meeting of the year and discussed the Basic Principles of FY2007 Budget Formulation, the tax system, the Asia Gateway Vision and regional revitalization. Then, I made a proposal on reorganizing the expert committee on government assets and debts reform in line with handouts, and this received approval.

On the budget, the expert members presented five principles. They proposed that a supplementary budget also be discussed in line with the principles and that we proceed with efforts while checking if each year's budget is positioned within the range of achieving the five-year Integrated Reform of Expenditure and Revenue under the Basic Policies 2006. In this regard, I believe that the five principles were approved without objections raised. As well, the following opinions were expressed:

The precondition for the five-year reform is the growth strategy. It is essential to increase both nominal and real economic growth rates based on the growth strategy.

For the growth strategy, the expenditure with emphasis on the appropriate areas, not pork-barrel spending, is also required in FY2007 budget after limiting quality and quantity.

While multi-year management for the period of five years is important, it is also essential to raise growth potential over a medium to long term. Both the fiscal consolidation and the growth strategy are necessary.

In responding to budgetary requirements for the growth strategy, we should firmly keep the five principles.

We should supplement expenditure for the growth strategy by reduction in other expenses in line with the expert members' principles.

There are discussions on a supplementary budget, but the growth strategy should also be structurally incorporated into the principal budget.

A temporary increase in tax revenues should not be earmarked for structural expenditures, let alone economic stimulus measures now.

On a supplementary budget, (1) it is important to give priority to fiscal consolidation, but a viewpoint of bringing forward the growth strategy may be allowed in part. (2) A viewpoint of putting the economy on a solid growth path under the growth strategy may be allowed.

We should steadily respond to the growth strategy in the principal budget rather than the supplementary budget. A natural increase in revenues is something unpredictable, so by this nature this cannot be used. Such revenue increase should be used for redeeming government bonds. If the economy plunges into a deflationary spiral, however, expenditure would need to be expanded.

Since the FY2007 budget is to visualize the Abe Cabinet's first fiscal policy, it is extremely important to give priority to both growth and fiscal consolidation. We must also consider that if fiscal discipline is eased, rise in long-term interest rates may arise to affect the economy.

I made the following summary:

As agreement has been reached on the expert members' principles for the Abe Cabinet's budget formulation, it is essential to work on future budget formulation based on these principles.

It is significant that a supplementary budget has been discussed at a forum open to the people, namely the CEFPP.

As agreement was also reached on another proposal by the expert members to check if the draft budget is positioned within the range of achieving a surplus in the primary balance and the medium-term target, the Cabinet Office will make estimates in line with the proposal and report them to the CEFPP. I request the Ministry of Finance and the Ministry of Internal Affairs and Communications to provide required information.

As for the draft Basic Principles of FY2007 Budget Formulation, I would like to work on the required modification based on today's discussion and coordinate with the ruling parties so that the Prime Minister can consult the CEFPP's recommendation at the next meeting.

The Prime Minister made the following conclusions:

Expenditure reductions which were promoted under the Koizumi Cabinet are now growing tougher, but the policy of implementing tough expenditure reductions and eliminating budget wastes will stand firm under the Abe Cabinet as well. I intend to keep the expert members' principles.

Various arguments were made on a supplementary budget, but its original purpose is to finance emergency measures such as disaster control directly linked to the people's safety and security. Other use of a supplementary budget will follow the basic principles.

I believe that the amount of new government bonds under the FY2007 budget should be substantially reduced from FY2006. This should be indicated in the Basic Principles of FY2007 Budget Formulation.

Stress on the growth strategy will be made in the budget formulation for the next fiscal year.

To achieve the medium-term goal, I request that you strive to implement expenditure reform from a viewpoint encompassing multiple years as proposed by the expert members.

As for the tax system, the Chair of the Tax Commission, Mr. Honma, gave a briefing on what arguments have been made at the panel's group discussions. Then, the expert members remarked based on their papers that the basic concept of the tax system should be worked out in preparation for full-fledged discussions starting in autumn next year. Mr. Amari also gave explanations about his handouts. In response, the following arguments came out:

In order to facilitate discussions starting in next autumn, it is necessary to steadily advance our debate. We should have consistent discussions on how the Abe Cabinet's policy of constructing an open economy full of vitality and promoting the Challenge-Again Assistance Measures should be reflected in a philosophy or concept of the tax system. The FY2007 tax reform should also be conducted based on such approach.

There has been clamor for the corporate tax cuts recently, but we should consider the issue from the viewpoint of whether tax burden on individuals and companies is appropriately balanced. Considering ways for the corporate tax cuts to contribute to profit distribution for employees, subcontractors and small- and medium-sized enterprise is also needed so that the tax cuts will not become the sole prominent demand. We should commit ourselves to creating a

virtuous circle of consumption and corporate earnings which link expanded consumption with corporate earnings.

Securing stable revenue sources for the local governments by introducing a tax system which features less maldistributed revenue will help decentralization. In this sense, distribution of consumption tax should be considered.

In response to the expert members' request that the progress of the Tax Commission's deliberations be reported to the CEFP around next April to incorporate it into the new Basic Policies, the Chair Honma remarked that he was somewhat concerned about how far deliberations will move on by then and how much he will be able to say. So, I asked Mr. Honma to report the situation of the panel's deliberations to be made at that time, stating that it is important for the Cabinet to include the tax reform concept in the Basic Policies 2007.

In my summary, I also proposed that comprehensive and multifaceted deliberations on the basic concept of the tax reform be conducted at the CEFP as well for full-fledged and specific discussions starting in the next fiscal year, and this was approved. For future consideration, I requested the expert members as well as the Tax Commission to consider cross-sectoral issues in particular and give a report to the CEFP.

In addition, the Chair Honma voiced his intention to steadily conduct basic analysis and survey while expert members also suggested that analysis is important. In this regard, I added that secretariats of Cabinet Office and the Tax Commission will coordinate for sharing data and methodology.

The Prime Minister made the following remarks:

I would like the Tax Commission to deepen discussions from both macro and micro perspectives.

On the other hand, tax is politics itself. Therefore, it is important to give easy-to-understand explanations to the people and win their understanding.

For full-fledged and specific discussions on the tax reform starting next autumn, I request that the CEFP and the Tax Commission cooperate in considering a basic philosophy of the tax reform understandable to the public.

In the first half of next year, I would like to incorporate the basic philosophy into the Basic Policies 2007 based on such discussions.

On the Asia Gateway Vision, Special Advisor to the Prime Minister, Mr. Nemoto, made explanations. Key points of the discussions are as follows:

It is important to make concrete achievements. Narrowing the focus of discussions is required. For example, it is essential to promote the internationalization of Haneda Airport by utilizing midnight and early morning slots. The whole of Asia including Japan should tackle the Open Sky initiative where the private sector can freely open flights between countries which signed agreements. Japan should play a major role in the initiative and lead an aviation Big Bang in Asia. Opening airports and seaports is extremely important.

Irrespective of differences in language and philosophy, restrictions on moves will make Japan a fatally isolated country. We should develop a 24-hour operation system.

In narrowing the focus of discussions, priority should be given to international competitiveness.

Information and communications technologies (ICT) should be emphasized.

The Prime Minister made the following remarks:

I am now aware of why 24-hour opening of airports and seaports is difficult.

The Abe Cabinet intends to solve the issue without spending too much time.

When I attended the APEC meeting, I called for changing the view that Japan is closed. I made a statement that Japan will make a dramatic change over the next several years. Thus, I will steadily implement such change.

This will contribute to enhancing Japan's competitiveness as well and will be welcomed by Asian people.

On regional revitalization, temporary member Mr. Sata (Minister of state for Regional Revitalization), then Mr. Suga and Mr. Amari, presented explanations in line with their handouts. Key points of the discussions are as follows:

Special zones for structural reform are important.

It is important to establish distinct roles of the national government, local governments and the private sector. The national government should not disturb or intervene in businesses of local governments and the private sector.

We should consider policies from the viewpoint of what customers or consumers are pursuing. Such viewpoint should also be applied to what causes the closing of shopping streets.

The Prime Minister made the following summary:

Regional revitalization once meant public works. Over the past five years, the

national government has made bold changes in its policy. However, local governments have yet to develop their own systems. They are still in the process of trial and error.

Regional revitalization is a major pillar of the Abe Cabinet, and this will be based on regional ideas. It is important for the national government to support regional ideas and viewpoints.

In some regards, attraction of local communities is not fully recognized even by residents, so efforts to provide them with ideas are important.

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