

The Medium-term Program for Establishing a Sustainable Social Security System and Securing Its Stable Revenue Sources

December 24, 2008

Cabinet Decision

I. Actions for Economic Recovery

(1) In order to protect the lives of the people from the global economic turmoil, top policy priority will be given to achieving economic recovery within the three year period starting FY2008. To this end, the government and the ruling coalition are determined to implement economic measures totaling ¥75 trillion (“Comprehensive Immediate Policy Package”: “Economic Policy Package : Measures to Support People's Daily Lives”; “Immediate Policy Package to Safeguard People's Daily Lives”), including tax reductions and a fixed-sum stipend to each person, introduced temporarily for the period until economic recovery, on the premise that a fundamental reform of the tax system will be undertaken. The government will make the greatest possible effort to appropriately utilize various policy instruments, particularly in areas that have a major impact in tackling the economic recession, such as employment, the cash-flow of companies and supporting people in need. Furthermore, the government will work together with the Bank of Japan to fully ensure that the economy is managed appropriately.

(2) In parallel, the government will specify and promote an economic growth strategy aimed at activating Japan's latent power and vitality to the full, with an eye to achieving economic growth that takes advantage of the change of tide in the global economy.

II. Securing Stable Social Security Revenue Sources to Increase People’s Sense of Security

Three Basic Principles for Increasing People’s Sense of Security

1. Aiming for achieving a medium-level welfare state matched with medium-sized burdens
2. Simultaneously working on increasing people’s sense of security and securing social security revenue sources
3. Securing stable revenue sources while striking a balance between security and responsibility

1. Building a robust and sustainable social security system based on the principle of "medium-level

welfare matched with medium-sized burdens"

In order to ensure that people feel a sense of security in the face of a rapidly falling birthrate and an aging population, the government will work on the following two sets of agendas with regard to Japan's social security system, thereby establishing a robust and sustainable system based on the principle of "medium-level welfare matched with medium-sized burdens."

(1) To respond properly to various problems in the current social security system and to the fraying of the "medium-level welfare" system in Japan, which were pointed out in studies such as the "Final Report of the National Commission on Social Security" (November 4, 2008), the government will endeavor to realize a high-quality "medium-level welfare" system that provides people with a sense of security by enhancing its functions and improving its efficiency.

(2) Regarding revenue sources for the social security system (contributions, government spending and payments of individual beneficiaries), a third of government spending is currently financed by issuing government bonds, with the burden passed onto future generations. The government will change this situation and bring the system into balance by securing stable revenue sources through requesting a broad and moderate tax burden from the whole population, and thereby building a robust and sustainable social security system based on the principle of "medium-level welfare matched with medium-sized burdens."

2. Simultaneously working on increasing people's sense of security and securing social security revenue sources

To increase people's sense of security and to establish a sustainable and high-quality "medium-level welfare" system, action will be taken to enhance the functions and improve the efficiency of the social security system with regard to pension and medical and nursing care program benefits. Also, there will be expenditure allotted to countermeasures against the falling birthrate. Actions will include measures such as reinforcing basic pension benefits towards guaranteeing a minimum acceptable standard of living, improving medical and nursing care systems and strengthening childcare benefits and services. To this end, the government will push forward with the discussions on the reforms by reviewing the agenda shown in the attached timetable and bearing in mind the schedule for the corresponding legislative revisions, and will implement the reform step by step after securing stable revenue sources necessary for the establishment and institutionalization of such reforms.

3. Securing revenue sources while striking a balance between sense of security and responsibility

- (1) The government will secure a stable revenue source for social security primarily through taxation on consumption, based on the idea that the level of tax burdens should be commensurate with the level of benefits and that the costs of a social security system benefiting all people should be born by all generations widely and fairly. This will be achieved as part of the fundamental reform of the tax system.

- (2) The ultimate and ideal goal of this practice is to secure stable revenue sources of central and local governments that will fully cover their spending on social security benefits relating to the pension and medical and nursing care programs as well as on the countermeasures against the falling birthrate.

As a first step, in the mid-2010s, the tax reform will aim, with taxation on consumption playing a principal role, to attain revenue sources that will stably finance the costs for: the hike of the state-contribution portion of basic pension benefits to half of the overall; the government's expenses required for the establishment and institutionalization of reforms described in 2. above; and the government's contribution to the basic pension scheme, geriatric medical care and nursing care programs, ---- financing intended to strike a balance between ensuring a sense of security among present generations and taking responsibility for future generations.

More specifics, as well as their implementation methods, will be determined by the time the fundamental tax reform bills are submitted, taking into account the current conditions and future prospects of expenses required for the aforementioned social security benefits and falling birthrate countermeasures as well as developments in the government's fiscal restructuring.

III. Overview of the Fundamental Reform of the Tax System

Three Basic Principles of the Fundamental Reform of the Tax System are to be implemented after an upturn in the Economy

1. Tax cuts and increases over a multi-fiscal-year period are decided in consolidated form by law and executed in a stepwise manner with the timing of their implementation clearly specified.
2. Implementation of tax reform is conditional to the upturn in the economy and is judged by various factors including whether Japan has entered the stage in which its economy is expected to grow at or more than its potential growth rate. The reform will also incorporate a mechanism that allows flexibility against unexpected economic changes.
3. Consumption tax revenues are spent only on the expense of the established and institutionalized social security system, thus all being returned to the people and none used for an expansion of government bureaucracy.

1. Timetable for the fundamental reform of the tax system

- (1) The government will take the necessary legislative action by FY2011 in order to promptly implement the fundamental reform of the tax system including that of the consumption tax on the condition that an upturn in the Japanese economy is achieved through intensive efforts toward economic recovery within next three years starting from FY2008. The government will carry out the reform step-by-step with the intention of establishing a sustainable fiscal structure by the mid-2010s. The reform will take into account the procurement of financial resources for an increase in the ratio of the state-contribution portion of basic pension benefits to half of the overall total, as well as the prospect of necessary expenses for social security benefits relating to the pension and medical and nursing care programs and the countermeasures against the falling birthrate. Implementation of the tax reform is conditional on an upturn in the economy, and the government will assess the progress of economic recovery and developments in the global economy utilizing various factors including whether Japan has entered the stage in which its economy is expected to grow at or more than its potential growth rate. The reform will also incorporate a mechanism that allows for flexibility in the face of unexpected economic changes.
- (2) Social security costs financed by consumption tax revenues are to be rigorously separated from other budget accounts and the corresponding relationship between consumption tax revenues and social security costs are to be shown explicitly in both budget formulation and final accounts. Specifically, consumption tax revenues are to be allocated in full to expenses for social security

benefits relating to the pension and medical and nursing care programs, and expenses for falling birthrate countermeasures that have been established and instituted, thus in effect all being returned to the people with none being used for an expansion of government bureaucracy.

2. Basic ideas for the fundamental reform of the tax system

In order to consistently and systematically address the challenges Japan is facing, such as securing stable revenue sources for the social security system, alleviating various disparities in society, boosting Japan's potential for economic growth, and making the tax system greener, reform is to be further examined and realized, following the basic ideas outlined below:

- (1) With regard to personal income tax, from the viewpoint of alleviating disparities and restoring its income redistribution functions, various tax deductions and the tax rate structure are to be reviewed. As well as increasing the tax burden for high-income earners through adjustments of the maximum tax rate and the ceiling for wage income deduction, the government will study a reduction in the tax burden for medium- and low-income households with due considerations for childcare, as part of a comprehensive measure that comprises a study of expenditures including refundable tax credits. The integration of taxation on financial income will also be promoted further.
- (2) From the perspective of ensuring international tax harmony and enhancing international competitiveness, consideration will be given to a reduction in the effective corporate income tax rate together with an expansion of the tax base, while taking into consideration real corporate burdens including social insurance premiums.
- (3) The government will consider possible changes to the consumption tax rate on the condition that it makes it clear in the budgets and statements of accounts that all consumption tax revenues will be allocated to social security benefits relating to the pension and medical and nursing care programs as well as countermeasures against the falling birthrate that have been established and instituted, in order to elucidate that the consumption tax burden is to be in effect returned to the people. Consideration will also be given to alleviating low-income earners' burdens through comprehensive measures including an expenditure scheme; multiple tax rates are also a matter for consideration.
- (4) The government will consider simplifying automobile taxes, as well as reducing taxpayers'

burdens through a comprehensive review of the tax system and tax rates, including provisional tax rates, paying due attention to the severe fiscal conditions and impacts on the environment.

- (5) The government will consider optimizing the property tax burden by reviewing the inheritance tax base and tax rate structure from the perspective of alleviating descendent disparities and dealing with the enlarged share of burden social security systems shoulder in supporting aged dependents.
- (6) The government will strive to streamline the tax system and make it more convenient for taxpayers, including preparations for the introduction of a taxpayer identification number system.
- (7) The government will move forward with the construction of local taxation systems that provide stable revenue and whose revenue gaps among jurisdictions are small. To this end, the government will review local corporate taxation, and will consider enhancing the local consumption tax system from the perspective of promoting government decentralization and securing central and local government stable revenue sources for social security programs.
- (8) The government will intend to make the tax system "greener" from the perspective of facilitating the development of a low carbon society.

IV. Future Course of Action in Expenditure Reform

Principles of Expenditure Reform

1. Ceaseless administrative reforms and continued elimination of wasteful expenditures are the major prerequisites to the realization of the fundamental tax reform.
2. Until the economy recovers, with fiscal discipline maintained, decisive measures are to be taken promptly and flexibly in response to changes in economic conditions.
3. Once the economy is back on the track of recovery, rigorous fiscal discipline is to be ensured with stable revenue sources for social security secured.

(1) Until the economic recovers, with fiscal discipline maintained, from the perspective of realizing both economic recovery and fiscal consolidation, bold actions are to be taken promptly and flexibly in response to changes in economic conditions.

(2) Once the economy is back on the track of recovery, strict fiscal discipline is to be ensured in order to restore the fiscal position that had deteriorated during the economic downturn, while at the same time the fundamental tax reform including that of the consumption tax is to be implemented for the purpose of toward securing stable fiscal sources for social security.

Specifically, ceaseless reforms are to be implemented through the central and local governments in each sector of social security and in other areas under the following basic outlines described below.

(Social security sector)

In order to ensure the standard of services corresponding to "medium-level welfare," the social security system is to be reinforced in parallel with securing stable fiscal sources. At the same time, streamlining, such as cost reduction and benefit payment prioritization, is to be addressed.

(Other than social security sector)

In sectors other than social security, based on the principle of avoiding an expansion of the scale of government expenditure as a whole, effective and efficient public services are to be provided so as to meet people's needs.

V. Preparation and Implementation of the Medium-term Program

Principles for Preparation and Implementation

1. For prompt implementation after an upturn in the economy, institutional preparations should be made ahead of the implementation of the fundamental tax reform.
2. In order to ensure the steady implementation of the “Medium-term Program” with the understanding of the people, the timetable for the fundamental reform of the tax system should be legislatively illustrated.

(1) In order to promptly implement the fundamental reform of the tax system after an upturn in the economy, the details of the reform are to be specified and the legislative bills and other institutional preparations are to be made ahead of implementation. Relevant government ministries and agencies are to coordinate the consideration of implementation, in line with deliberations held by the Council on Fiscal and Economic Policy and the Government Tax Commission.

(2) The timetable and basic ideas for the fundamental tax reform mentioned in Chapter III are to be legislatively illustrated in the supplementary provisions of the FY2009 tax reform act.

(3) The hike of the state-contribution portion of basic pension benefits to half of the overall total is to be made permanent, in line with the National Pension Law (revised in 2004), once the required stable revenue sources are secured under the aforementioned fundamental tax reform. For the fiscal years of 2009 and 2010, the state-contribution portion of basic pension benefits is to be half of the overall total by allocating temporary fiscal resources. In the case of "unexpected economic changes" as described in III-1-(1), the state-contribution portion shall be provisionally kept to half of the overall total by allocating temporary fiscal resources until the procurement of the necessary financial resources is secured under the delayed implementation of tax reform.

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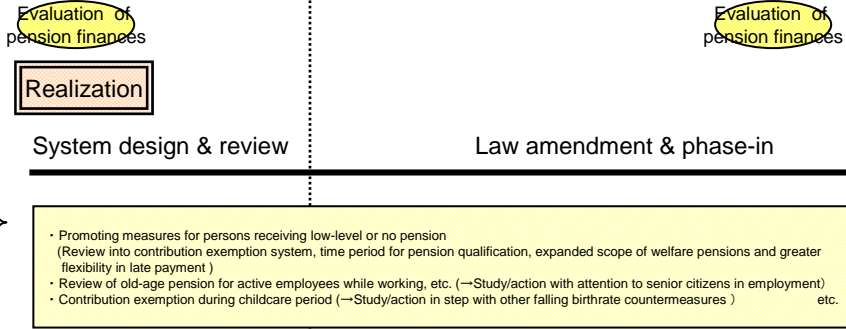
Timetable for Reinforcement of Social Security Functions

Based on vision described in the "Interim Report" and the "Final Report" of the National Commission on Social Security

2009 2010 2011 2012 2013 2014 2015 (~2025)

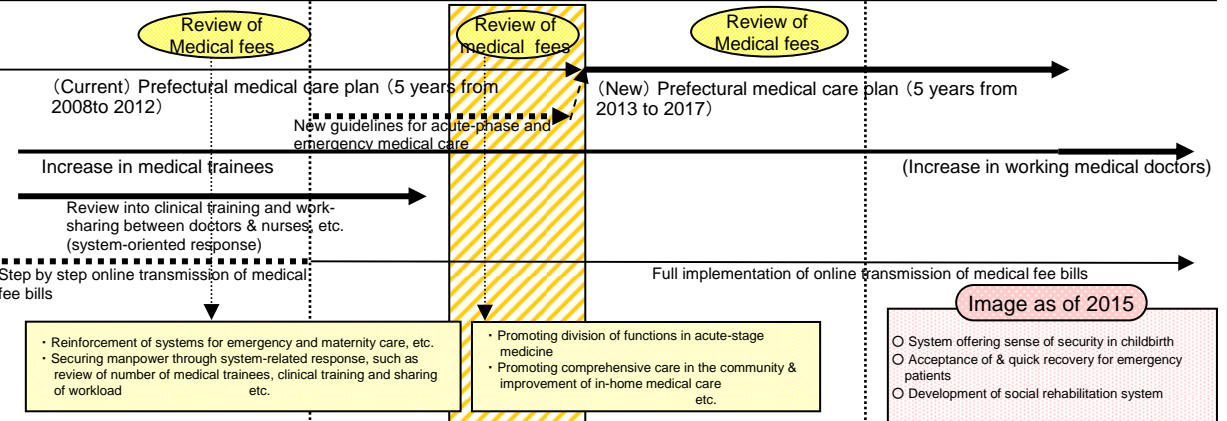
Pension

- Providing 50% coverage of basic pension with state contributions
- Boost in minimum assurance of basic pension
- Response to changes in social structures



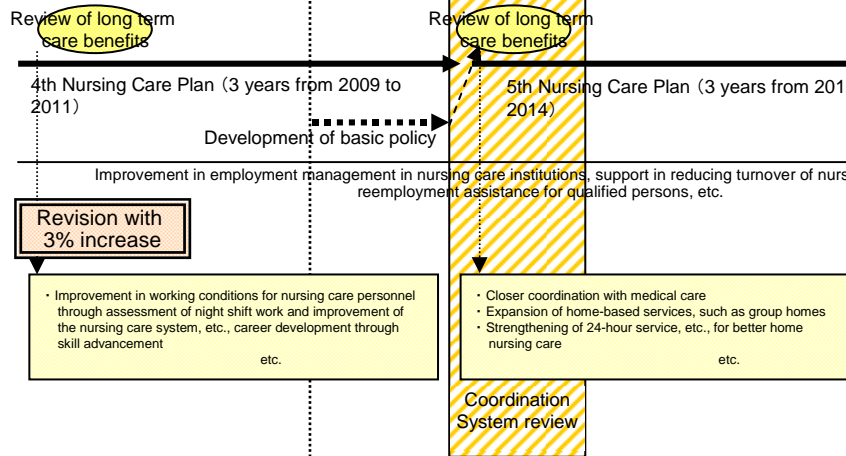
Medical & Nursing Care

- (Medical care)
- Boost function of acute-phase medical care
- Measures to secure medical doctors & related manpower



- Image as of 2015**
- System offering sense of security in childbirth
 - Acceptance of & quick recovery for emergency patients
 - Development of social rehabilitation system

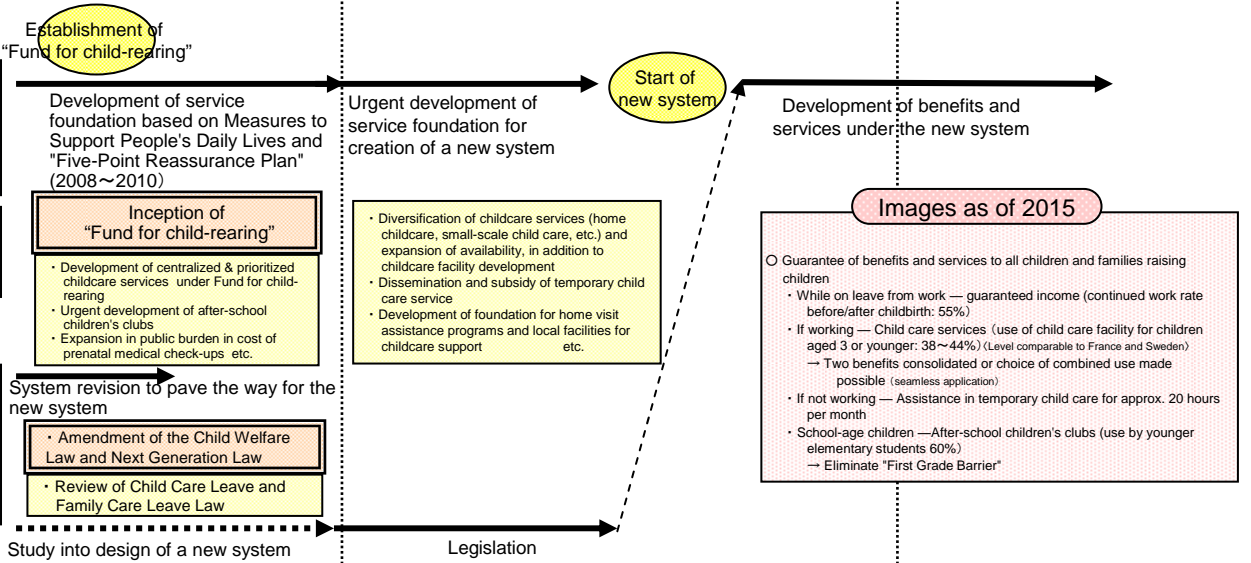
- (Nursing Care)
- Securing & improving working conditions for nursing care personnel
- Enrichment of home services and home nursing care



- Image as of 2015**
- Enrichment of home-base services, 24-hour services and improvement of small-scale, multi-functional services for reinforcement and development of home nursing care services
 - Reinforcement of nursing care facilities, such as adaptation to chronic illness, terminal illness, availability of private rooms and units, etc.

Falling birthrate counter measures

- Assurance of service quality & volume to realize work and child care for parents
- Reinforcement of childcare support for all households
- Development of a new system providing consolidated childcare support services



- Images as of 2015**
- Guarantee of benefits and services to all children and families raising children
 - While on leave from work — guaranteed income (continued work rate before/after childbirth: 55%)
 - If working — Child care services (use of child care facility for children aged 3 or younger: 38~44%) (Level comparable to France and Sweden)
 - Two benefits consolidated or choice of combined use made possible (seamless application)
 - If not working — Assistance in temporary child care for approx. 20 hours per month
 - School-age children — After-school children's clubs (use by younger elementary students 60%)
 - Eliminate "First Grade Barrier"

Common area

- Introduction of social security number & card

