

Guidelines for Formulation of the FY2003 Budget

November 29, 2002

Cabinet Decision

I. Promoting Structural Reform for the Rebirth of the Japanese Economy

1. Japan's current economic and fiscal conditions

(Current economic conditions)

An analysis of the global economy shows that there is a weak trend toward economic recovery in Europe and the United States. In this environment, with regard to the Japanese economy, exports are declining somewhat and the pace of recovery in industrial production has become more gradual. Although movement toward sustained recovery continues to be seen in the economy, its pace has become more gradual.

(Japanese economy in FY2002 and FY2003)

Due to increased exports and a recovery in industrial production and other factors from the beginning of the year, some movements toward recovery have been seen in the economy in FY2002. However, from the second half of the year onwards, there have been many uncertain factors including concerns over the outlook of the U.S. economy and the effect of depressed stock

prices. These factors have exerted downward pressures on final demand and it is projected that the pace of recovery will slacken even more during the second half of the year. In overall economic terms, the real growth rate for Gross Domestic Product (GDP) in FY2002 is projected to register positive growth, due to the contribution of the relatively high growth rate during the first half of the year.

Looking forward to FY2003, it is projected that the united efforts by Government of Japan and the Bank of Japan including the Comprehensive Measures to Accelerate Reforms, the Program to Accelerate Reforms adopted to complement and enhance those measures and the FY2002 supplementary budget to be formulated based on these will come into effect. In addition, gradual recovery is expected in the corporate sector, and moreover, it is expected that during the first half of the fiscal year the economy in the United States will gradually regain the path to moderate recovery and the global economy is also expected to gradually recover. As such, the Japanese economy is expected to gradually move toward a moderate recovery driven by private demand. Although there are concerns that deflationary trends will continue in prices, factors such as the recovery in demand will lead to a gradual decrease in deflationary pressures. However, there remain many uncertain factors in Japan, including trends in the global economy and the effect of accelerated disposal of non-performing loans and there is a need to pay careful attention to the existence of such various downward risks.

In addition, matters such as the specific economic growth rate will be indicated in the Economic Outlook and Basic Stance for Macroeconomic and Fiscal Management to be compiled by the Government at the end of the year.

(Fiscal conditions)

Since the collapse of the bubble economy, Japan's fiscal policies have been primarily focused on achieving an economic recovery. Since then, Japan's fiscal conditions have reached the most critical stage among the major advanced nations of the world. Although efforts have been made toward fiscal structural reform under the FY2002 budget, as a result of significant projected shortfalls in tax revenues, the fiscal situation is worsening.

Japan can no longer expect growth in tax revenues based on high economic growth rates. On the other hand, the rapid aging of society is raising government expenditures, while the expanding volume of outstanding government bonds is leading to an elevation of debt-servicing expenses. As a result, the government's revenue and expenditure structure is becoming increasingly rigid. Unless bold measures are taken to revise the current fiscal structure, there is a strong possibility that the large gap between tax revenues and expenditures will continue to grow in the years ahead. It is therefore necessary to implement reform of the fiscal structure steadily, without ignoring the increasing concerns with regards to the fiscal sustainability.

2. Toward the rebirth of the Japanese economy—Promoting structural reform and the Japanese economy

Even under the prevailing severe economic conditions, the only way to achieve a rebirth of the Japanese economy is by effecting structural reform. By standing firmly from the basic perspective of “no growth without reform” and striving toward economic revitalization by implementing the four pillars of structural reform, i.e. “financial system reform,” “tax reform,” “regulatory reform,” and “expenditure reform,” in an integrated and consistent manner the Government must counter deflation and create a new structure in which the latent potential of the Japanese economy can be fully brought out. It is of particular importance to advance structural reform placing an emphasis on increasing private demand and expanding employment. In this context, special zones for structural reform will be promoted as a major pillar to revitalize the Japanese economy.

In addition, the disposal of non-performing loans, which is a weight bearing on the Japanese economy and the settlement of the problem of excessive corporate debt—financial and industrial revitalization—are urgent tasks to be tackled. Toward this end, the Government recently compiled the “Comprehensive Measures to Accelerate Reforms” and, based on those measures, established the “Strategic Headquarters for Industrial Revival and Employment Measures.” Furthermore, based

on these response measures, the Government will advance business revitalization and industrial reorganization by promptly establishing the Industrial Revitalization Corporation (provisional name) and revising the Industrial Revitalization Law. Furthermore, in order to complement and enhance these response measures, the FY2002 supplementary budget will be formulated with the principle pillar of the creation of a safety net capable of responding to the ongoing economic and social structural reforms and the promotion of public investments in a manner that will bring about structural reform. The FY2002 supplementary budget will be implemented seamlessly with the FY2003 budget. Through the implementation of these measures, the Government will take every measure to ensure that “the people can live with without fear and corporations can concentrate on their businesses” over the coming two and a half years to the end of FY2004, by which time the disposal of non-performing loans will have been concluded.

II. Basic Principles of the FY2003 Budget

(Carrying forward the “budget for resolute reform”)

In formulating the FY2003 Budget, in order to build a vibrant economy and society and create a sustainable fiscal structure, the Government will maintain the basic path of the FY2002 Budget, deemed a “budget for resolute reform.” To this end, from the perspective of the shift “from the public to the private sector” and “from the central to the local governments,” bearing in mind the

considerations toward a fundamental review of systems and policies, the Government will accelerate government expenditures reform and conduct a thorough review of overall expenditures. The results of policy evaluations will be used in that process. In the FY2003 Budget, general expenditures and general account expenditures will be maintained at levels lower than those of FY2002 in real terms. In addition, carrying on the basic spirit of the FY2002 Budget of “keeping new government bond issuance to below 30 trillion yen,” the amount of government bond issues will be kept as low as possible.

In determining the allocations of the FY2003 Budget, bearing in mind the basic principles of advancing the structural reform of government expenditure, the Government will prioritize budget allocations to four areas that will lead to future development toward the revitalization of a vibrant economy and society; “progressing and utilizing human resource--education and culture, science and technology, and IT,” “building attractive urban areas and local areas with their own ideas and characteristics,” “taking necessary measures to build a fair and secure society addressing the aging society and the declining birth rate,” and “constructing an environment-friendly society and economy to deal with global environmental problems.” In addition, bearing in mind the current economic situation, priority attention will be paid to effects that will bring forth the potential vitality of the private sector and lead to the creation of employment. At the same time, it is appropriate to act to respond to the influence of reform and take all necessary measures to enhance the safety net for employment and for small and medium enterprises.

In order to prioritize budget allocations and make them efficient, in addition to classifying general expenditures into “public investment related expenditures,” “mandatory expenditures,” and “discretionary expenditures,” severe attention will be paid in determining actual budget allocations, although the request for an increase of up to 20% will be accepted. Amongst these, public investment related expenditures will be cut by no more than 3% of the total allocation for this category in the previous fiscal year. Secondly, a fundamental review will be made of the systems and measures related to mandatory expenditures with a view to reducing expenditures. Thirdly, a reduction will be made in discretionary expenditures with the ceiling to be fixed at an amount equivalent to a 2% reduction from the amount allocated in the previous fiscal year (excluding allocations for the Promotion of Science and Technology Expenditures).

In addition, the maximum possible efforts will be exerted to secure non-tax revenue.

Moreover, regarding the FY2003 Fiscal Investment and Loans Program, based on the purpose of pursuing administrative and fiscal reforms, the overall scale will be reduced and efforts will be made to prioritize resources to projects in areas that contribute to structural reform while at the same time, reflecting current economic and financial conditions, an accurate response will be made to funding requirements for the revival of enterprises and the financing of small and medium enterprises where deemed necessary for policy implementation.

(Administrative reform)

With a view to establishing a simple and efficient administrative system under the principle of pursuing “structural reform without sanctuaries,” efforts will be made to review the role of the administration in line with the needs of the times and to promote administrative structural reform through streamlining the administrative organization and increasing its efficiency and reforms of special public institutions and others.

Regarding the number of central government employees, steady implementation will be made of the policy of effecting a net reduction of 25% over a ten-year period, and in order to ensure that an appropriate response can be made to changes in administrative needs, a review will be made of administrative organizations and an active effort will be made to reorganize human resource allocations among ministries and agencies. Toward that end, during FY2003, while allowing for a concentrated increase in personnel for urgent measures to be implemented by the government as a whole, in other areas, efforts will be made to further restrict new increase in posts and to reduce the number of posts. Together with this, with a view to ensuring the most appropriate allocation of the total posts throughout the government, efforts will be made to advance a reassignment of the number of posts among government ministries. In addition, although the Food Safety Commission (provisional name) will be newly established, efforts will be made to ensure that this does not invite

a bloating of government. By so doing, it will be possible to realize a more sharply modulated allocation of posts while at the same time achieve a net reduction in the total number of civil servants employed by the national government. Furthermore, a severe reduction will be made to the number of posts at special public institutions. Similarly, regarding independent administrative institutions, efforts will be made to achieve a further increase in the efficiency of administrative operations, including a reduction in the number of executive directors and staff. Also, in light of the situation in the private sector, the level of retirement allowances paid to central government employees will be decreased. The basic policy of making vigorous efforts to reduce total personnel costs will be firmly maintained through the abovementioned approaches.

Regarding fiscal expenditures to special public institutions and others, by thoroughly reflecting in the FY2003 Budget the results of the thorough review of projects conducted based on the “Reorganization and Rationalization Plan for Special Public Institutions” (adopted by Cabinet Decision on 19 December 2001), a reduction and rationalization of fiscal expenditures for the independent administrative institutions, including those to be established in accordance with this Plan, will be conducted.

(Tax system reform)

A fundamental reform of the tax system will be undertaken with a view to building an “appropriate

tax system” in order to realize an activation of a sustainable economy and society.

Bearing in mind the prevailing economic situation, the Government will advance the deepest tax cuts possible in excess of 1 trillion yen. Aiming for a fair, simple and easy-to-understand tax system, under the framework of ensuring revenue-neutral in multiple fiscal years with a view to submitting to the next ordinary session of the Diet a single legislative package bill for overall tax reform, focused consideration will be advanced on the following items spanning the corporate tax, individual income tax, consumption tax and asset tax.

Regarding the corporate tax, consideration will be given to tax reductions for research and development and investments in information and technology (IT), as well as to a review to enhance the operating foundation of active small and medium enterprises. As for corporate tax rates, consideration will continue to be given in light of macroeconomic conditions, bearing in mind an international perspective and the modalities for the tax structure.

Regarding the pro forma standard taxation for corporate enterprise tax, a response will be taken along the lines indicated in the “Basic Policies for Economic and Fiscal Policy Management and Structural Reform 2002,” (hereinafter referred to as “Basic Policies 2002”) (adopted by Cabinet Decision on 25 June 2002).

Reviews will be made on the inheritance tax and gift tax with a view to facilitating a smooth transference of assets, including housing acquisition funds for promoting housing acquisitions (including housing renewals) to the next generation, on the land tax system in order to contribute to promoting effective land use, on the simplification of the taxation of securities and on the financial and securities tax system to effect a reform to promote a shift from saving to investment.

Consideration will be given to a review of exemptions to individual income tax and to tax exemption system on consumption tax.

III. Review of Government Expenditures and Promotion of Structural Reform

The FY2003 Budget will maintain the policy of the “budget for resolute reform” and feature a rigorous review of general expenditures and bold measures for qualitative improvement. In order to revitalize the Japanese economy and in accordance with “Basic Policies 2002,” priority shall be assigned to specific areas among the following four areas (1-4) eliciting conspicuous policy impact. Moreover, the Government will review systems and measures relating to the development of social infrastructure, the social security system and local finances (5-10).

1. Progress and Utilization of Human Resource – Education and Culture, Science and Technology, and IT

In order to foster world-class universities in a competitive environment, structural reform of universities will be promoted through the corporatization of national universities and other measures. Furthermore, educational reform will be promoted in the areas of primary and secondary education by reviewing existing measures in order to nurture human resources characterized by human warmth, academic achievement and creativity through the individuality and competition of schools and teachers. Current institutional subsidization systems will be further reviewed. At the same time, various measures will be implemented to support individual initiative and self-helping efforts of individuals with motivation and ability by enhancing the scholarship program. Moreover, through developing outstanding human resources in fields such as culture and the arts, the aim is to create an enriched and dynamic society as well as to revitalize regional communities.

Japan will strive to establish itself as a science and technology-based nation. For this purpose, priority will be given to world-class basic research and the following four areas: (1) life sciences, (2) information and communication technologies (IT), (3) the environment, and (4) nano-technologies and materials. Research and development projects to revitalize the economy will be advanced under appropriate burden-sharing between the private and public sectors, and reform of the science and technology system will be further moved ahead. In that process, the Government will aim for quality improvement by placing priority based on the assessment (4 grades of SABC). In particular, the Government is looking to reform the system and place priorities in regard to

competitive research funding. In addition, cooperative relations between industry, universities and government will proceed with the leadership of the private sector. In order to place priority on truly important measures for allocating research and development resources, reform towards highly fair and transparent research and development evaluation system will be conducted, combined with the necessary organization, rationalization and downsizing.

Based on the “e-Japan 2002 Priority Policy Program” (18 June 2002), reaching toward the goal of establishing a globally advanced IT nation, priority and strategic measures will be taken in five areas including the formation of the world’s most advanced high-speed information and communication networks. As the measures take shape, along with clarifying the division of roles between the public and private sectors while maintaining the principle of private sector leadership, the Government will put priority on digitization of the public sector such as electronic government, electronic local administration and Electronic Toll Collection (ETC) system, and basic technological research and development. Existing projects will be reviewed from the perspective of eliminating overlapping measures and verifying results.

2. Build attractive urban areas and local areas with their own ideas and characteristics

It is a critical issue facing the Government to achieve urban renaissance by increasing the attractiveness of cities and enhancing their international competitiveness, as they are the source of

Japan's dynamism. It can also be expected to contribute to the revitalization of the asset market. Therefore, by placing a high priority on improving urban infrastructure in various areas, through urban renaissance projects and other measures efforts will be made to induce private funds and know-how to stimulate new private investment and consumption. In addition, urban development projects based on "Basic Policies for Urban Renaissance" (adopted by Cabinet Decision on 19 July 2002), such as intensive support for the promotion of private-sector investments in designated areas based on the Urban Renaissance Special Measures Law, will be strongly promoted with the given priorities in mind.

Furthermore, in order to promote the revitalization and spontaneous development of unique local communities, the Government will give effective support to municipal mergers. A safety net for small and medium enterprises that have drive and ability will be maintained, including the smooth provision of financing. Initiatives taken by regional areas will also be supported to revitalize regional industry, revitalize city centers, assure the symbiotic relations and exchanges between urban areas and agricultural, forestry and fishing villages, and ensure safety in regional communities. In addition, the Government will promote measures for cooperation with local NPOs and international tourism, and by ensuring the safety and security of residents, the Government aims to develop communities in which people can live with peace of mind.

3. Take necessary measures to build a fair and secure society addressing the aging society and

declining birthrate

With the progressive decline in birth rates, Japan's population will begin to fall from 2007, and with a sharp increase in aging predicted, it is very important that efforts are made to develop sustainable social security systems.

Alongside moving forward on the strategies for achieving zero-waiting lists for nursery schools to support parents balancing the demands of child-raising and work, the Government is looking to reverse the falling birth rate and develop a more supportive environment for giving birth and raising children who will shoulder the burden of society in the future by strengthening efforts to support child-raising both in the workplace and on the level of the regions.

Efforts will be made to improve the efficiency of systems for supplying nursing care and child care services through the utilization of private finance initiatives (PFI) approaches, to enhance a healthy life expectancy that people can work lively and enjoy their life as a support for society as well as to ensure movement through expanding barrier-free public spaces in public facilities and public transport. Through these measures the Government aims to create a society in which the elderly can actively participate in society while maintaining their dignity.

In addition, in order to respond appropriately to heightened consumer awareness of food safety and

increased importation of food products, the Government will work to create a safe and reassuring food system through enacting the Basic Law on Food Product Safety (provisional name), implementing traceability systems (systems enabling tracing and confirmation of the history from production to sale) and enhancing safety measures for imported food products. Furthermore, in view of the importance of food to health, the Government will promote “dietary education.”

4. Create an environment-friendly society and economy to deal with global environmental problems

Harmony with the natural environment stands as an important requirement in the achievement of sustainable economic growth. To this end, the Government considers environmental areas as a new area for growth and efforts will be made on the creation and expansion of the environmental sector while reducing the environmental damage of economic activities, through promoting research and development for the commercialization of environmental technologies, such as waste disposal and recycling. Together with pursuing the creation of a “zero waste society” through steady implementation of the so-called “three Rs”, reduction, reuse and recycling of waste, the Government will move forward on the utilization of biomass.

Moreover, efforts among all levels of society will be made to promote measures to achieve the targets of the Kyoto Protocol. In addition to this, with regard to research and development aimed at

reducing greenhouse gas emissions and projects that will lead to the preservation and restoration of the natural ecosystem such as raising diverse and healthy forests that will have a significant effect on reducing and absorbing greenhouse gases in Japan, the Government as a whole, working in cooperation with the relevant ministries and agencies, will advance with these measures in a prioritized manner. Work will also be undertaken on measures to address urban heat islands.

5. Development of social infrastructure

In the FY2003 Budget, the Government will prioritize allocation to areas that contribute to the expansion of private demand and employment, focusing on the four priority areas. The content of state subsidies will be reviewed, and remaining in line with the constraints of public investment, based on “Structural Reform and Medium-Term Economic and Fiscal Perspectives” (adopted by Cabinet Decision on 25 January 2002, hereinafter referred to as “Reform and Perspectives”), the Government is looking to implement further greater reductions. In regard to the level of public investment-related expenditure, this spending will be cut by over 3% compared to last year’s initial budget.

(Review of long-term public works plans)

Regarding the nine land, infrastructure and transport-related long-term public works plans with

deadlines in FY2002 and FY2003, planning prioritization will be changed from the existing system of “project volume” to one of results to be achieved (outcome targets). At the same time, the Government will pursue further prioritization and efficiency in the development of social infrastructure and integrate these plans through measures such as total project costs not being included in plans in principle. The system based on the current emergency measures laws will also be revised and the required legislation enacted. Furthermore, with a view to achieving integration in the true sense, needs-based funding allocation will be implemented and enhanced cooperation between the relevant sectors promoted. Sweeping reviews in accordance with the foregoing will be undertaken in respect to other long-term public works plans, including the abolition of emergency measures laws.

(Review of the modality of earmarked fiscal resources)

As for the revenues earmarked for road construction and others, the diversification of purpose of use to areas such as the environment and urban transport will be studied while obtaining taxpayers’ understanding from the perspective of benefits and burdens.

(Prioritization in public investment)

The focus will be on measures in the priority areas designated in “Basic Policies 2002.” In this

process, measures even in the priority areas will be narrowed down so that the Government is able to extract the maximum policy outcome.

For the areas which the “Guidelines for Formulation of the FY2002 Budget” (adopted by Cabinet Decision on 4 December 2001) designate rigorous review, these are reflected more clearly in the FY2003 Budget. For public works-related state subsidies for municipal roads, sewage systems and others, review will be conducted from the perspective of the appropriate sharing of burden between national and local governments. At the same time, more effort will be put into moving from public works-centered policy measures to other types of policy measures (transition from “hard” to “soft” policies). Furthermore, cross-regional budget allocations will be made flexibly based on the development situation and project evaluation.

(Improving efficiency and transparency in public investment projects)

In search of improved efficiency and greater transparency in public investment projects, numerical targets for cost reduction will be set as soon as possible, and in order that this reduces actual costs, structural reform of costs will be undertaken. In order to improve competitiveness through the expansion of competitive bidding and other such means, the Government will take measures to adjust conditions such as introducing bid bonds.

Concrete action will be taken in relation to increasing the use of PFI, making effective use of existing stock, reviewing the excessive restrictions on bidding, managing the time taken on projects and integrating technical standards of all ministries and agencies.

The project evaluation system will be improved further by moving forward with the improvement and standardization of evaluation methods, strengthening the checking function of the third-party evaluation content and thorough disclosure of related information including rigorous demand estimates (models, data) based on population movement.

The results of project evaluation will be fully reflected in the Budget. Ex-ante evaluations, re-evaluations and post-facto evaluations will be disclosed, and cases of projects not meeting expectations in their results based on comparisons and verifications will be used in budget requests and plan reviews. The Government will introduce a system in which these cases are reflected in evaluation methods and in subsequent planning and inspections in the same field.

(Review of existing projects)

A review of existing projects will be made, with projects canceled where their necessity has ebbed with the passage of time. Therefore, for large-scale projects on which work has not yet started, works which have been stalled for a long time and works for which the use and cost projections at

the time of adoption have been significantly miscalculated will face a tough reassessment of their cost effectiveness and feasibility, on the basis of which their advisability will be judged.

6. Social security systems

Social security systems constitute the safety net that provides security to the people and stability in their lives. In order to sweep away the increasing unease of the people over the future in regard to employment and old age, the Government needs to create a sustainable, more robust system to last into the future in a comprehensive and integrated manner.

Since last year, the Government has implemented reform in the medical system as a first step, and reforms will be continued aimed at increasing the efficiency and securing stable operations of the medical system such as reforms for medical insurance system including reorganization and integration of insurers, and review of the medical fee system. In FY2003, the employment insurance system will be reorganized, and the Government will have a public debate on reforms toward a new pension system which is planned for the year after that.

Based on the opinion of the Council for Decentralization Reform, the Government will consider carrying out a review of the reduction or abolition of state subsidized projects, conversion to general account funding, and the review of compulsory placement regulations.

(Employment insurance system reform, etc.)

As for the employment insurance system, against a background of high unemployment and the dire financial circumstances of the insurance system, with a view to securing a stable safety net that extends into the future, radical reforms will be advanced including the setting of benefit standards that promote early re-employment, the leveling of benefits between ordinary labor and part-time labor, prioritization of benefit transfers to those out of work due to bankruptcy or firing, and prioritization and rationalization of the three employment insurance businesses.

Deliberations on the level of insurance premiums required to secure stable operation of the system will give consideration to its function as the automatic economic stabilizer. Deliberations will include consideration of workers' accident insurance premiums.

(Pensions and retirement allowances, etc.)

FY2003 pensions and retirement allowances will be lowered by a certain amount in comprehensive consideration of the wage and price situation, as the salaries of the current working population fall, and considering the need to maintain the equilibrium with working premium payers and the need to ensure confidence in the system.

(Nursing care insurance program)

In order to operate the nursing care insurance program in an even more efficient manner, in light of the actual state of use of nursing care insurance services and with a view to maintaining a balance among nursing care services, a system will be introduced under which the recipients of care will bear the burden of hotel costs for special nursing homes for the elderly, which are environments that provide care in a residential environment that approximates the home environment. At the same time, in light of downward trends in wages and prices, the actual state of management of nursing care providers, the trend toward an increase in nursing care insurance rates and other factors, a review will be made to ensure that appropriate overall standards are maintained for compensation for nursing care.

7. Finance of Local Government

(Review of local expenditures)

In light of the review of the modality of administrative tasks and projects of the central and local governments, such as the reduction of involvement of central government, abolishing or cutting back state-subsidized projects and the promotion of outsourcing, expenditures of local fiscal plans

will be thoroughly reviewed. At the same time, the scale of local fiscal plans will be curbed through measures such as the reduction of total personnel costs, including a systemic cutback in the number of personnel and the reduction in the level of retirement benefits to public servants in accordance with those to national government employees, and the reduction of independently implemented local projects. In addition, throughout the duration of the “Reform and Perspectives,” by striving for the systemic reduction of expenditures for local fiscal plans, efforts will be made to reduce the scale of plans.

(Reform of the Three Major Policies)

In light of the opinions held by the Council for Decentralization Reform, considerations will be made to abolish or cut back state-subsidized projects in areas such as welfare, education and social infrastructure, aiming to reduce state subsidies by a few trillion yen within the period of the “Reform and Perspectives.” At the same time, reform of the local allocation tax will be conducted. In this reform plan, the Government will review the overall functions of guaranteeing financial resources to each local government, which are to be reduced during the time frame provided for in “Reform and Perspectives.” On the other hand, there remains a need to correct the disparities in the fiscal strength among local governments. Parallel to these reforms, for those projects that are financed by state subsidies slated for abolition but need to be carried on by the local governments’ initiatives, part of the national financial resources should be reallocated to the respective local

governments as their own resources after careful examination of the required amount.

The reform of these issues of state subsidy, local allocation tax and the transfer of tax resources to local governments will be advanced in an integrated manner. The following measures will be considered for the FY2003 Budget.

(1) Reorganization and rationalization of state subsidies

From the perspective of increasing the autonomy of local governments, while reducing the involvement of central government by reviewing the role of central and local governments; and from the point of view of realizing the streamlining of administration in central and local governments, the scope covered by state subsidies will be reviewed, and measures such as reduction of the amounts of state subsidies will be promoted while taking appropriate measures to ensure availability of fiscal resources. Furthermore, projects for integrated subsidies will be further expanded.

(2) Local allocation tax reform

In light of the policy of systemic reduction of the expenditures of local fiscal plans during the period of "Reform and Perspectives," efforts will be made to curb the total amount of local

allocation tax through the reduction of fiscal shortfalls by cutting the scale of local fiscal plans.

In addition, the calculation method of local allocation tax will be reviewed in the direction of encouraging autonomous and independent fiscal management in local governments. In regard to local allocation tax for prefectural governments, the Government will increase the reserve revenue rate and will continue the review of the current system for cost modifications of public works projects and for stage-by-stage cost modifications.

(3) Review of tax resource allocation including the transfer of tax resources to local governments

Considerations will be made for the review of tax resource allocation including the transfer of tax resources to local governments together with the reduction of state subsidies and the reform of local allocation tax.

8. Official Development Assistance (ODA)

Given the severe economic and fiscal conditions, it is necessary to make efforts toward full and appropriate fulfillment of international responsibilities while striving for improvement in the prioritization, efficiency and transparency of Japan's Official Development Assistance (ODA). On the other hand, it is important to gain the understanding and support of the people for Japan's

economic cooperation.

Toward this end, by reviewing the basic policy on Japan's ODA including the ODA Charter, considerations will be made for the goals of policy, fields and regions on which priority will be placed and modality of the division of roles and cooperation between the public and private sectors. In this process, efforts will be made for the utilization of ODA for stability and growth of Asia, prioritization of areas for peace-building and human security such as education, capacity building and environmental conservation, as well as participation by the people and the increased visibility of Japanese aid. At the same time, efforts will be made toward the further rationalization of projects and strategic assistance while reviewing project costs, improving transparency and efficiency of execution and strengthening assessment and inspection.

Based on the above, the scale of the ODA budget will be reviewed during the budget formulation.

9. Agriculture, forestry and fisheries

In regard to agriculture, forestry and fisheries, the Government will accelerate structural reforms and will terminate the small-scale production systems, aiming at revitalization of the "food industry" that will fulfill people's expectations.

In order to achieve this, the Government will give consideration to the environmental conservation functions of agriculture, forestry and fisheries through measures such as fostering biomass industry based on the Biomass Japan Comprehensive Strategy, which will be decided separately. In addition to this, the Government will advance the change to policies that truly place strong emphasis on consumers, such as concentration of measures for highly motivated and capable management entities and establishment of management systems that are not dependent on subsidies by rigorously reviewing the policies up to now.

In addition, regarding future rice policies, measures will be steadily advance toward the creation of a production and distribution system, in which market mechanisms can be fully utilized from the consumers' perspective, based on structural reform of paddy field farming and efficient policy management. To this end, the Guidelines for Rice Policy (provisional name) will be formulated, which will include reform of measures in relation to rice production adjustments and paddy field farming.

Systems for agricultural committees and agricultural improvement and extension projects have been playing a certain role. However, in regard to the abolition or substantial relaxation of compulsory placement regulations for these systems and the modality of grants including shifting them to general account funding, in light of the opinion of the Council for Decentralization Reform, which recommended that considerations from the basis of the system are necessary, a specific

reform process will be steadily advanced, including the review of compulsory placement regulations and reduction of grants. In addition, considerations will be made for agricultural cooperatives in regard to administrative operation through agricultural cooperatives and conditions of fair competition with other business entities and fundamental reform of agricultural cooperatives will be promoted.

Furthermore, from the perspective of the appropriate division of roles between the central and local governments, the modality of supplementary projects through local governments will be reviewed to prioritize the projects.

10. Energy policy

Energy policy will be changed in the direction of taking global environmental measures into full consideration from the perspective of striving to balance the environment and economic development.

In conjunction with this review, with regard to the Special Account for Petroleum and the More Sophisticated Structure of Demand and Supply of Energy Policies and Special Account for Electric Power Development Promotion Policy, a thorough review of the structure of expenditures will be conducted and the content of expenditures will be fully examined. Items to be examined include

substantial reduction of budgets related to the Japan National Oil Corporation and existing research and development, and prioritized budget allocation to energy-related measures useful for curbing carbon dioxide emissions due to the utilization of energy that are promoted by cooperation between the Ministry of Economy, Trade and Industry and Ministry of the Environment.