FY2011 Review of Progress of Fiscal Management Strategy

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National Policy Unit, Cabinet Secretariat

Pursuant to the Fiscal Management Strategy (Cabinet Decision, June 22, 2010) and the Basic Policies on FY2011 Budget Formulation (Cabinet Decision, December 16, 2010), the status of progress of the Fiscal Management Strategy is described below, taking into account the draft FY2011 Budget, Fiscal 2011 Economic Outlook and Basic Stance for Economic and Fiscal Management (Cabinet Endorsement, December 22, 2010), and Economic and Fiscal Projections for Medium to Long Term Analysis (Cabinet Office, January 21, 2011) ("Cabinet Office's Projections").

1. Fiscal Consolidation Targets

(1) Flow Targets

1) The primary balance of national and local governments

The Fiscal Management Strategy set a target of halving the ratio of primary deficits of national and local governments combined to GDP from the FY2010 level by FY2015 at the latest, and achieving a surplus by FY 2020 at the latest.

According to the Cabinet Office's Projections (Prudent Scenario, hereinafter the same [Note 1]), the primary balance of national and local governments in FY2011 is projected to improve by approximately 0.9 percentage points of GDP compared to FY2010.

It is projected that the margin of improvement of the primary balances needed to achieve the abovementioned target (Note 2) in FY2015 will be approximately 1.0 percentage points of GDP, and the margin of improvement needed to achieve a primary surplus in FY2020 will be approximately 4.2 percentage points.

(Note 1) The Cabinet Office's Projections present prudent scenario and growth strategy scenario. The above projections are based on prudent scenario, since the Fiscal Management Strategy set forth that "prudent economic forecasts should be assumed when presenting the roadmap for fiscal consolidation".

(Note 2) The target levels for halving the deficit-to-GDP ratio are based on the Cabinet Office Projections as of the date on which the Fiscal Management Strategy was approved (June 22, 2010), and are set forth as follows: -3.2% of GDP for national and local governments; and -3.4% of GDP for the national government.

2) The primary balance of the national government

The Fiscal Management Strategy also provides the same primary balance target for the national government.

According to the Cabinet Office's Projections, the primary balance of the national government in FY2011 will improve by approximately 0.9 percentage point of GDP compared to FY2010.

It is projected that the margin of improvement in the primary balance needed to achieve the target in FY2015 will be approximately 1.5 percentage points of GDP, and the margin of improvement needed to achieve a primary surplus in FY2020 will be approximately 4.6 percentage points.

(2) Stock Target

The Fiscal Management Strategy also aims to achieve a stable reduction of the public debt-to-GDP ratio of national and local governments combined from FY2021.

According to the Cabinet Office's Projections, the public debt-to-GDP ratio in FY2011 is projected to increase (i.e., worsen) to 177% compared to FY2010 (174%).

(3) As indicated above, with the benefit of increase in tax revenues and other factors, the primary balance of national and local governments combined and that of the national government are projected to improve to some extent between FY2010 and FY2011. As stated above, however, substantial additional improvement in the fiscal balance is required to achieve the flow targets by FY2015 and FY2020.

On the other hand, the public debt-to-GDP ratio is projected to increase between FY2010 and FY2011.

2. Basic Rules of Fiscal Management

(1) Resource Assurance Rule ("Pay-As-You-Go Principle")

The Fiscal Management Strategy provides that "when a measure involving expenditure increase or revenue reduction is to be introduced or expanded, stable compensatory fiscal resources shall be secured by either permanent expenditure reductions or permanent revenue-raising measures" ("pay-as-you-go principle").

In the FY2011 Budget, the total primary expenses (all of the General Account expenditures, excluding debt repayment and interest payment) is below the level of the FY2010 budget(initial) as discussed below. Compensatory Fiscal Resources are also secured for the the Manifesto-related measures, including increased appropriations for the child allowance. As far as the expenditure-increasing measures are concerned, they are in line with the pay-as-you-go principle.

For measures involving decrease in revenues, the FY2011 Tax Reform Outline (Cabinet Decision, December 16, 2010) provides with respect to the reduction in the corporate tax that, "although compensatory fiscal resources is not sufficiently secured with respect to the pay-as-you-go principle, we decided upon tax reduction with a view to putting utmost priority to tackling deflation as well as expanding employment."

(2) Fiscal Deficit Reduction Rule

The Fiscal Management Strategy provides that "the government budget shall be formulated so as to steadily improve the fiscal position in terms of the reduction in the government bonds issuance, the reduction in the dependency on government bonds and improvement in the primary balance."

Compared to the FY2010 initial budget, the amount of new government bond issuance and its dependency ratio on government bond in FY2011 budget is projected to slightly decrease, coupled with the improvement in the primary balance as stated above. However, we need to take due consideration that there remains substantial uncertainties with respect to tax revenues and non-tax revenues.

(3) Securing Revenue Sources for Structural Expenditures

The Fiscal Management Strategy provides that "for items that will lead to structural expansion of expenditures, such as the social security outlays for pension and medical and care-giving benefits, stable fiscal resources shall be secured through the reform of both revenues and expenditures."

The FY2011 budget continues to rely on special deficit-financing bonds to cover substantial portion of the costs of the social security services and benefits enjoyed by the current generation. Furthermore, the state contribution portion of the basic pension system is to be maintained at one-half as a single-year measure funded by temporary fiscal measures, thus significant challenges remain toward fiscal consolidation.

(4) Basic Principles for Reviewing Expenditure

The Fiscal Management Strategy provides that wasteful expenditures shall be eliminated by constantly reviewing administrative works and projects in all expenditure areas, thereby carrying out major budget reformulations .

In formulating the FY2011 budget, pursuant to the Guidelines for FY2011 Budget Requests Reformulation, total amount of the expenditure was reduced by approximately 2.5 trillion yen at the stage of the budget request. In addition, expenditure was further reduced by approximately 0.3 trillion yen by reflecting the program review conducted by the Government Revitalization Unit, among other measures. Meanwhile, utilizing the “Special Allocation to Rejuvenate Vibrant Japan” of approximately 2.1 trillion yen, funds are to be allocated to high priority measures for achieving the New Growth Strategy. Through these and other measures, budget reformulation, which goes beyond the boundary of government ministries, has been carried out.

(5) Stable Management of Local Government Finances

The Fiscal Management Strategy provides that in order to achieve fiscal consolidation, mutual cooperation is required among the national government and the local governments which share the management of the public sector economy. It also provides that: “the national government should pay due respect to maintaining independent and stable fiscal management of local governments. The national government shall not take measures that would either undermine their autonomy or shift fiscal burdens onto them.”

The FY2011 budget is in line with this principle. The budget addresses local government finances appropriately securing the total amount of general resources available to the local governments. It also establishes “Strategic Grant for Regional Autonomy” which consolidates several investment-related subsidies into a single grant.

3. Medium-term Fiscal Framework

(1) Controlling the Amount of Government Bonds Issuance

The Medium-term Fiscal Framework provides that “The government will make every effort to ensure that the amount of government bonds newly issued in FY2011 will not exceed the level of the FY2010 budget (approximately 44 trillion yen).”

The amount of new government bonds issuance in the FY2011 budget is 44,298 billion yen and falls below the FY2010 budget’s level of 44,303 billion yen.

(2) Revenue-side Measures

The Medium-term Fiscal Framework provides that “in order to carry out comprehensive reforms of tax system, including personal income tax, corporate tax, and taxes on consumption and assets, specific details shall be decided upon as soon as possible.” Pursuant to the Promotion of Social Security Reform (Cabinet Decision, December 14, 2010), the government will need to swiftly proceed with discussions and come up with proposals on social security system reform and tax reform by the middle of this year.

(3) Expenditure-side Measures

The Medium-term Fiscal Framework provides that primary expenditures shall not, in substance, exceed the level of the initial budget of the previous fiscal year ("Overall Expenditure Limit").

The primary expenditures in the FY2011 budget are approximately 70,862.5 billion yen and fall below the FY2010 initial budget's level of approximately 70,931.9 billion yen.

Regarding FY2011 local government finances, the total amount of general resources available to the local governments, which is necessary for the stable fiscal management of local governments, is 59,499 billion yen. This exceeds 59,410.3 billion yen of the FY2010 Local Government Finance Plan, securing the same level of resources in substance. .

4. Conclusion

The FY2011 budget – first annual budget formulated under the Fiscal Management Strategy – is set to maintain the discipline of the Medium-term Fiscal Framework, and with the benefit of increasing tax revenues and other factors, also improve the primary balance. However, under the continued deflation and challenging economic circumstances, the amount of government bonds issuance continues to exceed that of tax revenues. The fiscal situation is quite serious, as the Cabinet Office's Projection projects that the public debt-to-GDP ratio will continue to increase, if left untackled. In order to achieve the Fiscal Consolidation Targets, substantial further fiscal consolidation will need to be carried out by FY2015 and FY2020.

Significant challenges remain for achieving "economic growth", "social security reform", and "fiscal consolidation" in an integrated manner. It is necessary for the Government to proceed with the discussions on the social security reform and tax reform and to come up with proposals by the middle of this year, as well as to present more clearly a roadmap for achieving the fiscal consolidation targets in the process of revising the Medium-term Fiscal Framework.