Medium-term Fiscal Framework (FY2012–FY2014)

August 12, 2011
Cabinet Decision

The government incorporated the concept of Medium-term Fiscal Framework into "Fiscal Management Strategy," the Cabinet Decision dated June 22, 2010, in order to work out annual budget with an outlook over several fiscal years considering the economic and fiscal forecasts and prospects.

"Fiscal Management Strategy" sets forth the first Medium-term Fiscal Framework from FY2011 to FY2013 and states, "the Medium-term Fiscal Framework will be revised around the middle of every year to create a new Medium-term Fiscal Framework for the subsequent three years starting from the following fiscal year." In line with this statement, the government sets out the Medium-term Fiscal Framework for FY2012–FY2014 to set down new measures on both revenue and expenditure sides.

1. Basic concepts for revising the Medium-term Fiscal Framework

The Great East Japan Earthquake on March 11, 2011, as unprecedented complex-type disasters consisting of earthquakes, *tsunami*, and nuclear power plant accidents, has posed severe damages and impacts on directly affected areas as well as on the entire Japan. The central and local governments are estimated to spend at least ¥19 trillion for the next five years and ¥23 billion for the next ten years on their recovery/reconstruction projects (financed by public funds), which will inevitably put additional significant burdens on public finance.

In this situation, the government will revise the Medium-term Fiscal Framework, recognizing that recovery/reconstruction from earthquake disasters is a top-priority matter at the time of unprecedented national crisis. The fiscal framework should not constrict recovery/reconstruction processes. In addition, flexible policy actions are necessary for addressing economic risks resulting from earthquake disasters. In accordance with the "Basic Policy for Reconstruction from the Great East Japan Earthquake" (Decision of the Reconstruction Headquarters in response to the Great East Japan Earthquake dated July 29, 2011), which designates separate revenue sources for earthquake disaster recovery/reconstruction projects and sets up a new framework for balancing revenues and expenditures on a multi-year basis, the government will give due considerations, such as creating separate management programs in the Medium-term Fiscal Framework.

Moreover, Japan has been posting a massive annual fiscal deficit of the order of ¥30 trillion to ¥40 trillion even before the Great East Japan Earthquake, keeping an increase in public debt outstanding. This means Japan is facing an "emergency situation" from fiscal perspectives as well. For this reason, the government will make all-out efforts for recovery/reconstruction from earthquake disasters regardless of the fiscal frameworks, while steadily working on achieving fiscal consolidation target, in order to secure confidence in the government bond market.

Securing market confidence through these efforts and revitalizing the Japanese economy are essential for making a successful recovery from earthquake disasters as well as revitalizing the entire Japan.

2. Specific contents of the revision of the Medium-term Fiscal Framework

Section "(2) Measures on both revenue and expenditure" in "3. Medium-term Fiscal Framework," Chapter II of "Fiscal Management Strategy," shall be amended as follows. Other statements in the section "Medium-term Fiscal Framework" will, in principle, stay effective in or after FY2012.

1) Government bonds issuance

In order to make sure that the fiscal consolidation targets are achieved and to make clear government's active stance toward fiscal consolidation, thereby securing confidence in the market, the government will make every effort to ensure that the amount of government bonds newly issued in FY 2012 (except for reconstruction bonds as set forth in Paragraph 1, Article 8 of Basic Act on Great East Japan Earthquake Reconstruction; hereinafter, such bonds are referred to as "Reconstruction Bonds") does not exceed the level in the FY 2011 initial budget (about ¥44 trillion). The government will also make every effort to steadily reduce the amount of newly issued government bonds (except for Reconstruction Bonds) after that toward the achievement of the fiscal consolidation targets.

In order to achieve these objectives, a great deal of effort will be made in the areas of both revenue and expenditure.

2) Measures on revenue

As for the Comprehensive Reform of the Tax System, including individual income taxation, corporation taxation, consumption taxation, and property taxation, etc., the direction of reform is presented in Article 104, Paragraph 3 of the supplementary provisions of the Tax Reform Act 2009 as well as in the FY2010/FY2011 Tax Reform Outlines. In addition, "Definite Plan for the

Comprehensive Reform of Social Security and Tax" (Decision by the Headquarters of the Government and Ruling Parties for Social Security Reform on June 30, 2011) summarized in line with "Promotion of Social Security Reform" (Cabinet Decision on December 14, 2010), also suggests specific directions of the Comprehensive Reform of Social Security and Tax.

The government will further deepen the deliberations in line with these documents and will take the necessary legislative measures by the end of FY2011 in accordance with the roadmap as described in Article 104 of the supplementary provisions of the Tax Reform Act 2009.

Special taxation measures shall be subject to zero-based review according to the policy presented in the FY2010 Tax Reform Outline as well as in the FY2011 Tax Reform Outline.

In principle, new taxation-related measures involving reduction in revenue have to be introduced while making sure that there are new resources to cover the reduction in accordance with II. 2. (1) in Fiscal Management Strategy.

3) Measures on expenditure

(i) To achieve the fiscal consolidation targets, "primary balance expenses" (expenditure of the government's general account minus national debt service and the refund to the Settlement Adjustment Fund) during the period from FY 2012 to FY 2014 shall not, in substance, exceed the level in the initial budget for the previous fiscal year (this amount is referred to as the "Overall Expenditure Limit"), and shall be reduced as far as possible by permanent reduction of expenditures. (Note)

(ii) Notwithstanding 3) (i), with regard to the expenditures for recovery/reconstruction from the Great East Japan Earthquake that exceeds the amount compensated for by the reduction of other existing expenditures, and are financed by Reconstruction Bonds, additional non-tax revenues, or temporary taxation, the amount of such expenditures shall be managed separately with their revenue sources and shall be added to the "Overall Expenditure Limit."

(iii) Notwithstanding 3) (i), in accordance with the "Basic Policy on Framework for Overall Settlement of Type-B Hepatitis Lawsuits" (Cabinet Decision dated July 29, 2011), with regard to the expenditures that are related to benefits or other payments to type-B hepatitis patients, and are financed by temporary taxation, the amount of such expenditures shall be managed separately with their revenue sources and shall be added to the "Overall Expenditure Limit."

(iv) If significant economic risks resulting from the Earthquake or other factors materialize, the government will strive for flexible and agile fiscal management.

(Note) The gap between the basic pension's government contribution rate (1/2) and 36.5% from FY2012 onward (hereinafter, this gap is referred to as "pension gap") will be financed by revenue sources secured from the Comprehensive Reform of the Tax System. For this reason, "Overall Expenditure Limit" from FY2012 onward includes the pension gap financed by revenue sources secured from the Comprehensive Reform of the Tax System.

(No amendment will be made hereinafter.)

[Exhibit]

Primary Balance Expenses from FY2012 to FY2014

(Unit: trillion yen)

	Overall Expenditure Limit		
	FY2012	FY2013	FY2014
Primary balance expenses (Note 1)	71 (Notes 2–4)	71 (Notes 2–4)	71 (Notes 2–4)
(Expenses other than the pension gap)	68.4	68.4	68.4
Of which: Contingency Reserve for Economic Crisis Response and Regional Revitalization (0.8 for FY2011)	1 (Note 5)	1 (Note 5)	1 (Note 5)

Additional expenses for recovery/reconstruction from the Great East Japan Earthquake	+α (Note 6)	+α (Note 6)	+α (Note 6)
Additional expenses for benefits or other payments to type-B hepatitis patients	+β (Note 7)	+β (Note 7)	+β (Note 7)

(Note 1) The term “Primary balance expenses” refers to the amount obtained by subtracting national debt service and the refund to the Settlement Adjustment Fund from the expenditure of general account. In the initial FY2011 budget, the primary balance expenses stand at approximately ¥71 trillion.

(Note 2) If permanent increase in revenue is secured through a new reform of the system in relation to an introduction of a new measure, up to the amount secured by the permanently assured revenue may be added to the “Overall Expenditure Limit," provided that it is in line with the rules on control of the amount of government bond issuance.

(Note 3) The breakdown of the “primary balance expenses” for FY 2012 and subsequent fiscal years will be decided through budget requests and other processes of budget compilation. Local Allocation Tax will be also decided through consideration of fiscal measures for local government finances, taking system reform related to administration and fiscal management of local governments into consideration.

In line with the basic rules “Stable management of local government finances” as set forth in “Fiscal Management Strategy,” local governments should act in concert with the central government’s efforts for expenditures reduction, but the total amount of local general revenues necessary for stable civil services of local governments, including local allocation tax recipients, should remain unchanged in substance for the aforementioned period so that they will not fall below the local general revenues level as stated in the FY2011 Local Finance Plan.

(Note 4) "Overall Expenditure Limit" from FY2012 onward includes the pension gap financed by additional revenue sources secured by the Comprehensive Reform of the Tax System.

(Note 5) The treatment of "Contingency Reserve for Economic Crisis Response and Regional Revitalization" for FY2012 and subsequent years (¥1 trillion) will be considered in the process of budget compilation, because it is difficult to forecast future economic conditions or economic risks resulting from earthquake disasters at the current moment.

(Note 6) With regard to the expenditures for recovery/reconstruction from the Great East Japan Earthquake that exceed the amount compensated for by the reduction of other existing expenditures, and are financed by Reconstruction Bonds, additional non-tax revenues, or temporary taxation, the amount of such expenditures (=α) shall be added to the "Overall Expenditure Limit." (The expenditures for recovery/reconstruction from the Great East Japan Earthquake will be equal to the sum of α and the recovery/reconstruction costs financed by the reduction of other expenditures in the same fiscal year.)

(Note 7) With regard to the expenditures related to benefits or other payments to type-B hepatitis patients that are financed by temporary taxation, the amount of such expenditures (=β) shall be managed separately with theire revenue sources and shall be added to the "Overall Expenditure Limit."

(Note 8) The government will examine expenditures measures based on the Definite Plan for the Comprehensive Reform of Social Security and Tax in accordance with the legislative measures as mentioned in 2(2) and incorporate them as appropriate at the time of next revision of the Medium-term Fiscal Framework, around the middle of 2012.