Medium-term Fiscal Framework (FY2013–FY2015)

August 31, 2012
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, and premised on revisions to the previous Medium-term Fiscal Framework from FY2012 to FY2014, the government has formulated the Medium-term Fiscal Framework for FY2013 to FY2015 as detailed below, which sets out new measures on both revenue and expenditure sides.

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

The construction of sustainable fiscal and social security systems will help to avoid any deterioration in the fiscal situation impacting the economy or having an adverse effect on the daily lives of the people of Japan, similar to that which has been seen in European countries that have encountered fiscal crises. The construction of such systems will also reduce public concerns, promote consumption, and create a foundation for new growth through expanded economic activities.

To this end, in addition to realizing the comprehensive reform of social security and taxation systems, in line with the "Strategy for Rebirth of Japan" (Cabinet Decision dated July 31, 2012) it is necessary to allocate budget to prioritized areas in a bold manner for the rebirth of Japan. In addition, it is also vital to implement a thorough revision of expenditure overall, including social security, thereby achieving both economic growth and fiscal consolidation, as well as securing confidence in the market and realizing the rebirth of the Japanese economy.

Furthermore, in order to make a concerted and full-fledged response to reconstruction from the Great East Japan Earthquake and efforts to realize the rebirth of Fukushima, which are positioned as issues of the highest priority and importance, it is necessary to utilize the special account for reconstruction from the Great East Japan Earthquake to steadily implement the projects that are required.

In line with this basic recognition and from the perspective of working steadily to achieve the target of halving the deficit ratio to GDP of the government's primary balance by 2015 as stipulated in the Fiscal Management Strategy, these revisions will be implemented to the Medium-term Fiscal Framework for the period from FY2013 to

FY2015. Based on this Medium-term Fiscal Framework, in order to inject fiscal resources to prioritized areas under the "Strategy for Rebirth of Japan," cross-government efforts shall be implemented to achieve a bold budget reallocation.

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

Among the statements detailed in "3. Medium-term Fiscal Framework" in Chapter II of "Fiscal Management Strategy," including those items revised in August 2011, section "(2) Measures on both revenue and expenditure" shall be amended as follows. Other statements in the section "Medium-term Fiscal Framework" will, in principle, stay effective in or after FY2013.

1) Government bonds issuance

In order to make sure that the fiscal consolidation targets are achieved and to make clear the 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 FY2013 (except for government bonds that are used separately as stipulated by law as collateralization for specified redemption funds, including special pension-financing bonds; the same applies hereunder) does not exceed the level in the FY2012 initial budget (about ¥44 trillion). The government will also make every effort to steadily reduce the amount of newly issued government 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.

With regard to the stipulations of the "Medium-term Fiscal Framework (FY2012-FY2014)" (Cabinet Decision of August 12, 2011) that relate to FY2012, the provision concerning the amount of government bonds newly issued, excepting pension-financing bonds, shall also be applied.

2) Measures on revenue

As for the Comprehensive Reform of the Tax System, including individual income taxation, corporate income taxation, consumption taxation, and property taxation, etc., following revisions based upon agreement reached among the three parties of the Democratic Party of Japan, Liberal Democratic Party and New Komeito Party (hereinafter referred to as the "Three-party Agreement"), the bill to partially amend the Consumption Tax Act in order to implement fundamental reform of the taxation system to secure stable fiscal resources for social security and the bill to partially amend the Local Taxation Act and the Local Allocation Taxation Act in order to implement fundamental reform of the taxation system to secure stable fiscal resources for social security were passed by the Diet. Reforms from now will be implemented in accordance with these laws and in line with the Three-party Agreement.

With regard to the various items for consideration stipulated in the abovementioned laws, in line with the Three-party Agreement, consideration will be given to revisions to budget compilation and tax system revisions each fiscal year and the necessary measures will be taken depending on the results of such considerations.

Special taxation measures shall be subject to zero-based review according to the policy presented in the Tax Reform Outlines from FY2010 to FY2012.

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 the Fiscal Management Strategy.

3) <u>Measures on expenditure</u>

(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 FY2013 to FY2015 shall not, in substance, exceed the level in the initial budget for the previous fiscal year (hereinafter this amount is referred to as the “Overall Expenditure Limit”), and shall be reduced as far as possible by permanent reduction of expenditures.

The gap between the basic pension’s government contribution rate (1/2) and 36.5% from FY2013 to FY 2015 (hereinafter, this gap is referred to as the “pension gap”) is included in the “Overall Expenditure Limit.”

(ii) With regard to FY2014 and FY2015, expenses for enhancements to the social security system that are implemented after fiscal resources are secured as part of the comprehensive reform of social security and taxation systems, shall be deliberated in the budget compilation process in each fiscal year and shall be added to the “Overall Expenditure Limit.”

(No amendment will be made hereinafter.)

[Attachment]

Primary Balance Expenses from FY2013 to FY2015

(Unit: trillion yen)

	Overall Expenditure Limit		
	FY2013	FY2014	FY2015
Primary balance expenses (Note 1)	71 (Notes 2–4, 6, 8)	71 (Notes 2–4, 6, 8)	71 (Notes 2–4, 6, 8)
Of which: Contingency Reserve for Economic Crisis Response and Regional Revitalization (0.9 for FY2012)	0.9 (Note 5)	0.9 (Note 5)	0.9 (Note 5)

(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 FY2012 budget, the primary balance expenses stand at approximately ¥68.4 trillion. (In addition, funds raised through the issuance of special pension-financing bonds funded by the portion of the increase in consumption tax will be included in the pension gap amount (2.6 trillion yen) that is transferred into pension finances.)

(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 FY2013 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 for "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 FY2012 Local Finance Plan.

However, these shall exclude general revenues allocated for recovery and reconstruction projects from the Great East Japan Earthquake and for emergency disaster prevention and disaster reduction projects related to the Great East Japan Earthquake. They shall be appropriately based on the following increases that will accompany the comprehensive reform of social security and taxation systems: (a) increase in local burden arising from structural reforms to enhance social security as detailed in (Note 6) (ii); (b) increase in local burden relating to social security expenditure (four social security expenses) brought about by the rise in the consumption tax rate (national and local) as detailed in (Note 6) (iii); and (c) increase in expenditures exceeding the national average level brought about by the rise in local consumption tax. In addition, with regard to the increase in local burden relating to procurement of goods other than for the four social security expenses due to the rise in the consumption tax rate (national and local), this too will be appropriately harmonized with measures relating to the national government burden as detailed in (Note 7).

(Note 4) With regard to the gap between the basic pension's government contribution rate (1/2) and 36.5% in FY2013 (hereinafter, this gap is referred to as the "pension gap"), as pension-financing bonds funded by the portion of the increase in the consumption tax will be issued and transferred into pension finances, for FY2013 the pension gap is included in the "Overall Expenditure Limit."

(Note 5) The treatment of "Contingency Reserve for Economic Crisis Response and Regional Revitalization" for FY2012 and subsequent years (¥0.9 trillion) will be considered in the process of budget compilation, because it is difficult to forecast future economic conditions at the current moment.

(Note 6) With regard to expenditure relating to the comprehensive reform of social security and taxation systems, based on the measures created to secure stable fiscal resources for social security, including the natural increase following the implementation of the comprehensive reform, taking into appropriate account this natural increase, the following measures shall be implemented:

(i) The funds required to raise the basic pension's government contribution rate to one-half shall be prepared as part of the primary balance expenses for FY2014 and FY2015;

(ii) Expenses for enhancement of social security and for measures for the provision of simple benefits, given that the national consumption tax rate is scheduled to be raised to 7.8% during the course of FY2015, meaning that in FY2014 and FY2015 it is anticipated that ultimately tax revenue equivalent to 3.8% will not be secured for the comprehensive reform, and also the specific content and implementation schedule for reform will be deliberated from now, based on the results of deliberations, consideration will be given in the budget formulation process each fiscal year and will be added to the "Overall Expenditure Limit."

(iii) With regard to the expenses for increases in social security expenditure (the four social security expenses of pensions, medical care, long-term care and childcare) that will occur following the rising in the consumption tax rate (national and local), based on the price increase effect the consumption tax hike will have, consideration will be given in the budget formulation process each fiscal year and will be added to the "Overall Expenditure Limit."

(iv) With regard to the enhancement of the local allocation tax calculation rate in line with consumption tax towards ensuring the securing of stable fiscal resources for social security by national and local government, consideration will be given in the budget formulation process each fiscal year and will be added to the "Overall Expenditure Limit."

(Note 7) The rise in consumption tax (national and local) is expected to have an impact on expenditure for procurement of goods other than those for the four social security expenses, caused by the increase in prices that the consumption tax hike will bring about. However, as is it expected that these increases can be partially covered through efforts to improve balances, including through the comprehensive reform of social security and taxation systems, specific consideration on how to handle any increase in expenditure for procurement of goods will be made in the budget formulation process each fiscal year.

(Note 8) With regard to the expenditures related to benefits or other payments to type-B hepatitis patients that are financed by taxation and other measures, the amount of such expenditures shall be managed separately with their revenue sources and shall be added to the "Overall Expenditure Limit."