

HIGHLIGHTS
OF THE BUDGET FOR FY2004

December 2003
Ministry of Finance

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Outline of the FY2004 budget

Concept of Structural Reform

Reform of Financial Relationship between Central and Local governments: "Trinity Reform"

- <"¥1 trillion" reduction in state subsidies>
- Reforming state subsidies to compulsory education. (¥230.9 billion)
 - Increasing discretion about salaries of teachers, etc.
 - De-earmarking retirement fund, etc.
- Reducing state subsidies to public works. (around ¥450 billion)
 - "Community Development Grant" (¥133 billion)
 - Eliminating small-size subsidies
- Reducing encouragement subsidies. (approx. ¥260 billion)
- De-earmarking state subsidies
 - De-earmarking state subsidies to public nursery schools. (¥474.9 billion)
- <Reform of local allocation tax>
- Thorough review of local gov't expenditures

| | | | |
|--|----------------|----------------|-----------------|
| Expenditures in the Local Public Finance Program | ¥86.2 trillion | ¥84.7 trillion | (¥1.5 trillion) |
|--|----------------|----------------|-----------------|
- Drastic reduction in local allocation tax

| | | | |
|---|----------------|----------------|-----------------|
| Local allocation tax, etc. in the general account | ¥17.4 trillion | ¥16.5 trillion | (¥0.9 trillion) |
|---|----------------|----------------|-----------------|
- <Transfer of tax resources to local governments>
- Transferring a portion of individual income tax as local transfer tax. (¥424.9 billion)
- State subsidies to compulsory education. (¥230.9 billion)
- Temporary measure by a special grant

Reform of the Pension System

- <State contribution to the benefits of the Basic Pension>
- The state contribution rate 1/2 of basic pension (by FY 2009)
- Tax reform to ensure its financial resources. (by around FY2007)
- Temporarily financed by the revenue increase based on the review of pension benefit taxation. (¥27.2 billion in FY2004, ¥163.2 billion on average)
- Additional raise of the state contribution rate in FY2005-2006.
- Based on the tax measures decided by the Conference on Tax System of the ruling coalition (Dec.17, 2003).
- <Future benefit level>
- Ensuring 50% of average take-home pay at least.
- <Contribution rate of employees' pension>
- 18.35% at most. Further restraint before the submission of a pension reform bill to the Diet next year.
- Raising 0.354% a year from October 2004 onward.

Indexation of Pension Benefits (reduction by around 0.2-0.3%)

Reform of the Health Insurance

- <Revision of medical fees and drug pricing>
- 1.0% reduction (approx. ¥71.7 billion)
- Drug pricing -1.0%
- Medical fees ±0% (prioritized allocation)

Innovation of the Budget Formulation Process

<Policy Packages> 10 policy package requests examined from 3 viewpoints.

- | | | |
|---|---|--|
| 1) Inter-ministerial cooperation and streamlining | 2) Combining budget and regulatory reform, etc. | 3) Stimulating the potential in the private sector |
|---|---|--|
- | | | |
|--|---|---|
| "Regional economy growth driven by science and technology" (¥82.4 billion) Streamlining the support systems for joint research by defining the roles of Ministries. | "Building the world's most advanced 'low-emission vehicle' society" (¥14.6 billion) Expanding low-emission vehicles with subsidies and regulation based on Automobile NOx/PM Law | "Welfare and social rehabilitation support system for criminals in cooperation with the private sector" (26 billion yen) PFI methods and outsourcing for prison management |
|--|---|---|
- <Model Projects > (10 projects)
 - Quantitative outcome targets and strict *ex post* evaluations with:
 - 1) Facilitation of multi-year projects by contract authorization, etc.
 - 2) Relaxation of input controls.
 Example (Ministry of Foreign Affairs)
 (Target) Registration rate of overseas voters: 20%
 (Relaxation) Consolidating various budget items to single appropriation
 - <Establishing the management cycle of "Plan-Do-See" in the budget formulation process >
 - Strengthening the "See" phase by improving financial statements
 - New financial statements for special accounts
 - Financial statements for individual ministries (now deliberating)
 - Appropriately reflecting the findings of the budget execution surveys in the FY2004 budget.
 - Utilizing policy evaluations

Concept for Improving Efficiency

Budget Execution Surveys

Expanded to 51 projects including 20 projects in 18 special accounts in FY2003, and appropriately reflected in the FY2004 budget. (¥49.2 billion)

Review of Special Accounts (SAs)

- Comprehensive study by Special Account Subcommittee of Fiscal System Council
- Reviewing principles and more than 50 concrete recommendations.
- <Examples in the FY2004 budget>
- Streamlining of the three employment insurance services (Labor Insurance SA)
- Drastic cost reduction in welfare facilities (Welfare Insurances SA, National Pensions SA)
- Reduction in loans to preceded acquisition business of lands and in the borrowing from the Fiscal Loan Fund (Urban Development Loan SA)
- Reduction in transfer to the general account by restraining oil-stock-related expenses, etc. (Measures for Petroleum and the Advancement of Energy Demand and Supply Structure SA)

Cost Reduction

- <Examples of public works>
- Steady promotion of "structural reform of the cost"
- 15% reduction of total cost in the next 5 years
- Utilizing experiences in the private sector (e.g. the construction project of Central Japan International Airport)
- Improvement in the FY2004 budget
 - Introducing the price negotiation method to the order placement
 - Reflecting the price for large size transaction in the cost calculation
- Reducing the number of civil servants**
- FY2003: -321 persons FY2004: -445 persons (non-enterprise)

Concept of Prioritization for Vitality and Security

Emphasis on Science and Technology

- | | | | |
|--|--|--|---|
| Prioritization based on the "SABC" grading across the ministries by Council for Science and Technology Policy (growth rate) S: +17% B: -3% A: +6% C: -21% | <Expanding competitive research funding> (approx. ¥362 billion, +3.7%) Facilitating the development of science, technology and other areas | <R&D for active economy > (¥105 billion, +42.3%) R&D expected for practical use, creation of employment, etc. Example: Advanced measurement/analysis technology approx. ¥8.5 billion | <Important R&D projects from the national and international standpoint > • Radio telescope (ALMA project) ¥1 billion • Neutrino laboratory ¥0.6 billion • Successor of the antarctic explorer "Shirase" ¥3 billion |
|--|--|--|---|

Prioritization of Public Investment

- <Prioritization of public works>
- Prioritization in line with role allocation between central and local governments based on "Basic Policies 2003."
- Hub airports in large cities +30%
- Key international ports and harbors +7%
- Loop roads in the 3 largest urban areas +9%
- Underground power lines +4%
- Septic tank +21%
- PCB disposal +132%

Measures for Urban Renaissance >

- "Community Development Grant" (approx. ¥133 billion)
- Respect for local autonomy
- Wide coverage
- *Ex post* evaluations
- Cadastral research (approx. ¥10.2 billion)

Ensuring the "Security" of People

- <Increase in the number of security officers>

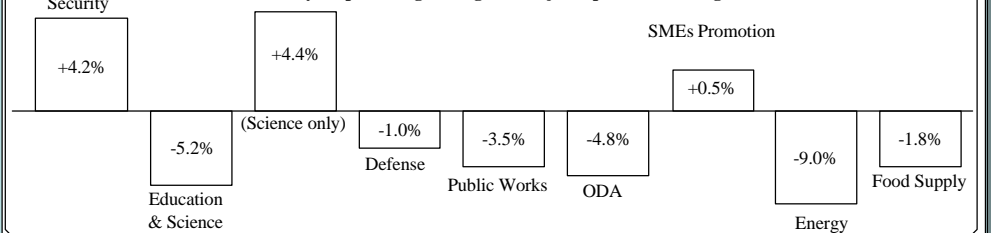
| | | | |
|-------------|--------|-------------|------|
| Correction | +451 | Immigration | +168 |
| Prosecution | +56 | Customs | +185 |
| Police | +3,150 | (persons) | |

- <Improvement of prisons>
(¥17.9 billion, +7.2%)
- <Enhanced immigration control, and measures against illegal overstaying foreigners>(¥2.1 billion, +57.8%)
- Nationally enhancing immigration control
- Halving the illegal overstaying foreigners
- <Safety and security of food>
- Safety of pesticides and feed (¥1.7 billion, +103%)
- Inspecting and guiding food labeling (¥0.5 billion, +19%)

Measures for the Employment

- <Employment of young people >
- Job encouragement to the youth and vocational capability development
- Japanese "Dual System" (¥7.5 billion)
- Job Supporters (¥1.3 billion, +2,250%)
- <Promotion of early reemployment >
- Employment Support Navigator (¥4.4 billion, +46.3%)
- Reemployment Planner (¥1.3 billion)
- Providing the employment information (¥0.8 billion yen, +14.4%)

Year-on-year percentage changes in major expenditures categories



Concept for Restraint in the Issuance of Government Bonds

| | The FY2003 Budget | Overall Picture of the FY2004 Budget | (In billions of yen) |
|-------------------------------------|------------------------|--------------------------------------|---|
| Tax revenues | 41,786.0 (-5,030.0) | 41,747.0 (-39.0) | Effect of tax resources transfer: 425 |
| Government bond issues | 36,445.0 (+6,445.0) | 36,590.0 (+145.0) | Bond Dependency: 44.6% (FY2003 initial budget: 44.6%) |
| Local Allocation Tax Grants | 17,398.8 (+387.2) | 16,493.5 (-905.3) | Drastic reduction in local allocation tax through the review of local government expenditures |
| General Expenditures | 47,592.2 (+45.0) | 47,632.0 (+39.8) | Below the level of the FY2003 budget, excluding some exceptional factors including: • Inevitable increase due to a population growth of the elderly (275.4), • Expenses related to the House of Councilors election (65.9), and • Increase due to the rise of the state contribution to the basic pension benefits (27.2). |
| General Account Expenditures | 81,789.1 (+559.1) | 82,110.9 (+321.8) | |

General Account Budget (FY2004 Budget)

(Unit: billion yen)

| | FY2003 (Initial) | FY2004 (Initial) | | Note |
|--|---------------------|---------------------|--------|---|
| | | FY2003 | FY2004 | |
| (Revenue) | | | | |
| Tax Revenues | 41,786.0 | 41,747.0 | -39.0 | Effect of transfer of tax resources is 425.0 billion yen. |
| Non-tax Revenues | 3,558.1 | 3,773.9 | 215.8 | Including redemption of 'NTT interest-free loans' (416.9 billion yen). |
| Government Bond Issues | 36,445.0 | 36,590.0 | 145.0 | Bond dependency: 44.6% (FY 2003 initial budget: 44.6%) |
| Construction bonds | 6,420.0 | 6,500.0 | 80.0 | |
| Special Deficit-financing bonds | 30,025.0 | 30,090.0 | 65.0 | |
| [TOTAL] | 81,789.1 | 82,110.9 | 321.8 | |
| (Expenditure) | | | | |
| National Debt Service | 16,798.1 | 17,568.5 | 770.4 | Including inevitable increases such as increased fixed-rate transfer due to a rise in the government bond outstanding (459.7 billion yen) and redemption of 'NTT interest-free loans' (416.9 billion yen). |
| Local Allocation Tax Grants | 17,398.8 | 16,493.5 | -905.3 | |
| General Expenditures | 47,592.2 | 47,632.0 | 39.8 | Including inevitable increases due to a rise in the number of the elderly (275.4 billion yen), the House of Councilors election (65.9 billion yen) and the rise of the state contribution to the basic pension benefits (27.2 billion yen). |
| Subsidies for redemption of 'NTT interest-free loans' (B type) | - | 416.9 | 416.9 | |
| [TOTAL] | 81,789.1 | 82,110.9 | 321.8 | |

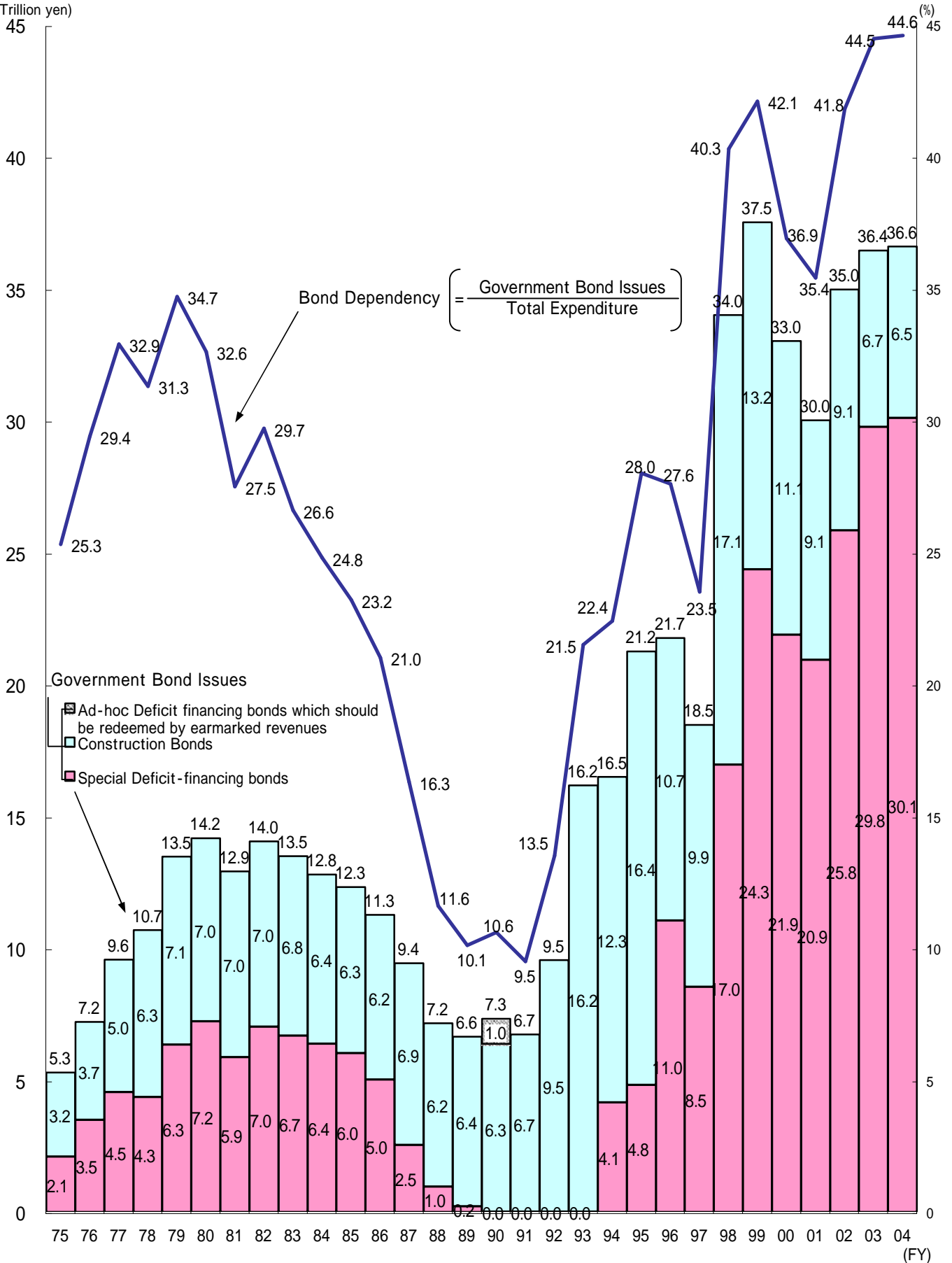
Outline of General Expenditures by Major Expenditure Programs (FY2004 Budget)

(unit: billion yen)

| | FY2003 Budget | | | FY2004 Budget | | |
|---|---------------|--------|----------|---------------|--------|----------|
| | FY2002 | FY2003 | % change | FY2003 | FY2004 | % change |
| Social Security | 18,990.7 | 713.9 | 3.9 | 19,797.0 | 806.3 | 4.2 |
| Education and Science | 6,471.2 | -234.4 | -3.5 | 6,133.0 | -338.2 | -5.2 |
| (Science only) | 1,229.8 | 46.6 | 3.9 | 1,284.1 | 54.3 | 4.4 |
| Government Employee Pensions and Others | 1,202.9 | -69.8 | -5.5 | 1,132.1 | -70.8 | -5.9 |
| National Defense | 4,953.0 | -3.0 | -0.1 | 4,903.0 | -50.0 | -1.0 |
| Public Works | 8,097.1 | -326.8 | -3.9 | 7,815.9 | -281.2 | -3.5 |
| Economic Assistance | 816.1 | -40.5 | -4.7 | 768.6 | -47.5 | -5.8 |
| ODA (reference only) | 857.8 | -52.8 | -5.8 | 816.9 | -40.9 | -4.8 |
| Small and Medium Size Businesses | 172.9 | -13.2 | -7.1 | 173.8 | 0.9 | 0.5 |
| Energy | 556.7 | -12.7 | -2.2 | 506.5 | -50.2 | -9.0 |
| Food Supply | 687.5 | -42.2 | -5.8 | 674.9 | -12.6 | -1.8 |
| Transfer to the Industrial Investment Special Account | 163.6 | 18.1 | 12.4 | 98.8 | -64.8 | -39.6 |
| Miscellaneous | 5,130.5 | 55.6 | 1.1 | 5,278.4 | 147.9 | 2.9 |
| Reserve Funds | 350.0 | 0.0 | 0.0 | 350.0 | 0.0 | 0.0 |
| [TOTAL] | 47,592.2 | 45.0 | 0.1 | 47,632.0 | 39.8 | 0.1 |

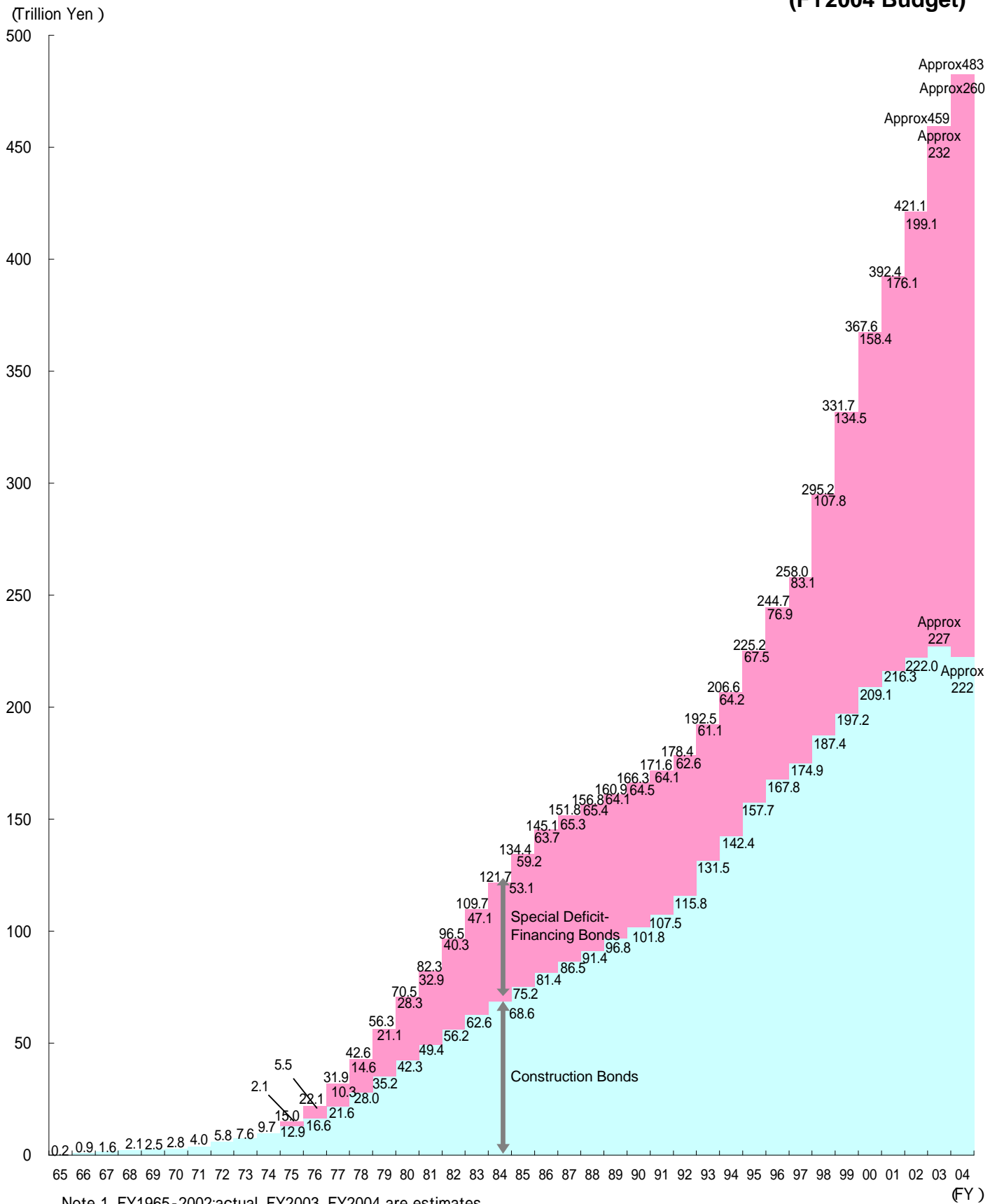
Trends of Government Bond Issues (FY2004 Budget)

(Trillion yen)



Note: FY1975-2002: settlement, FY2003: revised, FY2004: budget

Trends of Accumulated Government Bonds Outstanding (FY2004 Budget)



Note 1. FY1965-2002:actual. FY2003, FY2004 are estimates.

Note 2. The special deficit-financing bond amount includes refunding bonds for long term debts transferred from JNR Corp. settlement and National Forest Service, etc.

Long Term Debt Outstanding (FY2004 Budget)

(trillion yen)

| | FY1994 <Settlement> | FY1999 <Settlement> | FY2002 <Settlement> | FY2003 <Revised> | FY2004 <Budget> |
|----------------|------------------------|------------------------|---|---------------------|--------------------|
| National Gov. | 269 | 449 | 536 (487) <small>Note 1</small> | 528 | 548 |
| Straight Bonds | 207 | 332 | 421 | 459 | 483 |
| Local Gov. | 106 | 174 | 193 | 199 | 204 |
| Duplication | - 7 | - 22 | - 31 | - 32 | - 33 |
| Total | 368 | 600 | 698 (649) <small>Note 1</small> | 695 | 719 |
| % of GDP | 74.8% | 118.2% | 140.3% (130.5%) <small>Note 1</small> | 139.5% | 143.6% |

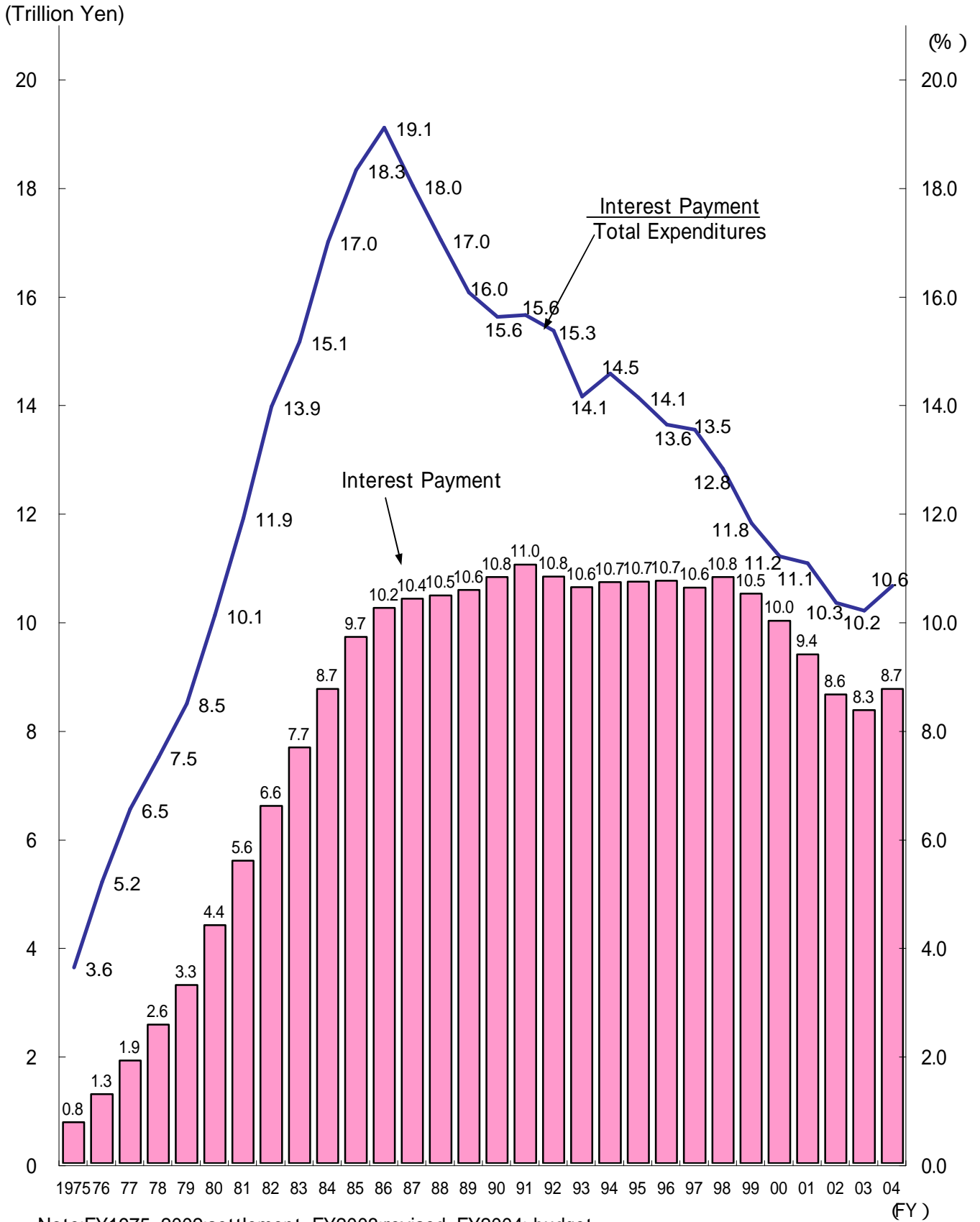
Note 1. Postal Service Special Account and Postal Saving Special Account are to be abolished at the end of FY2002. The figures in parenthesis of FY2002 exclude their liabilities.

Note 2. GDP for FY2003: estimates. FY2004: forecast.

Note 3. The outstanding debt of the Fiscal Loan Fund Special Account at the end of FY2004 is estimated to be approximately 124 trillion yen.

Trends of Interest Payment of Government Bonds

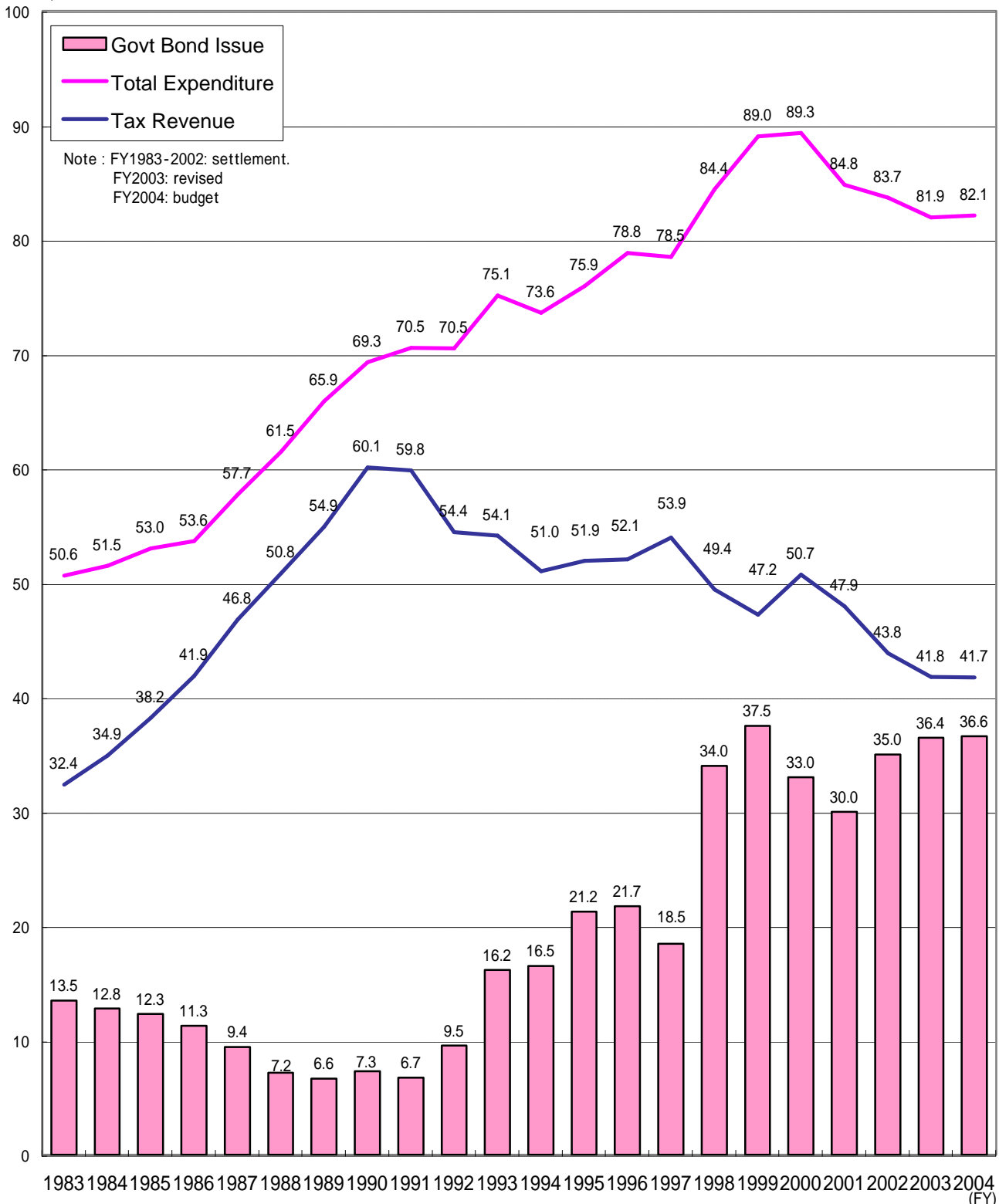
(FY2004 Budget)



Note: FY1975-2002: settlement, FY2003: revised, FY2004: budget

Trends of General Account Tax Revenues, Total Expenditures, and Government Bond Issues

(Trillion Yen)



1983 1984 1985 1986 1987 1988 1989 1990 1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 (FY)

| | | | | | |
|----------------------------|-------|-------|-------|-------|-------|
| Nominal GDP (Trillion Yen) | 286.3 | 414.7 | 491.3 | 508.0 | 500.6 |
|----------------------------|-------|-------|-------|-------|-------|

(FY2004 figures are estimates)

(Note) The permanent tax reductions (national and local) which substantially exceed 6 trillion yen (full effect basis) is continuing since FY 1999.

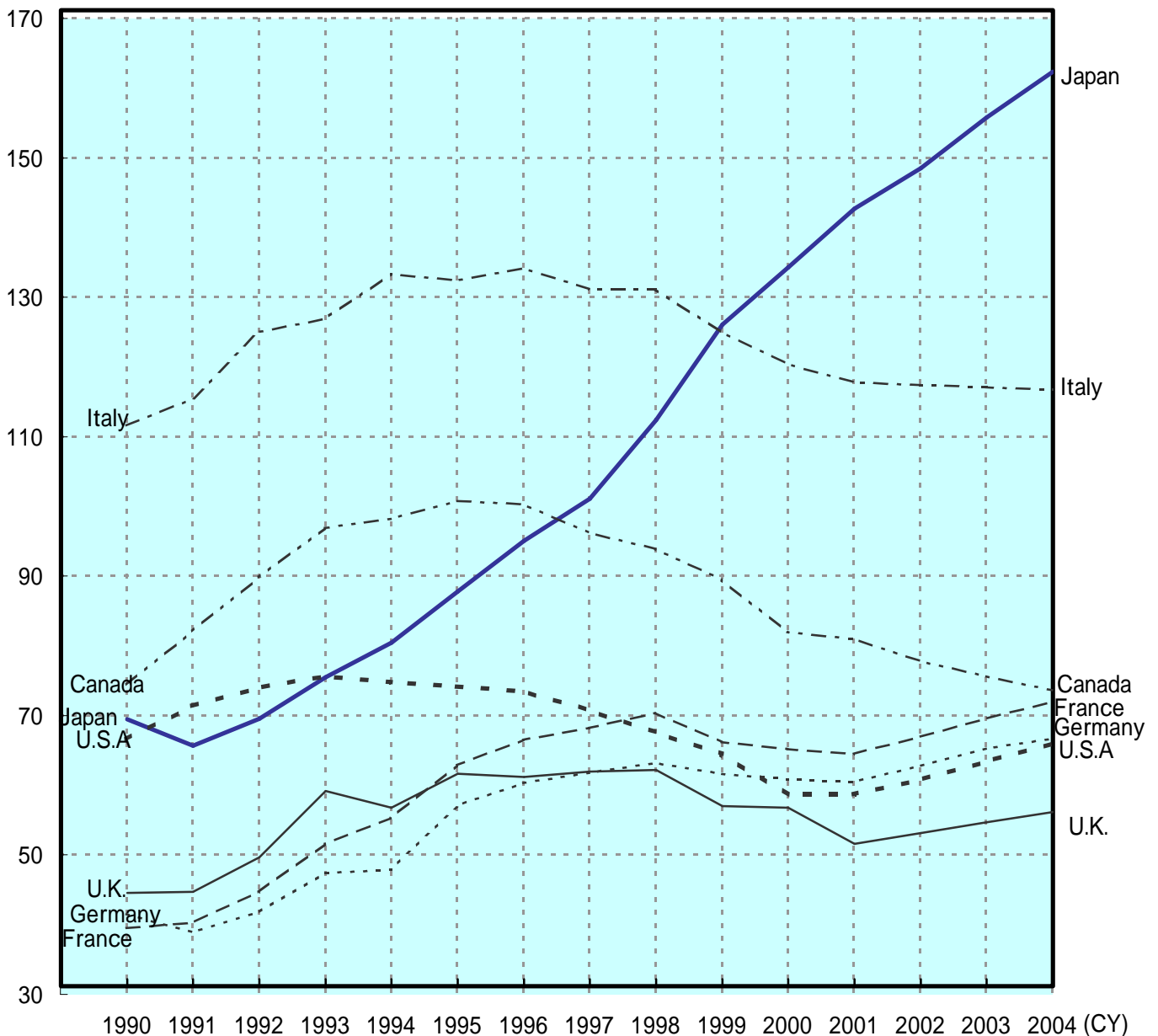
General Government Gross Debt (International Comparison)

(As a percentage of GDP)

| (CY) | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 |
|----------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Japan | 68.3 | 64.5 | 68.4 | 74.3 | 79.3 | 86.6 | 93.9 | 99.9 | 111.2 | 124.9 | 133.1 | 141.5 | 147.3 | 154.6 | 161.2 |
| United States | 66.6 | 71.4 | 74.0 | 75.6 | 74.8 | 74.2 | 73.5 | 70.8 | 67.6 | 64.5 | 58.7 | 58.7 | 60.8 | 63.4 | 66.0 |
| United Kingdom | 43.4 | 43.5 | 48.5 | 58.0 | 55.6 | 60.5 | 60.0 | 60.8 | 61.0 | 55.8 | 55.6 | 50.4 | 52.0 | 53.5 | 55.0 |
| Germany | 41.5 | 38.9 | 41.8 | 47.4 | 47.9 | 57.1 | 60.3 | 61.8 | 63.2 | 61.6 | 60.9 | 60.5 | 62.8 | 65.3 | 66.7 |
| France | 39.5 | 40.3 | 44.7 | 51.6 | 55.3 | 62.9 | 66.5 | 68.2 | 70.4 | 66.2 | 65.2 | 64.5 | 67.0 | 69.5 | 72.0 |
| Italy | 111.6 | 115.5 | 125.0 | 126.9 | 133.3 | 132.4 | 134.2 | 131.2 | 131.2 | 125.0 | 120.4 | 117.8 | 117.4 | 117.1 | 116.7 |
| Canada | 74.5 | 82.1 | 89.9 | 96.9 | 98.2 | 100.8 | 100.3 | 96.2 | 93.9 | 89.5 | 82.0 | 81.0 | 77.8 | 75.6 | 73.6 |

Source: OECD Economic Outlook 74 (December 2003). Figures are general government figures calculated on a

(% of GDP)



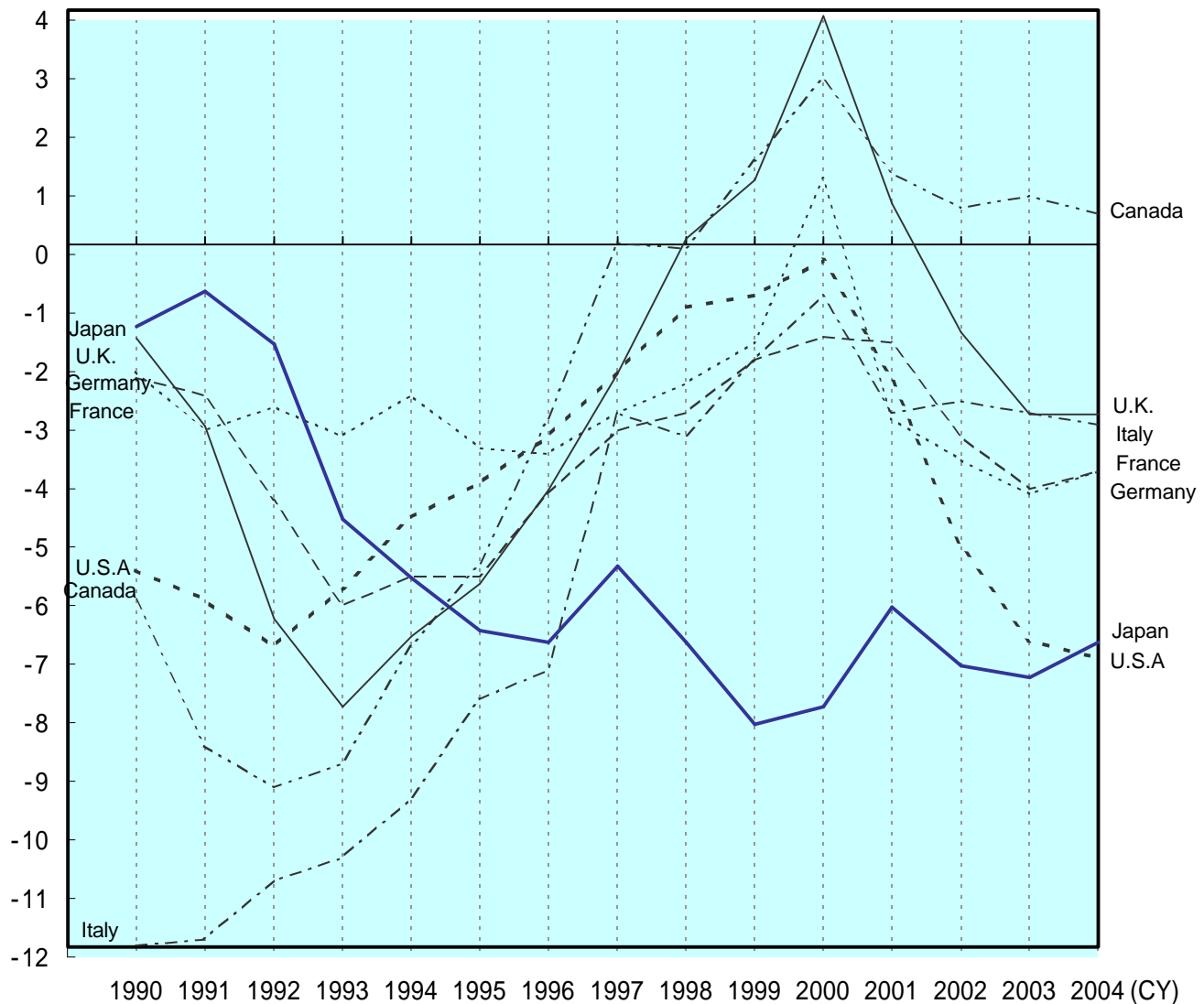
General Government Financial Balances (International)

(As a percentage of GDP)

| (CY) | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 |
|---|-------|-------|-------|-------|------|------|------|------|------|------|------|------|------|------|------|
| General Government Excluding Social Security | | | | | | | | | | | | | | | |
| Japan | -1.4 | -0.8 | -1.7 | -4.7 | -5.7 | -6.6 | -6.8 | -5.5 | -6.8 | -8.2 | -7.9 | -6.2 | -7.2 | -7.4 | -6.8 |
| United States | -5.4 | -5.9 | -6.7 | -5.7 | -4.5 | -3.9 | -3.1 | -2.0 | -0.9 | -0.7 | -0.1 | -2.1 | -5.0 | -6.6 | -6.9 |
| General Government | | | | | | | | | | | | | | | |
| Japan | 2.0 | 1.8 | 0.8 | -2.4 | -3.7 | -4.7 | -5.0 | -3.8 | -5.5 | -7.2 | -7.4 | -6.1 | -7.1 | -7.4 | -6.8 |
| United States | -4.3 | -5.0 | -5.9 | -5.0 | -3.6 | -3.1 | -2.2 | -0.9 | 0.3 | 0.7 | 1.4 | -0.5 | -3.4 | -4.9 | -5.1 |
| United Kingdom | -1.6 | -3.1 | -6.4 | -7.9 | -6.7 | -5.8 | -4.2 | -2.2 | 0.1 | 1.1 | 3.9 | 0.7 | -1.5 | -2.9 | -2.9 |
| Germany | -2.0 | -3.0 | -2.6 | -3.1 | -2.4 | -3.3 | -3.4 | -2.7 | -2.2 | -1.5 | 1.3 | -2.8 | -3.5 | -4.1 | -3.7 |
| France | -2.1 | -2.4 | -4.2 | -6.0 | -5.5 | -5.5 | -4.1 | -3.0 | -2.7 | -1.8 | -1.4 | -1.5 | -3.1 | -4.0 | -3.7 |
| Italy | -11.8 | -11.7 | -10.7 | -10.3 | -9.3 | -7.6 | -7.1 | -2.7 | -3.1 | -1.8 | -0.7 | -2.7 | -2.5 | -2.7 | -2.9 |
| Canada | -5.9 | -8.4 | -9.1 | -8.7 | -6.7 | -5.3 | -2.8 | 0.2 | 0.1 | 1.6 | 3.0 | 1.4 | 0.8 | 1.0 | 0.7 |

Source: OECD Economic Outlook 74 (December 2003). Figures are general government figures calculated on a SNA basis.

(% of GDP)



Japan and United States: General government financial balance excluding social security.