

Fiscal Policy in Japan

- Issues and Future Directions -



Introduction

1. Social security benefits have been increasing every year due to the aging population.
2. With these situations, the public finance in Japan is the worst compared with other countries.
3. “The enhancement and sustainability of the social security system” and “the fiscal consolidation” should be achieved simultaneously.

**All revenues from the consumption tax
shall be used for social security.**

※excluding the ongoing local consumption tax revenue; 1%

July 2015

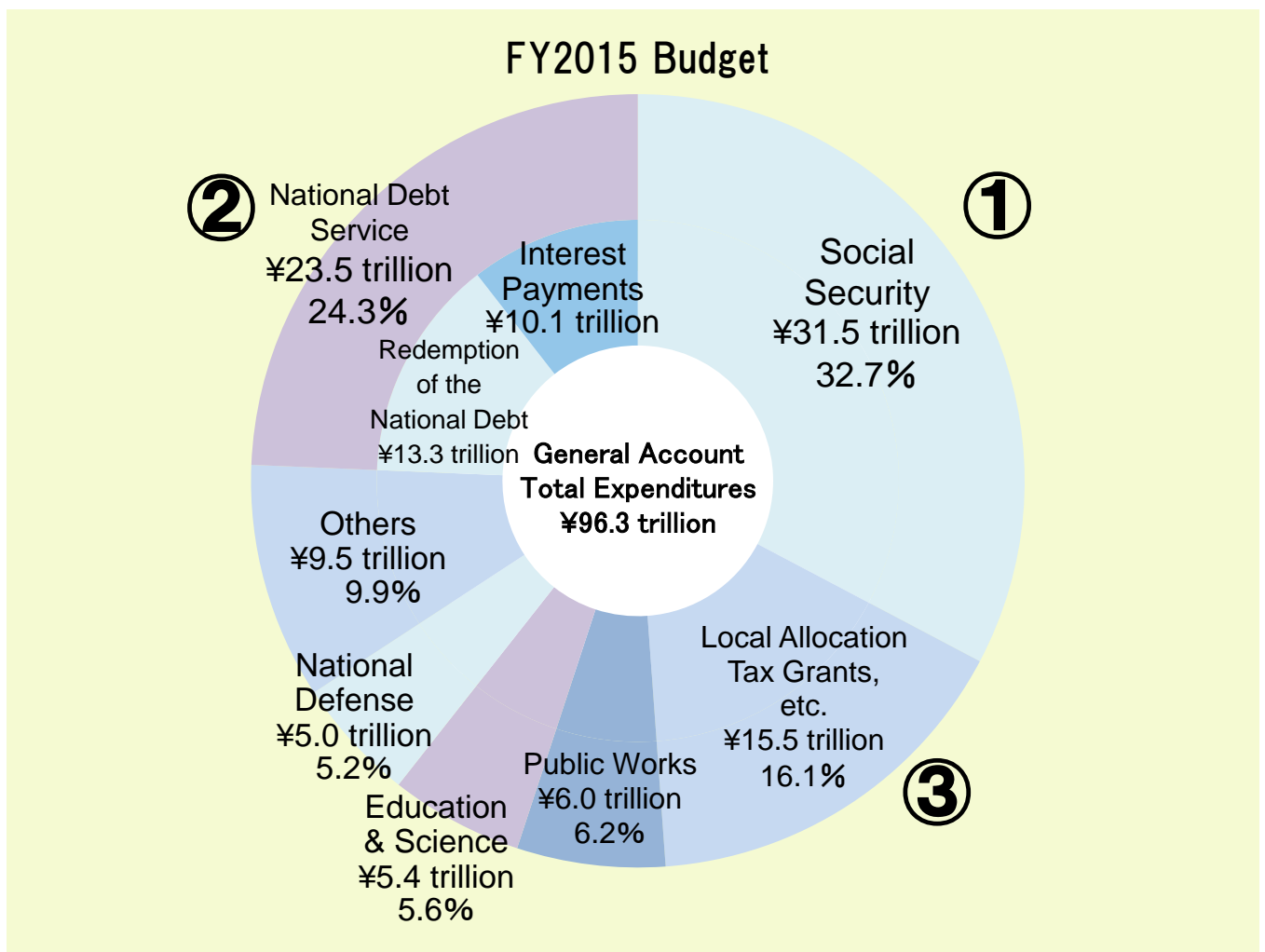
Ministry of Finance

The Structure of Total Expenditures

✓ Regarding the total expenditures in general account budget, social security expenditures and national debt service increase every year, while the ratios of other expenditures (public works, education and science, national defense, etc.) decrease every year.

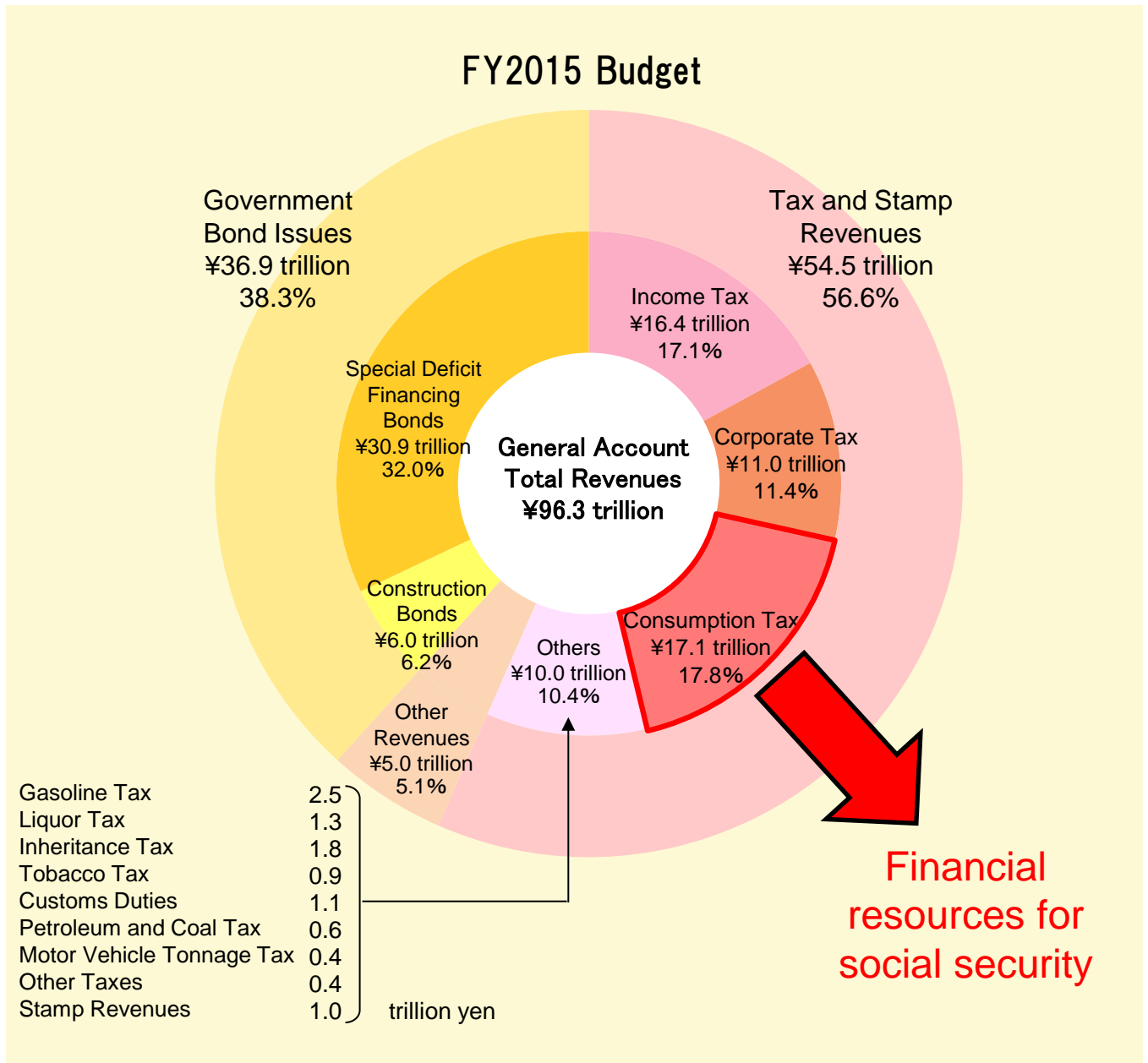
1. Social Security: expenditures for pension, medical care, and long-term care, etc., which increase by one trillion yen level every year due to the aging population.
2. National Debt Service: expenditures which consist of redemption and interest payments, and which increase with increasing government bonds outstanding.
3. Local Allocation Tax Grants: expenditures which are distributed to the local governments so that all of them can provide the minimum administrative services. The central government adjusts and distributes uneven tax revenues among the local governments.

These three expenditures account for 70% of total expenditures in general account budget.



The Structure of Total Revenues

- ✓ The total revenues in general account budget consist of income tax, corporate tax, consumption tax, other tax revenues, non-tax revenues, and government bond issues.
 - ✓ Currently, only 60% of the total expenditures are financed by tax revenues and non-tax revenues. As a result, about 40% depends on the government bond issues (debts) which will be the burden for future generations.
 - ✓ The consumption tax rate was raised from 5% to 8% in April 2014. All the revenues from the consumption tax shall be used for the financial resources for social security.
- ※ excluding the ongoing local consumption tax revenue (1% of the consumption tax rate)

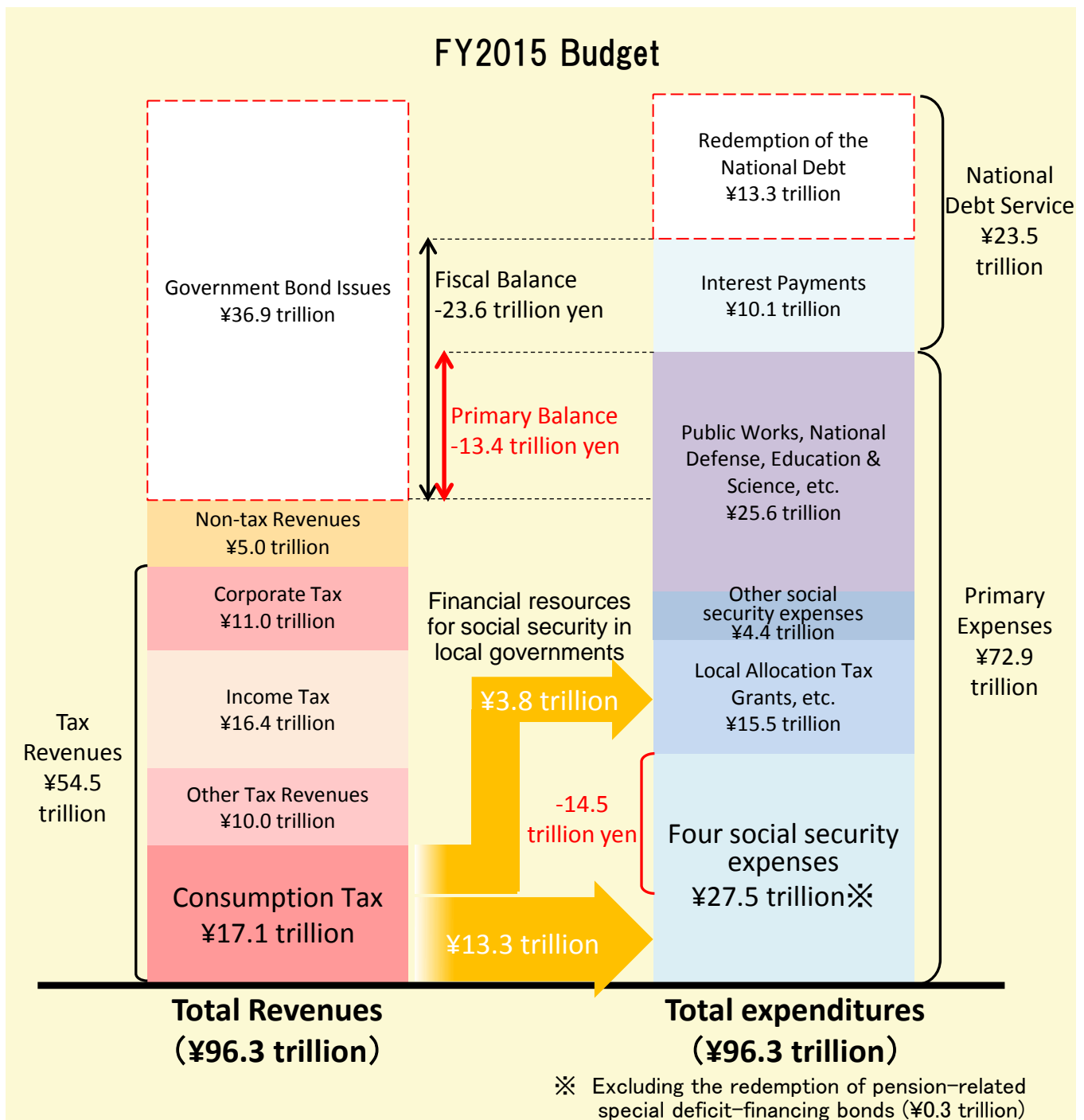


Consumption Tax Revenues for the Social Security

✓ All the revenues from the consumption tax shall be used for the financial resources of social security in the central and local governments.

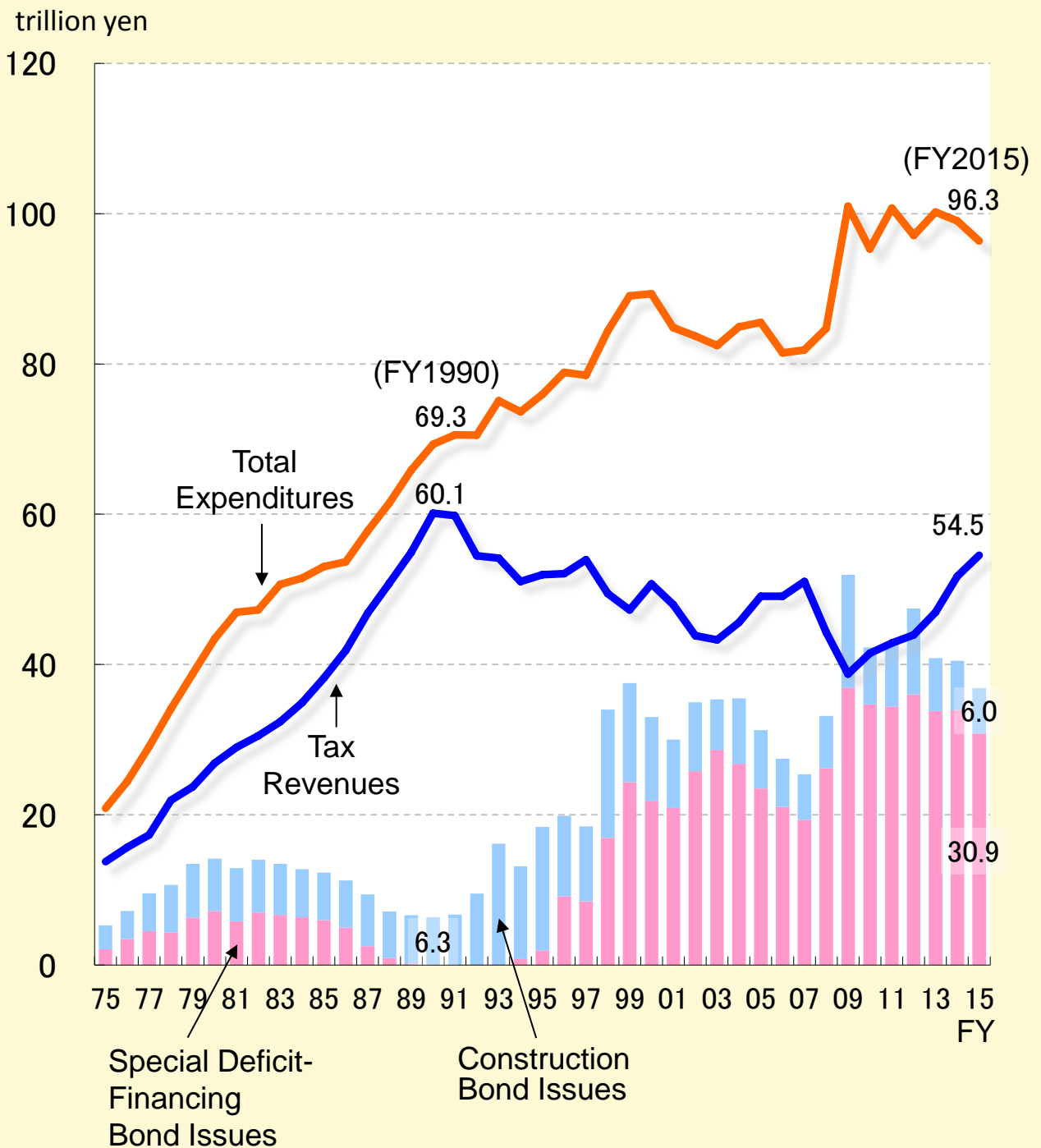
※ excluding the ongoing local consumption tax revenue (1% of the consumption tax rate)

✓ The Primary Balance (PB) is an indicator that shows to what extent the expenditures for policy measures (public works, education and science, national defense, etc.) are covered by tax revenues and non-tax revenues. The primary deficit is financed by public debts which will be the burden for future generations.



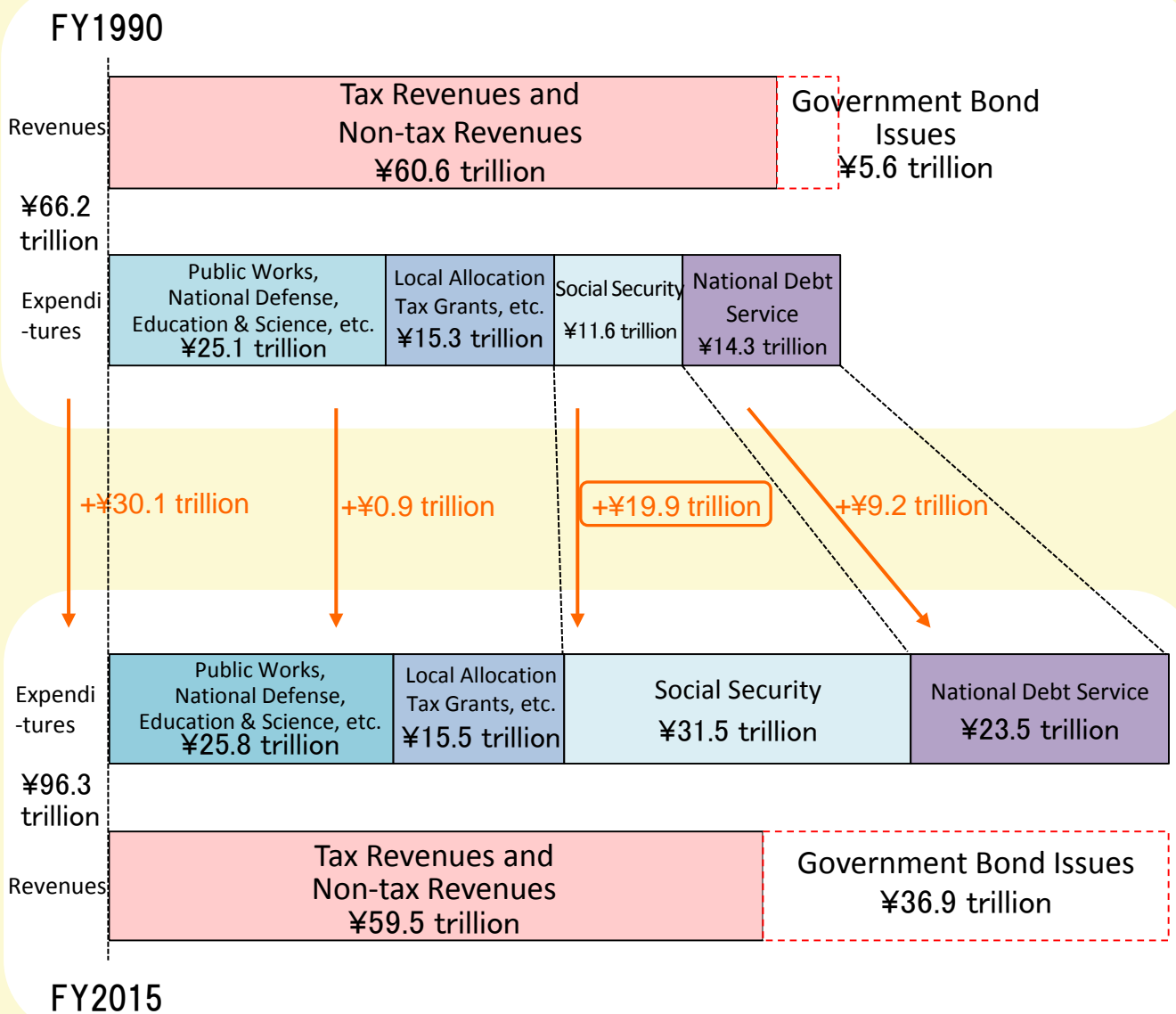
Trends in Expenditures and Revenues, and the Government Bond Issues

- ✓ While total expenditures have been consistently increasing, total revenues (tax revenues) have been growing at a sluggish pace.
- ✓ The gap is financed by the government bond issues (Special Deficit-Financing Bond and Construction Bond).



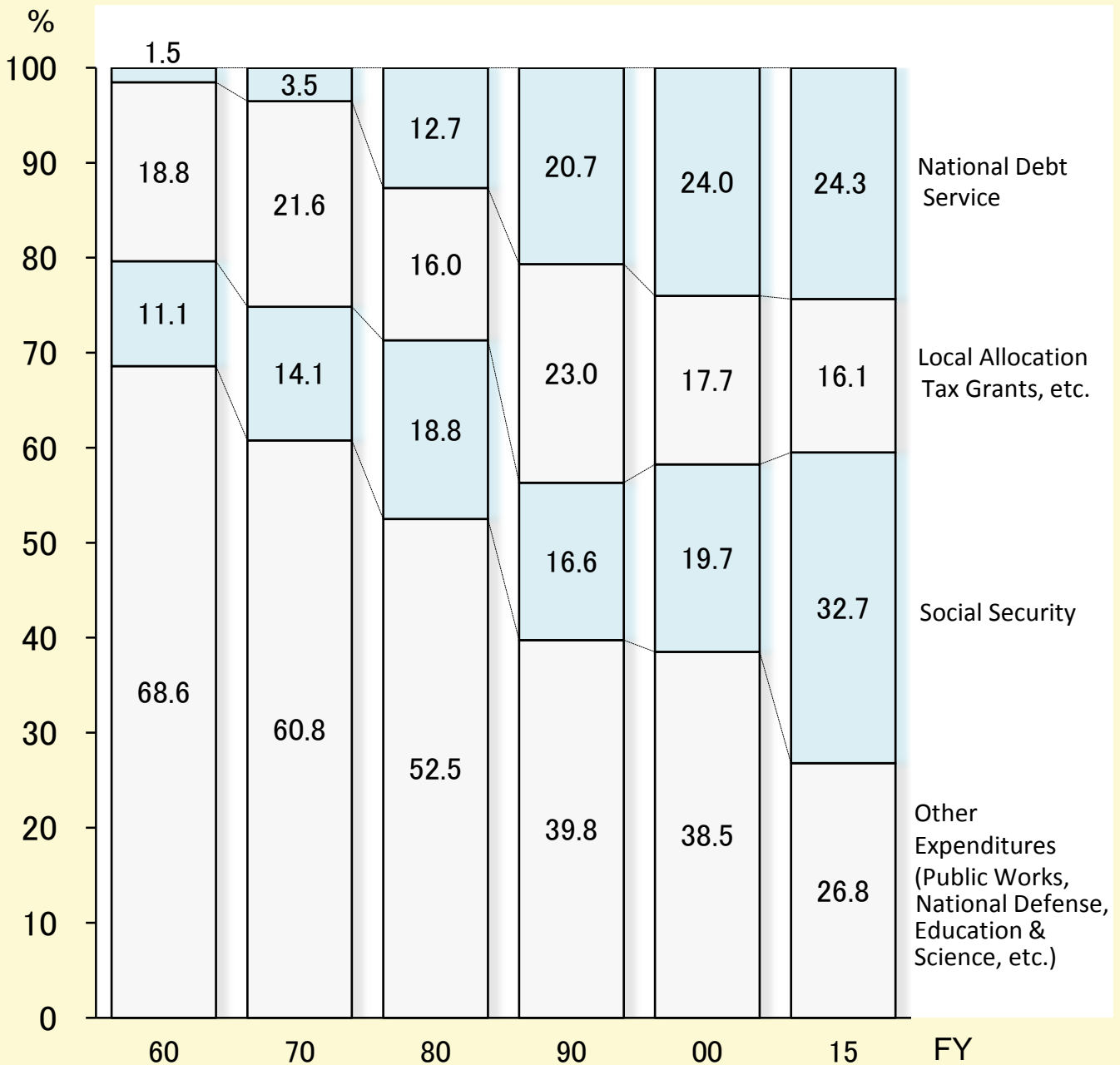
Change in the Fiscal Structure

- ✓ Comparing the FY2015 budget with FY1990, the expenditures have increased by 30 trillion yen. The breakdown of the expenditures shows that social security expenditures have increased by 20 trillion yen (about 3 times) and national debt service has increased by 10 trillion yen due to the increase in government bonds outstanding.
- ✓ The breakdown of the revenues shows that although tax revenues have not increased, the government bond issues have increased by about 30 trillion yen.
- ✓ This means that the increase in social security benefits due to the aging population has been financed not only by social insurance contributions but also by debts which will be the burden for future generations.



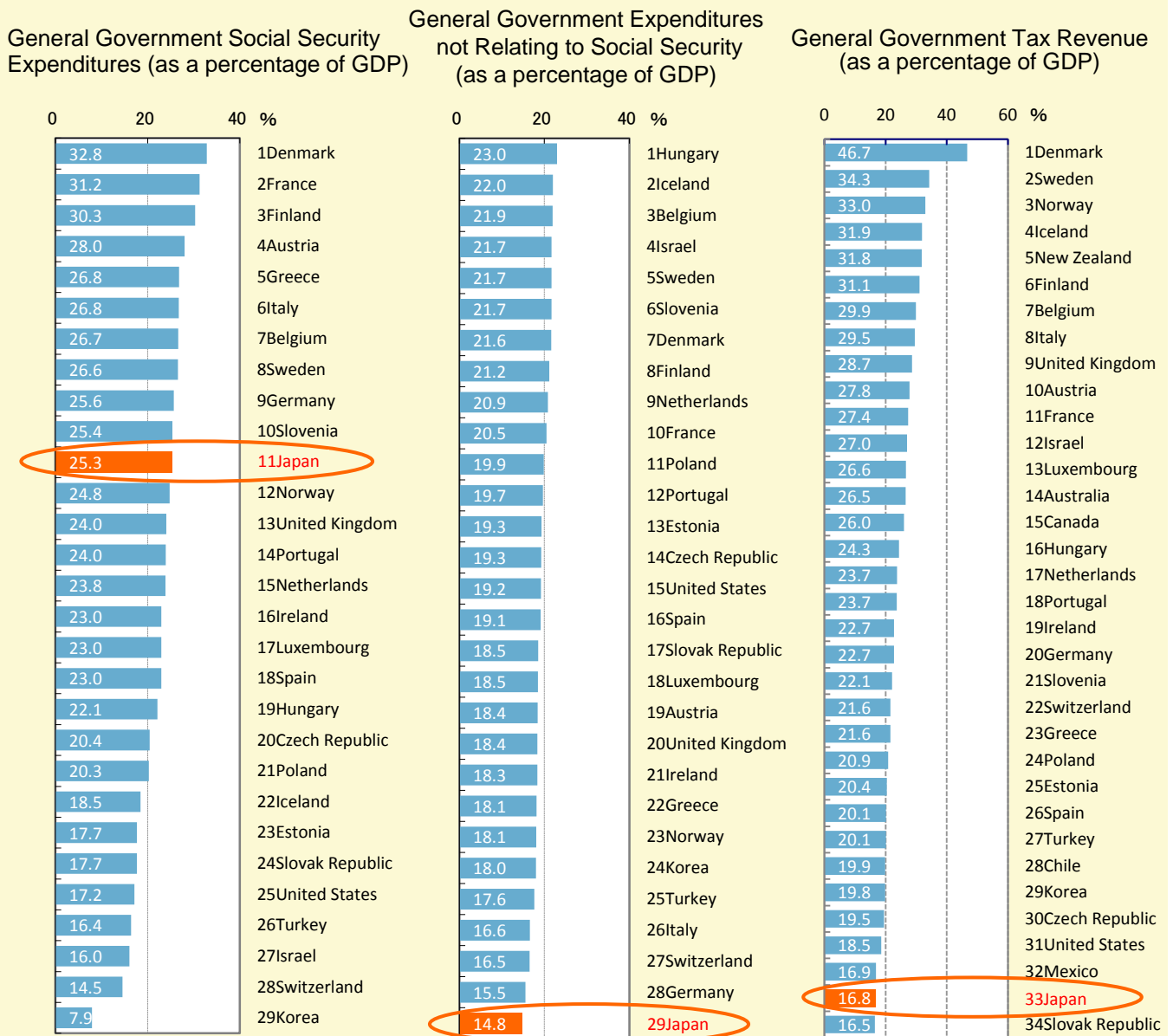
Change in the Structure of Total Expenditures

- ✓ The share of national debt service and social security expenditures has been consistently increasing.
- ✓ On the other hand, the share of other expenditures such as public works, national defense, and education and science has been consistently decreasing.



International Comparison of Fiscal Scales

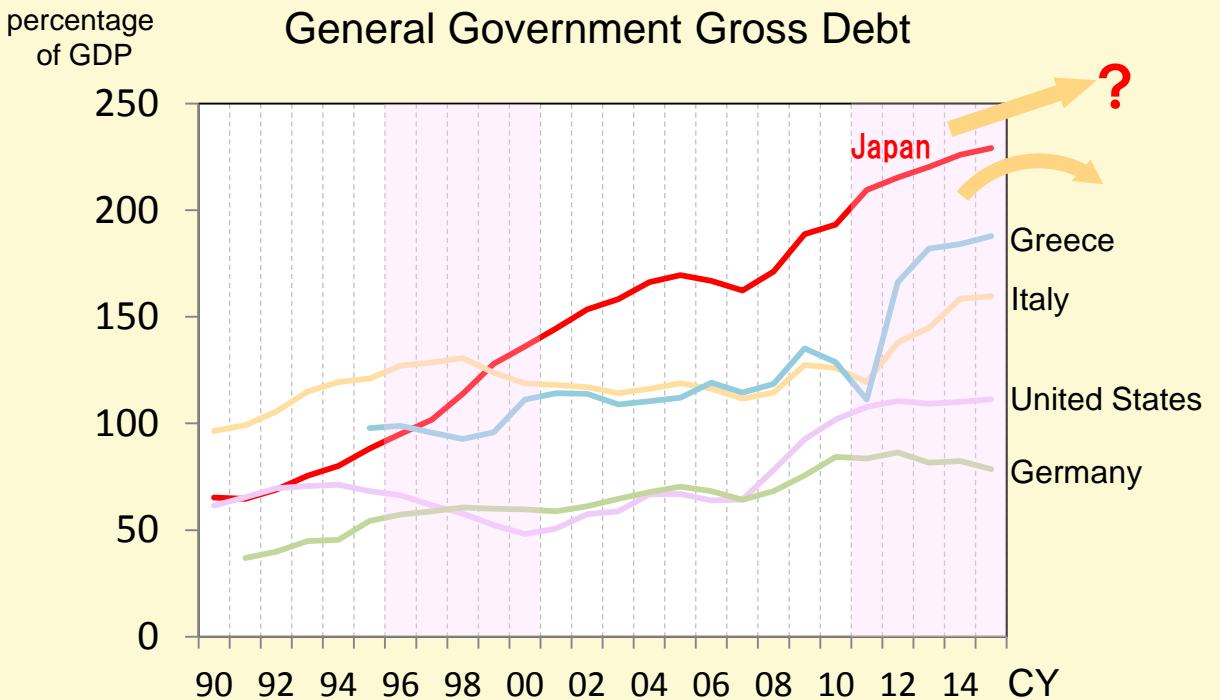
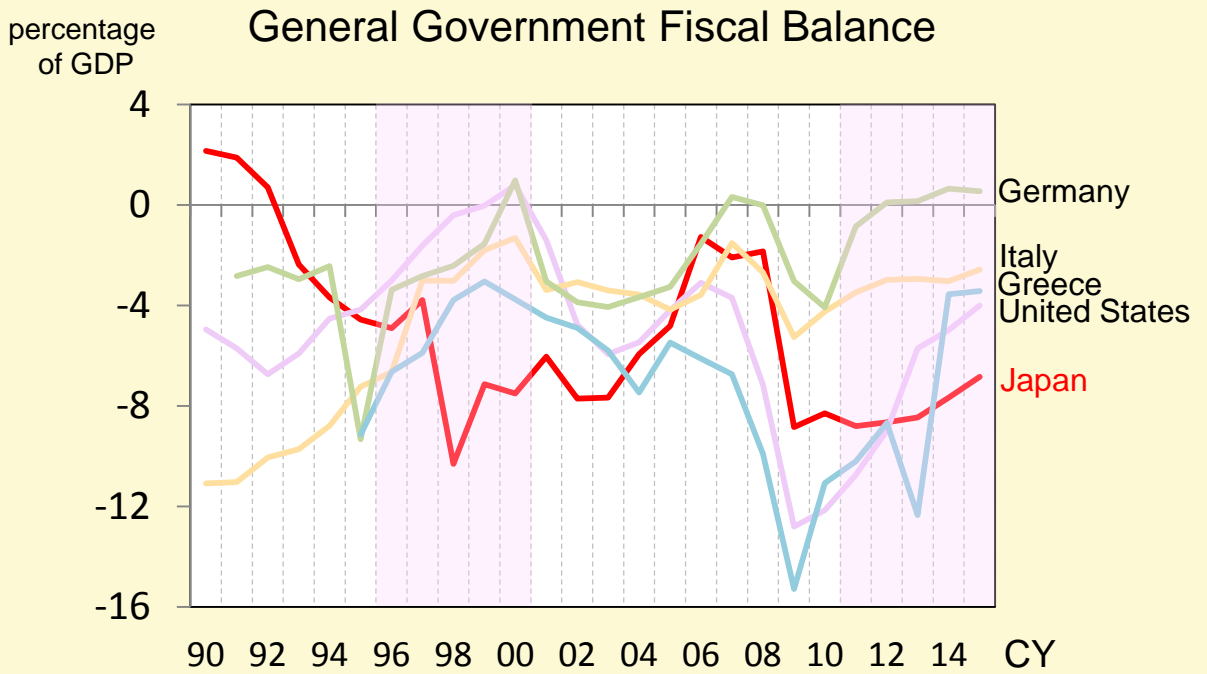
- ✓ Compared with other countries, the scale of social security expenditures is placed at the middle level but the scale of tax revenue is placed at the lowest level.
- ✓ In addition, the scale of expenditures not relating to social security is placed at the lowest level.



CY2011

International Comparison of Fiscal Balance and Gross Debt

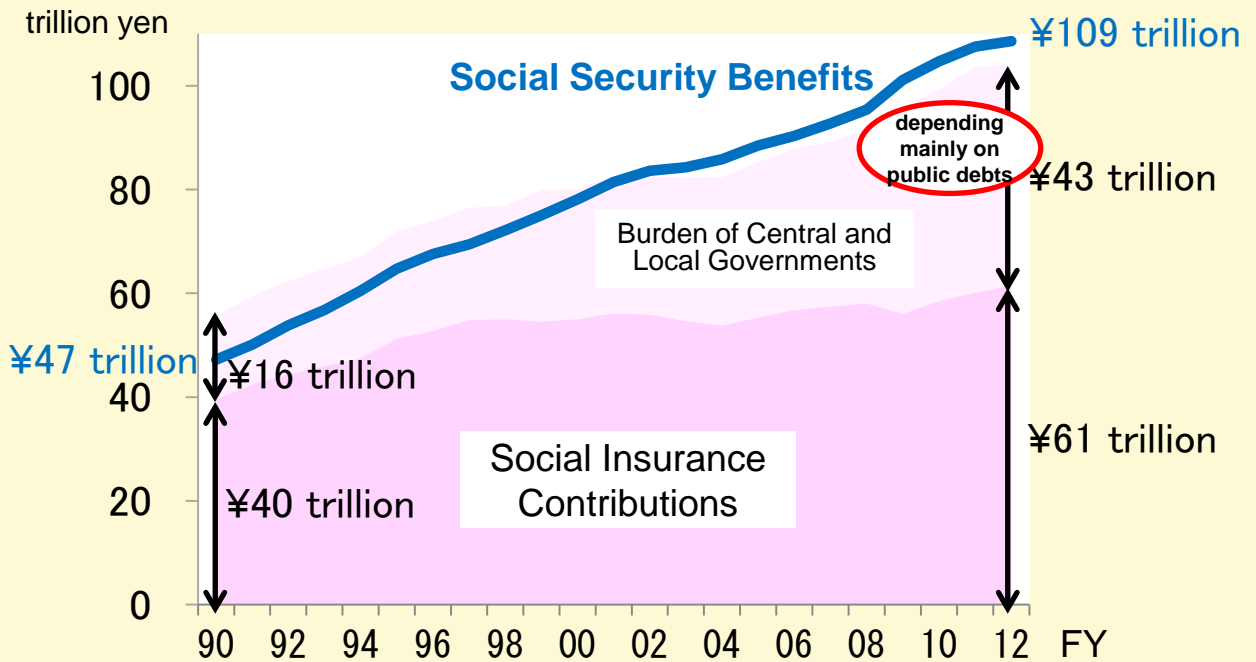
✓ While many countries have improved their fiscal balances, Japan continues to run significant fiscal deficits. As a result, the fiscal situation is the worst among other countries and the ratio of general government gross debt to GDP exceeds 200%.



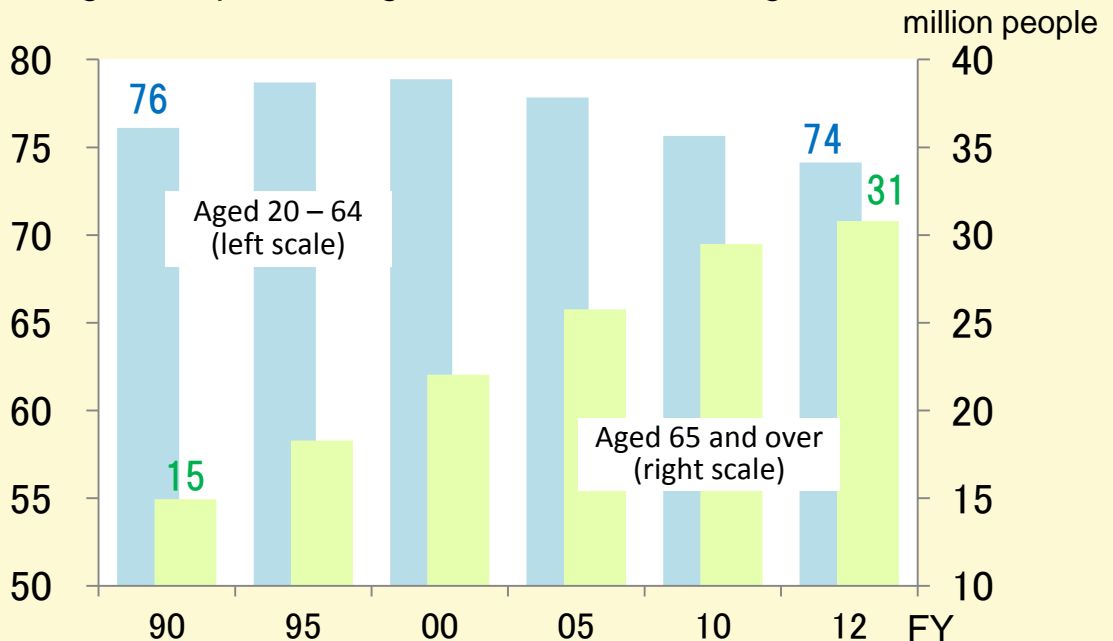
Aging Population and Increase in Social Security Benefits

- ✓ With the rapidly progressing population aging, social security benefits (pension, medical care, long-term care, etc.) have increased significantly. On the other hand, the revenues of social insurance contributions have not increased accordingly.
- ✓ Although the social security system in Japan is based on social insurance system, the gap between social security benefits and revenues of social insurance contributions has been subsidized by the central and local governments. The burden of the central government increases by one trillion yen level every year and most of its financial resources depends on public debts.

Financial Resources of Social Security Benefits



Change in Population Aged 65 and over, and Aged 20 – 64



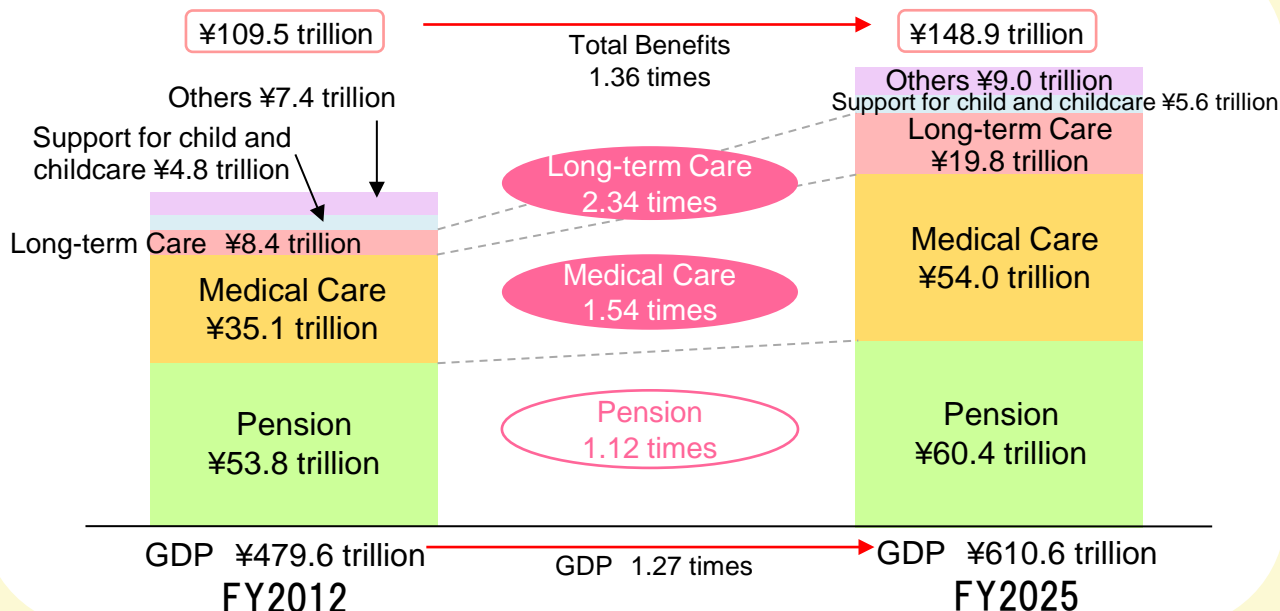
Prospect at the Social Security Benefits

- ✓ The population aging will progress further and all of the “first baby boomer generations” will be 75 years old and over in the early 2020s. The establishment of the sustainable social security system is urgently needed because the medical care and long-term care benefits per capita increase sharply with the increase in age.

Increase in the Number of Aged 75 and Over and Medical Care and Long-term Care Benefits Per Capita

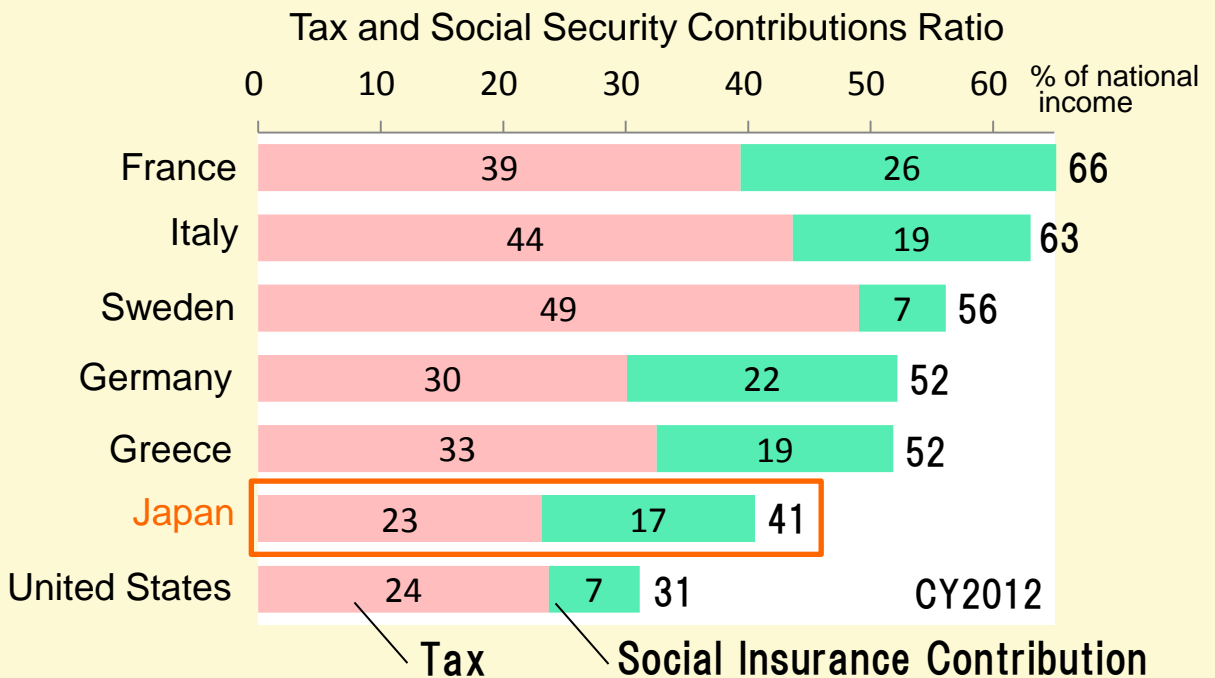
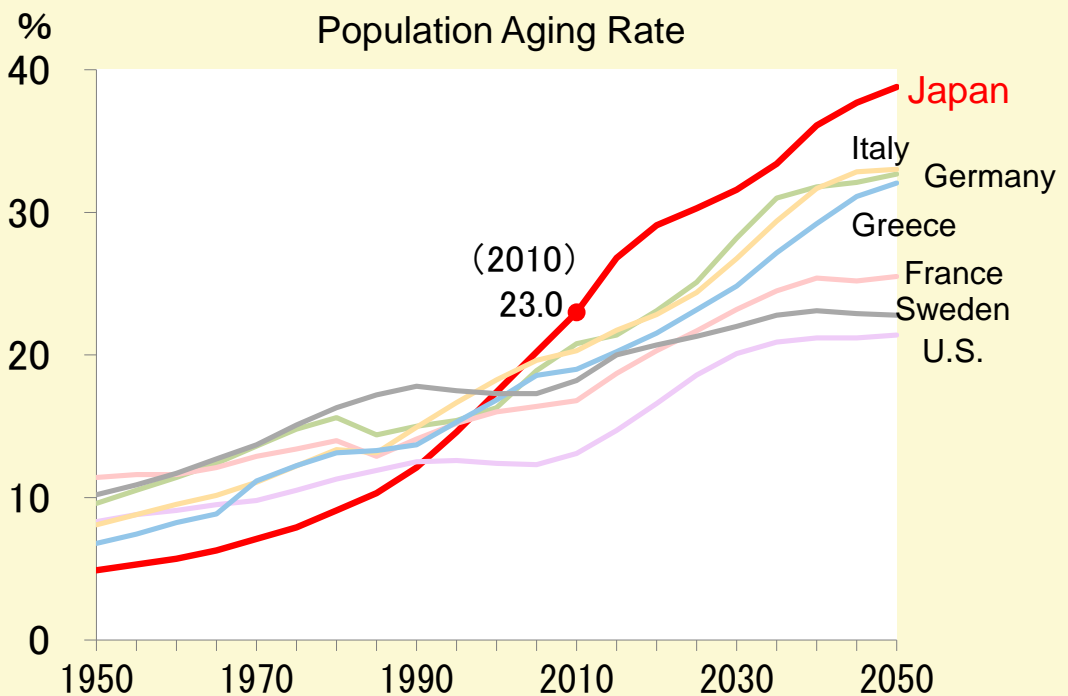
	Number and ratio to total population		Medical care (2011)		Long-term care (2012)	
	2012	2025	Medical care benefits per capita	Public aid per capita	Long-term care benefits per capita	Public aid per capita
	2012 - 13.0 million people (Aged 64 and under : 96.7 million → 84.1 million)	2025	(Aged 64 and under : ¥175 thousand	27 thousand	(Certification rate)	
Aged 65~74	- 1.0 million people 15.6 million (12.2%) → 14.8 million (12.3%)		¥553 thousand	¥85 thousand	¥50 thousand (4.4%)	¥14 thousand
Aged 75 and over	+ 7.0 million people 15.2 million (11.9%) → 21.8 million (18.1%)		¥892 thousand	¥326 thousand	¥461 thousand (31.3%)	¥131 thousand

Prospect of Social Security Benefits



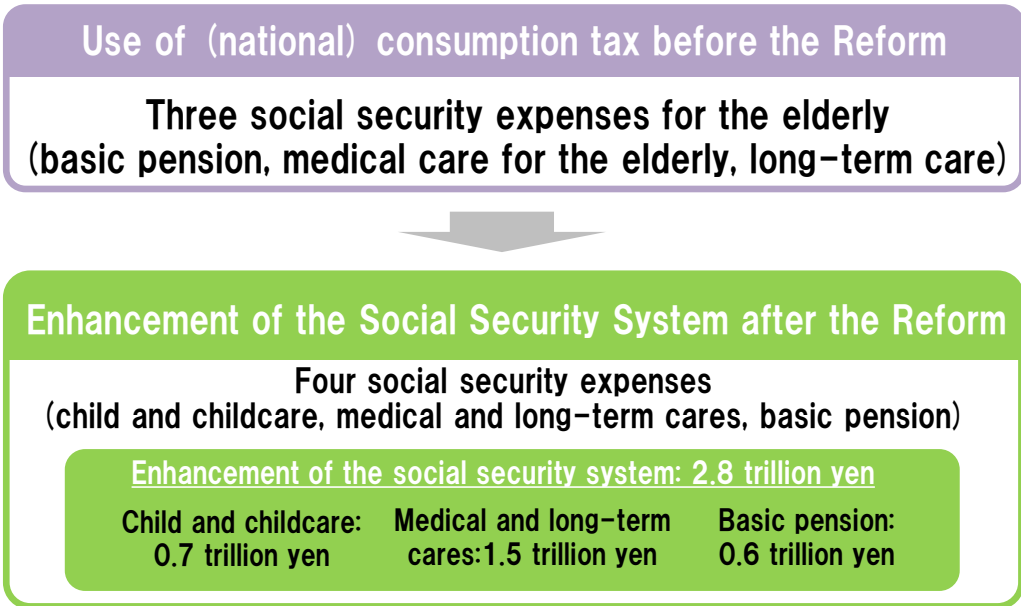
The Balance between Benefits and Contributions

- ✓ While Japan's population aging is progressing so rapidly compared with other countries, tax and social security contributions ratio in Japan is lower than other countries.
- ✓ In order to maintain the public finance and the social security system in Japan, the whole people need to discuss about the relationship between contributions and the increase in the social security benefits accompanied by population aging.



Comprehensive Reform of Social Security and Tax

- ✓ The government is currently implementing the comprehensive reform of social security and taxes for achieving “fiscal consolidation” and “enhancement and sustainability of social security system” simultaneously.
- ✓ All the revenues from consumption tax increase shall be used to enhance and sustain social security system. Therefore, the burdens for future generations as public debts of the central and local governments will be reduced.

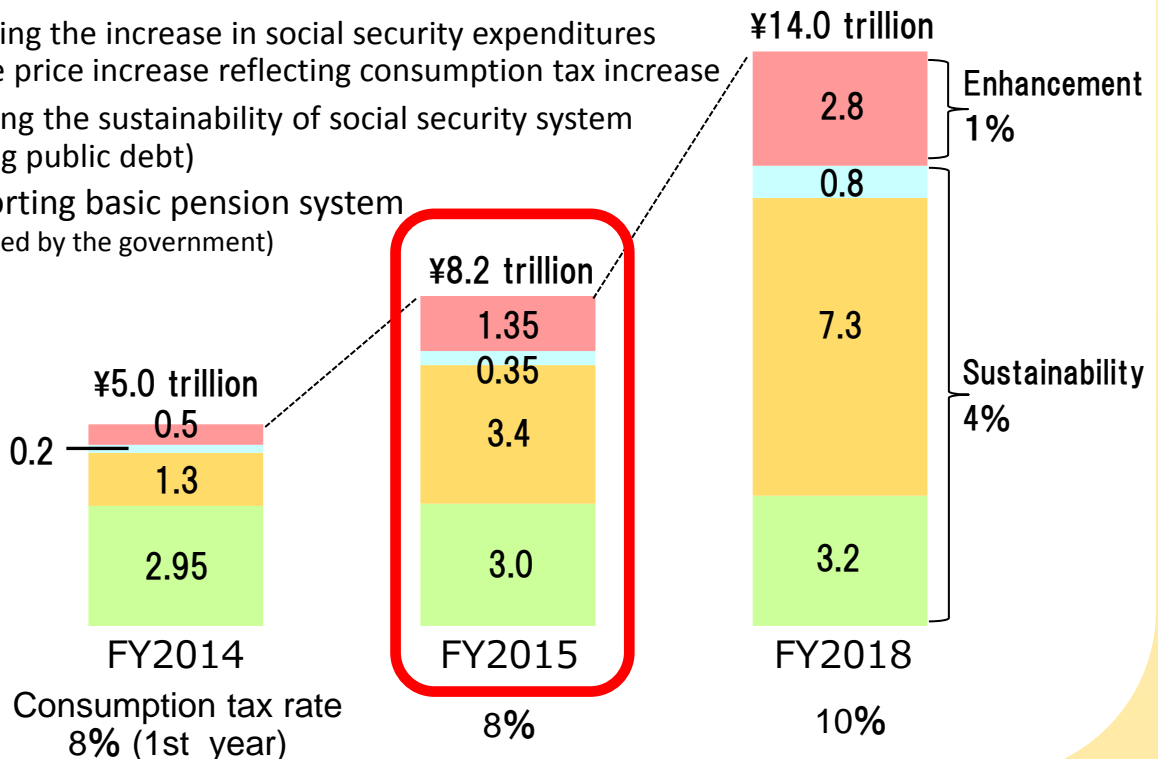


■ For enhancing social security system

■ For financing the increase in social security expenditures due to the price increase reflecting consumption tax increase

■ For ensuring the sustainability of social security system (= reducing public debt)

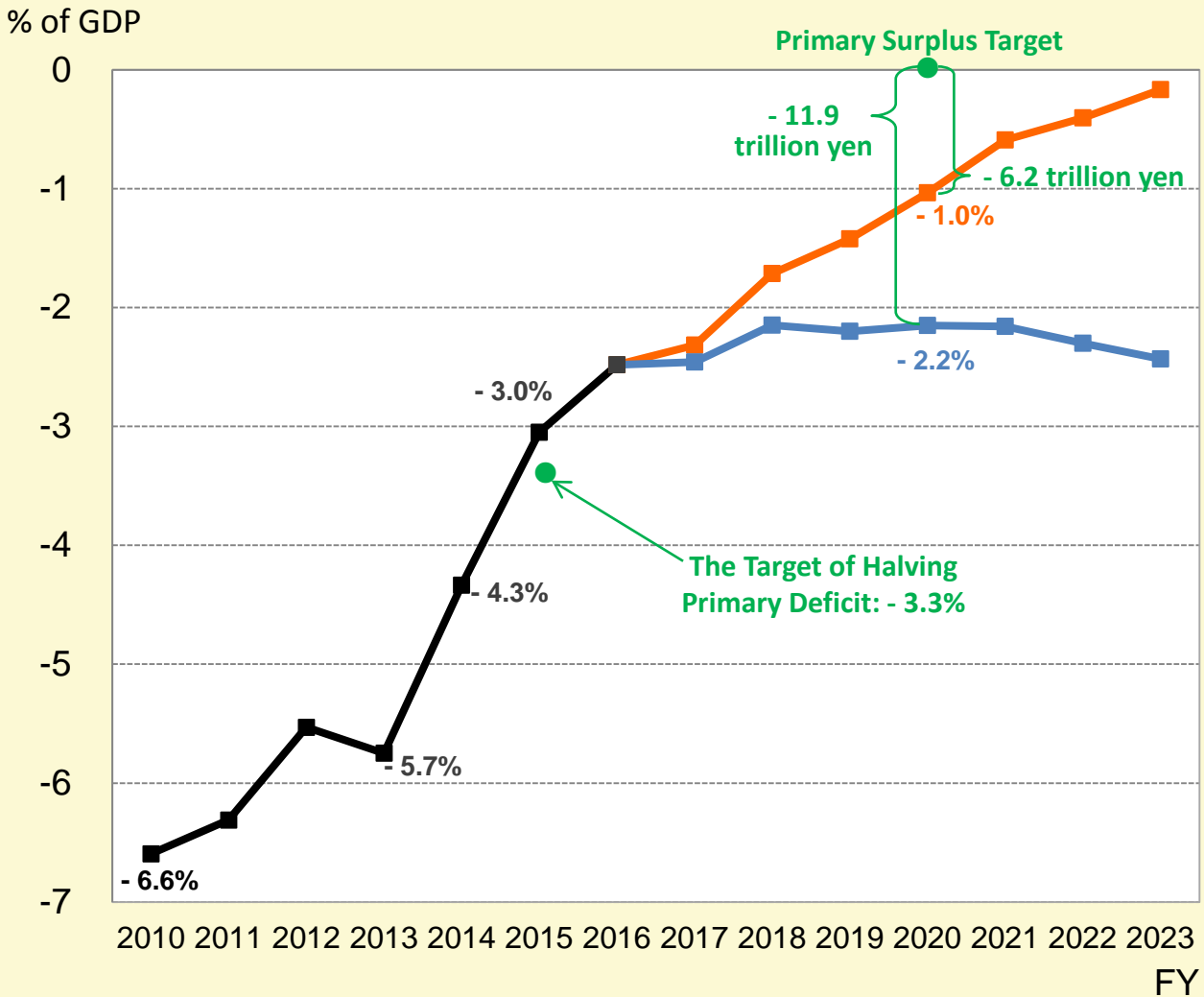
■ For supporting basic pension system (50% is funded by the government)



Economic and Fiscal Projections for Medium- to Long-term Analysis

- ✓ The government has already set up the following fiscal consolidation targets;
 1. To halve the primary deficit of the central and local governments to GDP ratio by FY2015 from the ratio in FY2010,
 2. To achieve a primary surplus by FY2020, and
 3. Thereafter, seeking to steadily reduce the public debt to GDP ratio
- ✓ According to “the Economic and Fiscal Projections for Medium- to Long-term Analysis” published by the Cabinet Office in July 2015, the FY2020 primary surplus target cannot be achieved even with the GDP growth of 3% in nominal and 2% in real.

Primary Balance of the Central and Local Governments to GDP ratio



- “Economic Revival Case”: The growth rate is 3% in nominal and 2% in real terms
- “Baseline Case”: The growth rate is mid 1% in nominal and slightly under 1% in real terms
- The Fiscal Consolidation Target

Clear Trajectory toward Fiscal Consolidation

- ✓ Therefore, the government formulated the fiscal consolidation plan called “The Plan to Advance Economic and Fiscal Revitalization” which shows the clear trajectory toward achieving the fiscal consolidation target and expenditure reform measures.

“The Plan to Advance Economic and Fiscal Revitalization” (excerpt) (Cabinet Decision on June 30th, 2015)

Across all expenditure items, the Abe Cabinet will further strengthen the measures which have been implemented over the past three years and proceed with a thorough review without any exceptions. Local governments will also proceed with thorough reviews in accordance with the central government’s efforts.

The government will strictly undertake full-fledged reforms from the budget for FY2016 which is the first year of the Plan. Designating the first three years of the Plan (FY2016-18) as the “intensive reform period,” the government will proceed with “Integrated Economic and Fiscal Reforms” intensively. Such efforts will be reflected in the annual budget formation process, all the related plans, basic policies, and bills.

At the midpoint of the Plan (FY2018), the government will assess the progress towards achieving the target. The government will use benchmarks of reform efforts during the intensive reform period such as the ratio of the primary deficit to GDP to around -1% for FY2018.

Regarding general expenditures of the central government *, the government is making efforts for expenditure reform in line with the past achievements of the Abe Cabinet, without presupposing an increase except in social security expenditure due to population aging, while taking into account a decline in total population and changes in wages and prices.

Regarding social security expenditures, the government carries out the enhancement of social security with the increase in consumption tax revenues, while considering the effects of population aging and the trend of increase in social security expenditure under the Abe Cabinet. It should be noted that the government will seek to control the year on year expenditure flexibly, not evenly. Local government expenditures shall be also controlled in line with the efforts by the central government.

Note: Regarding the benchmark of general expenditures of the central government, the trend of the past three years under the Abe Cabinet, indicating that an essential increase of approx. 1.6 trillion yen, shall be continued until FY 2018 with consideration of the future economic situation and price movements, etc.

* General expenditures = Total expenditures (in central government’s general account)
– (National debt service + Local allocation tax grants, etc.)

