

# Challenges for Fiscal Consolidation in Japan

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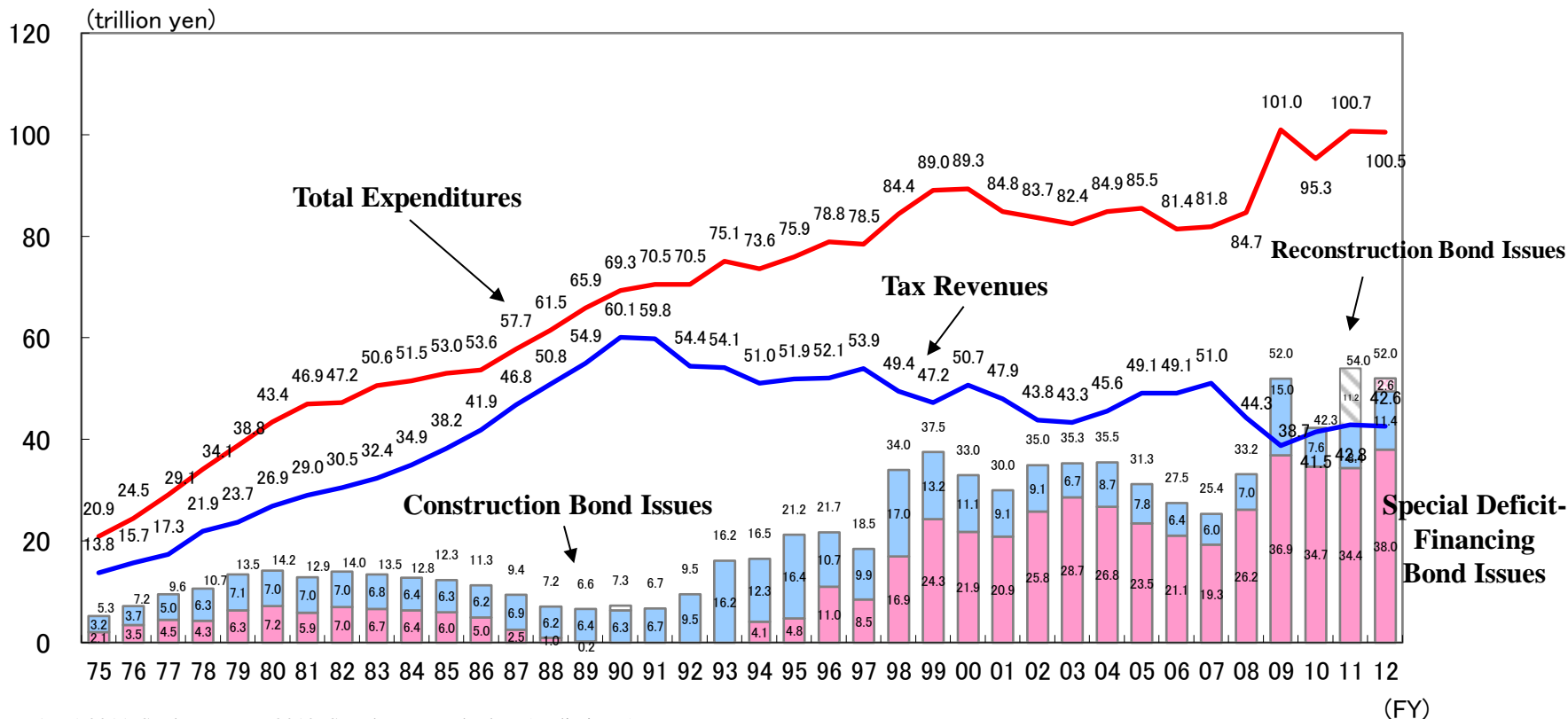
# Issues to be Discussed

- Japan's current fiscal situation
- How is it sustainable? Can it be sustained in the coming years?
- Struggle for fiscal consolidation
- Issues to be tackled in the future
- Japan's view of European situation

# **Japan's Current Fiscal Situations**

# Japan's Fiscal Situation①

## General Account Tax Revenues and Total Expenditures and Government Bond Issues



(Note 1) FY1975-2011: Settlement, FY2012: Supplementary budget (preliminary)

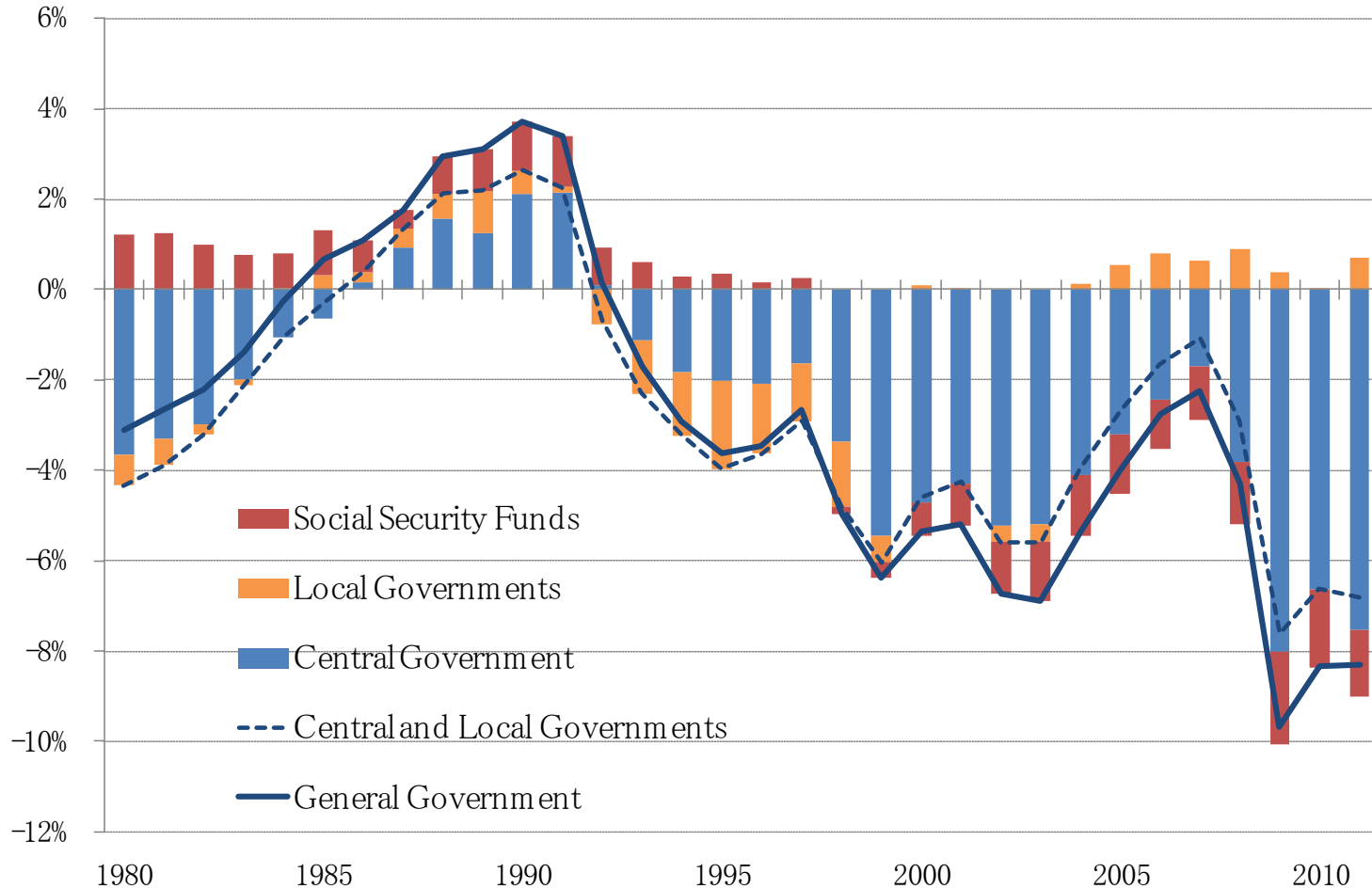
(Note 2) Ad-hoc deficit-financing bonds (approx. 1 trillion yen) were issued in FY1990 as a source of funds to support peace and reconstruction efforts in the Persian Gulf Region.

(Note 3) Reconstruction bonds (approx. 11.2 trillion yen) are issued in FY2011, which are used as a temporary means until when the financial resources are secured by the revenues including the special tax for reconstruction. Measures and projects for reconstruction from the Great East Japan Earthquake, expected to be implemented within the first five years (FY2011-FY2015), would be financed by the reconstruction bond issuance.

(Note 4) Ad-hoc deficit-financing bonds (2.6 trillion yen) were issued in FY2012 as a source of funds to secure the national subsidy (1/2 of benefit) to the basic pension.

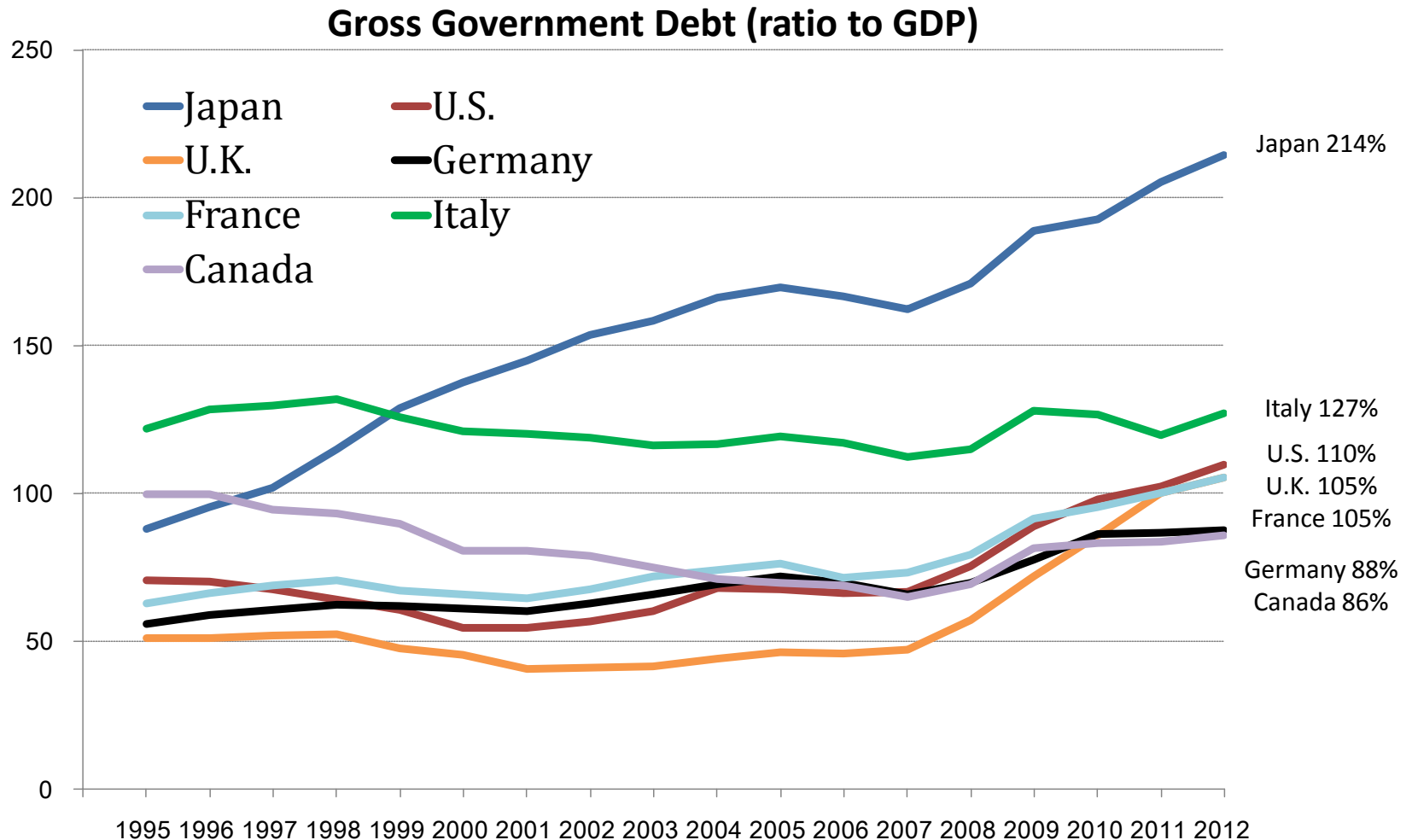
# Japan's Fiscal Situation②

## Primary Balance of General Government (ratio to GDP)



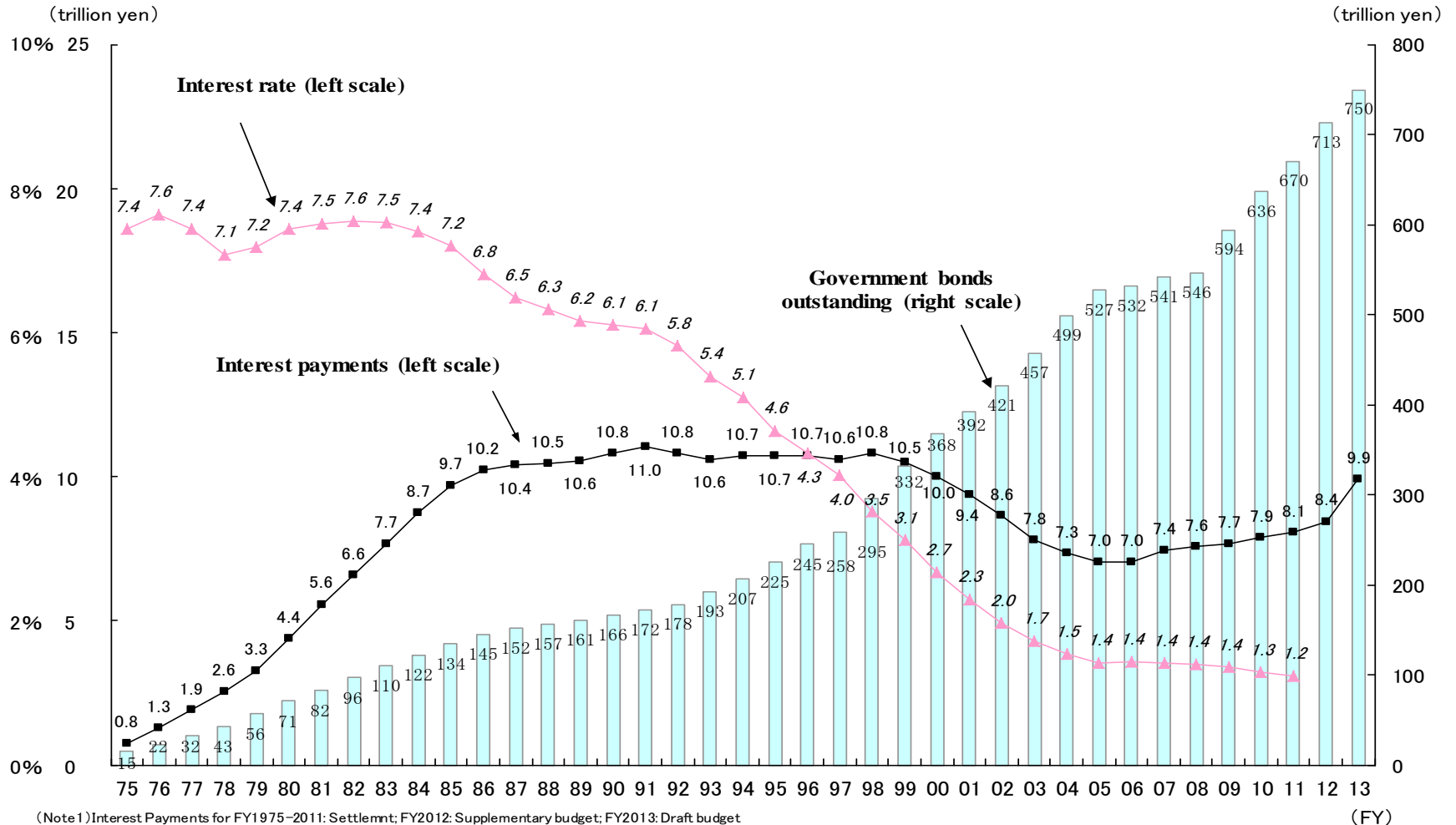
(Note) One-off capital transfers are excluded from expenditures and revenues.

# Japan's Fiscal Situation③



(Note) The figures are based on general governments (central governments, local governments and social security funds).

# Trends in Interest Rates and Payments



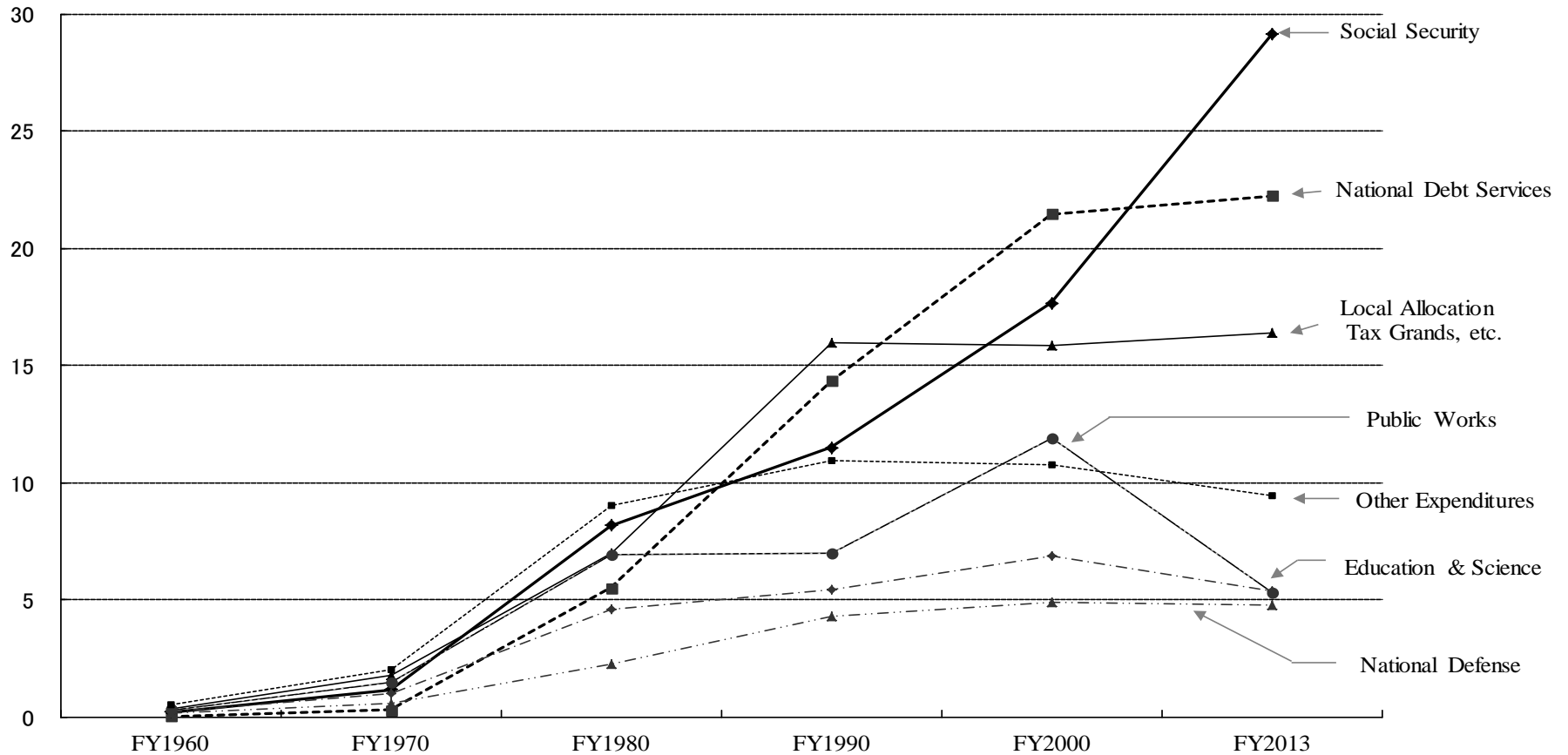
(Note1) Interest Payments for FY1975–2011: Settlement; FY2012: Supplementary budget; FY2013: Draft budget

(Note2) Government bonds outstanding for FY1975–2011: Actual; FY2012: Estimates; FY2013: Draft budget

(Note3) Government Bonds Outstanding includes reconstruction bonds issued in FY2011, FY2012 and FY2013 (FY2011: 10.7 trillion yen, FY2012: 11.2 trillion yen, FY2013: 12.2 trillion yen). Measures and projects for reconstruction from the Great East Japan Earthquake would be financed by reconstruction bonds, which are used as a temporary means until when the financial resources are secured by the revenues including the special tax for reconstruction.

# What are We Spending In?

(trillion yen)

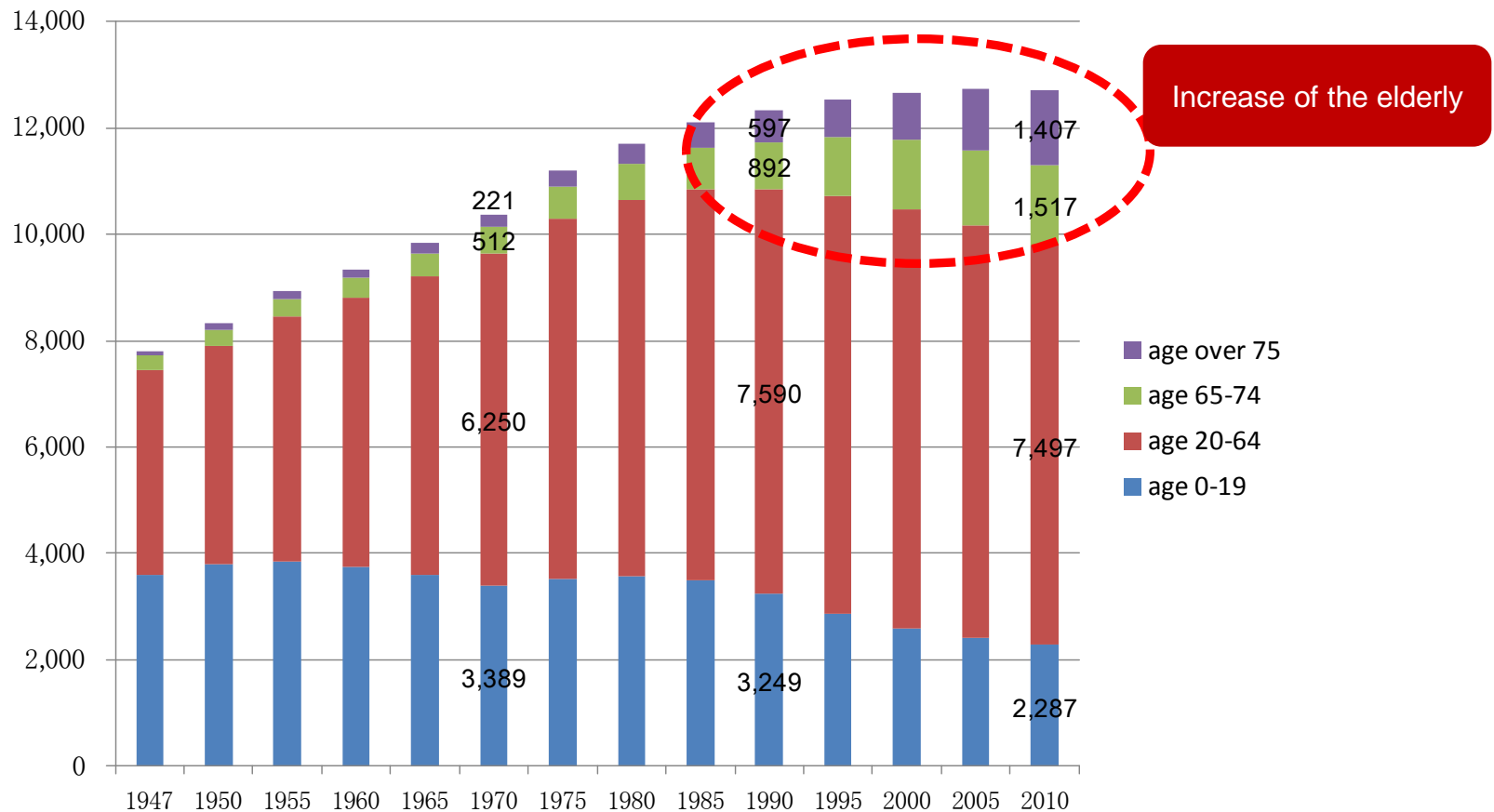


(Note) FY1960–2000: Settlement, FY2013: Draft budget



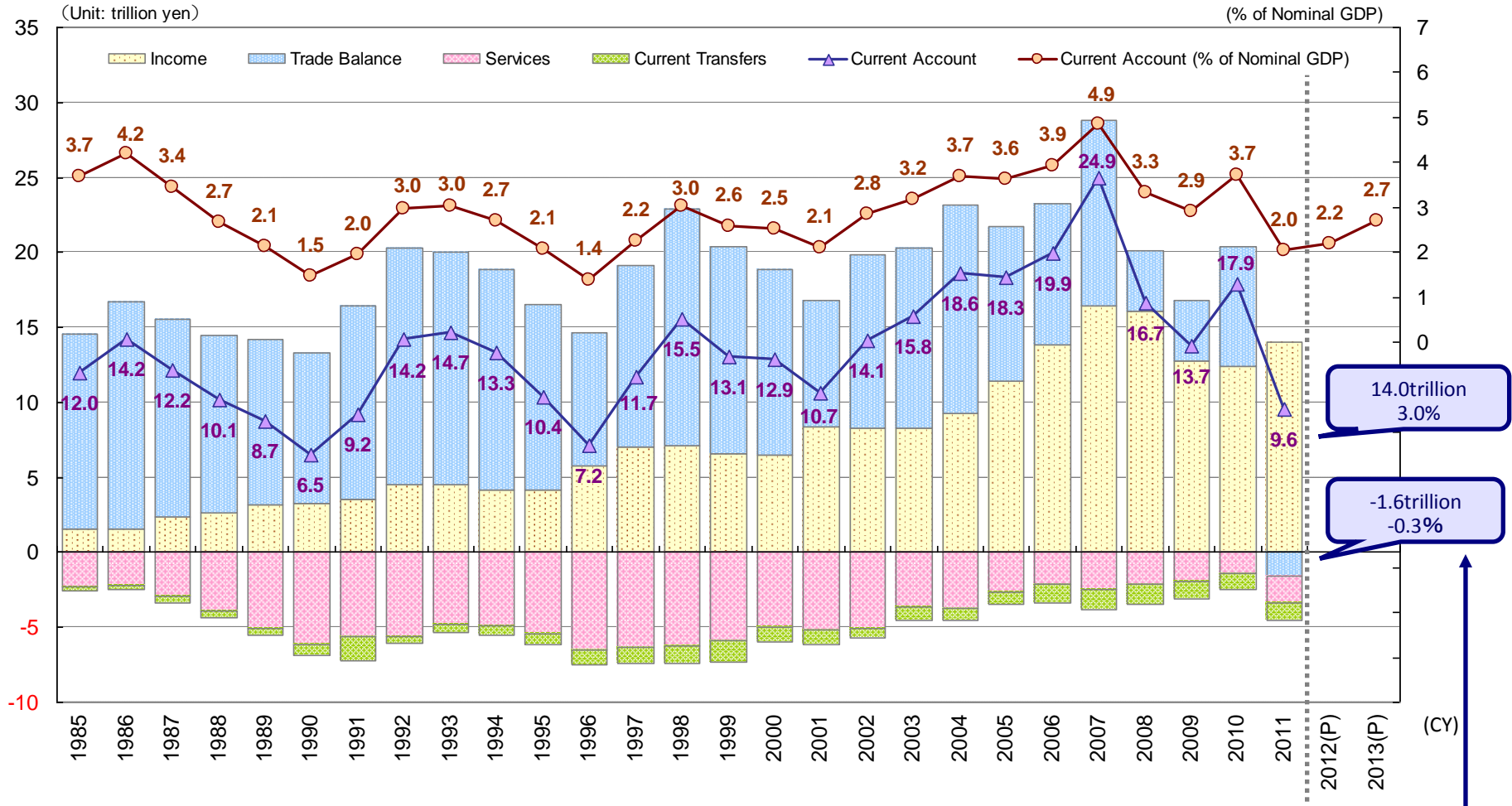
# Japan's Demographic Change

## Total Population Number and its Components



**How is it sustainable?  
Can it be sustained  
in the coming years?**

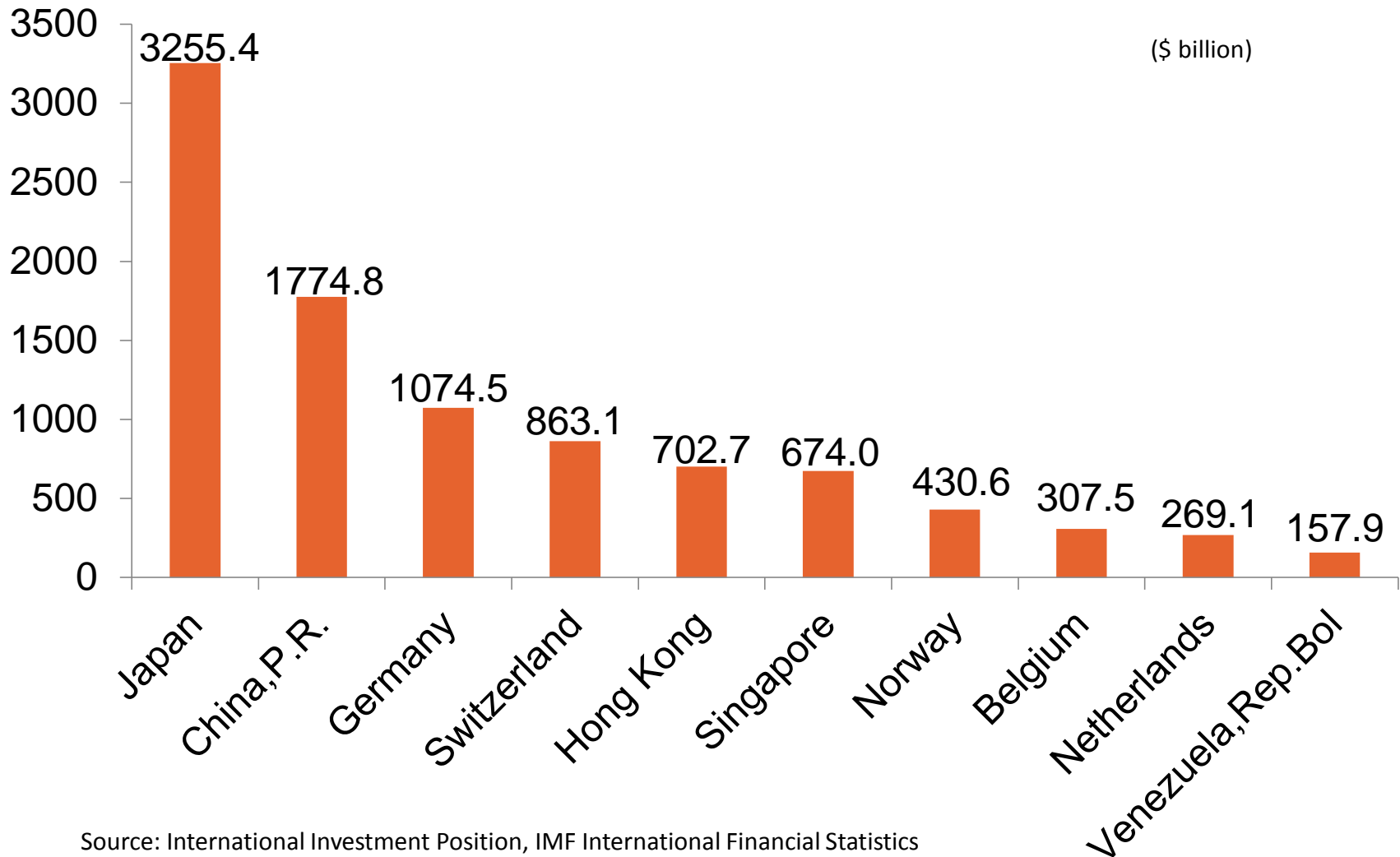
# Japan's Current Account



(Note) 2012, 2013: IMF estimates.

First deficit since 1980 (Trade statistics base)

# The Top 10 countries of Net Assets in 2011

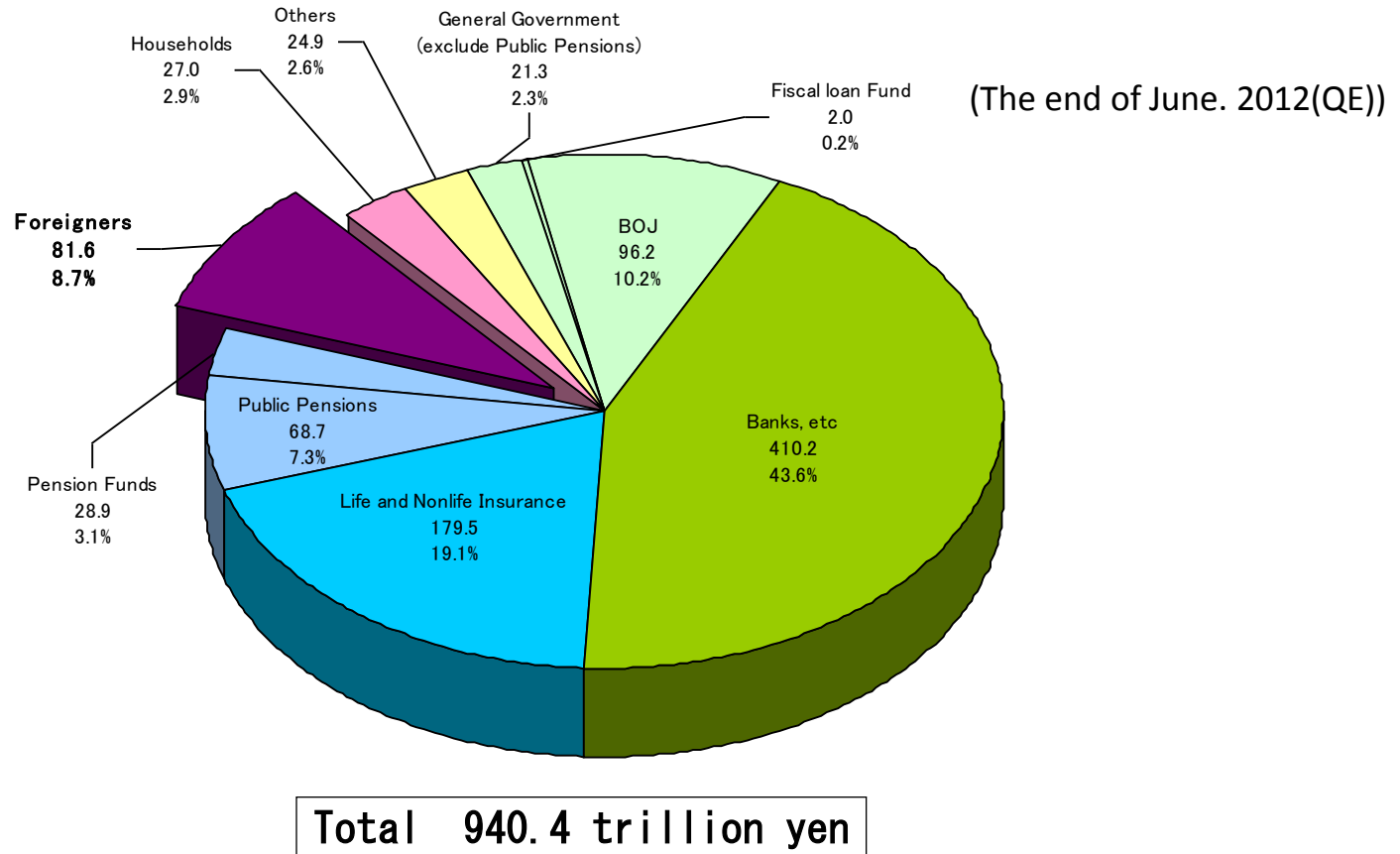


Source: International Investment Position, IMF International Financial Statistics

Note: Among 188 member countries, 110 countries submitted data.

# Breakdown of JGB Holders

○ More than 90% of JGBs are held by domestic investors and backed by their abundant personal financial assets

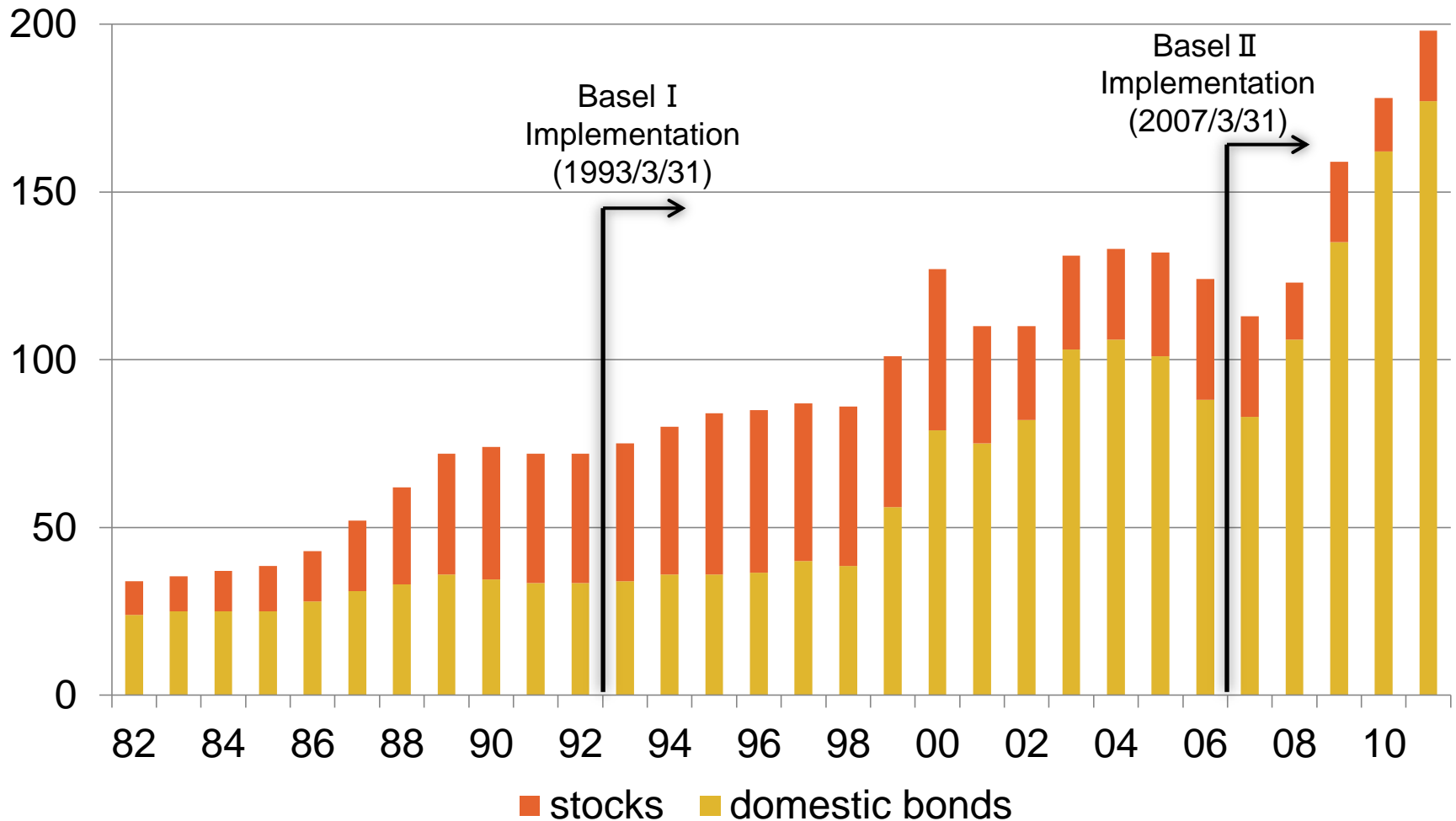


(Note1) "JGB" includes FILP Bonds and T-Bills.

(Note2) "Banks, etc." includes Japan Post Bank, "Securities investment trust" and "Securities Companies."

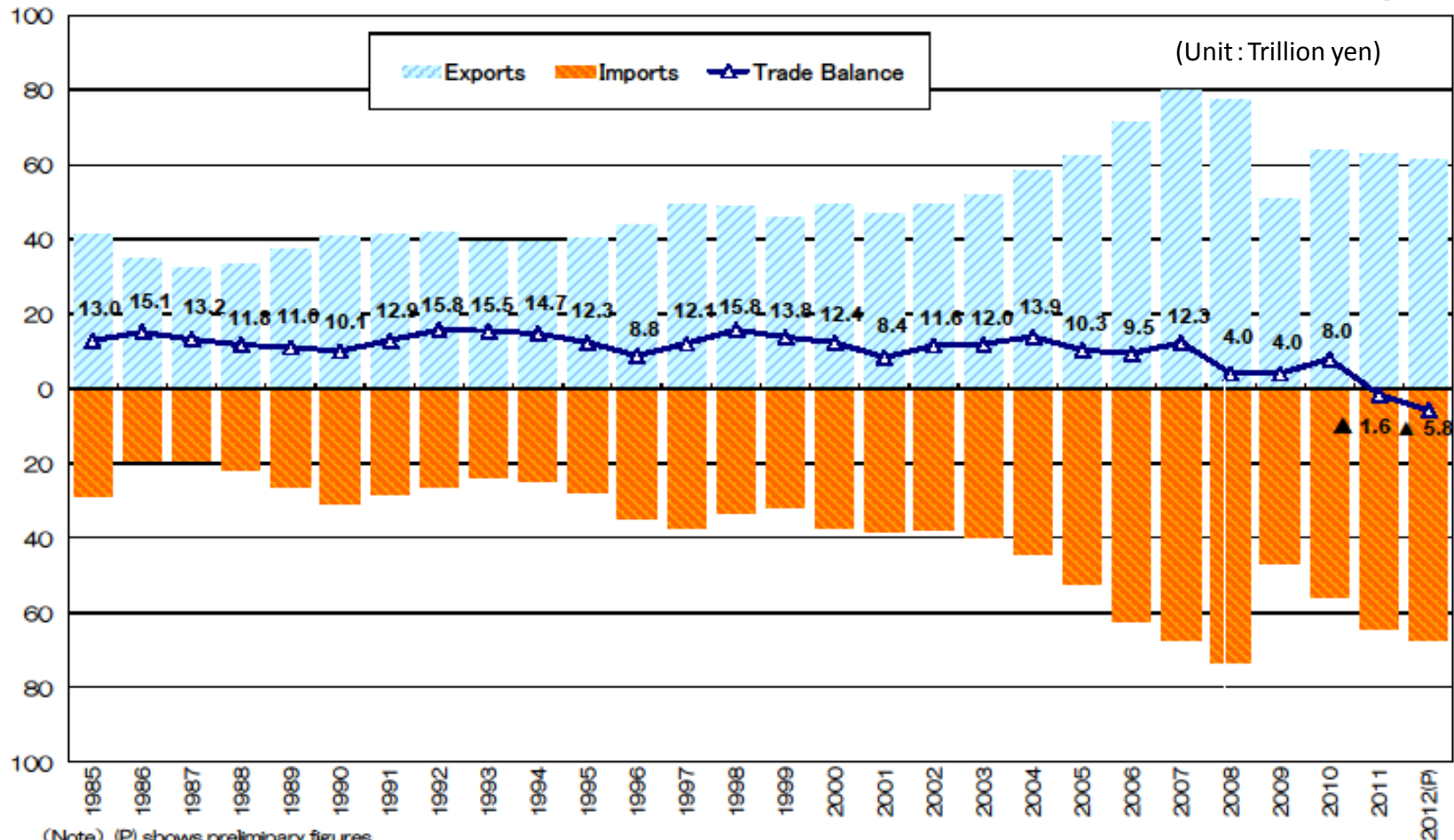
(Note3) "Life and Nonlife Insurance" includes Japan Post Insurance.

# Amount outstanding of stockholdings and bondholdings of Japan's major banks and regional banks



(Note) Data are not corrected retroactively although there have been changes in accounting system such as the implementation of current value accounting.

# Japan's Trade Balance (Based on Balance of Payments)



(Note) (P) shows preliminary figures.

Amount / definition of exports and imports in the balance of payments statistics is different from one in the trade statistics.

Source: Ministry of Finance Balance of Payments Statistics


# **Struggle for Fiscal Consolidation**




# Struggle for Fiscal Consolidation①

- Consumption Tax Rate 3%→5% (1997)
- The Fiscal Structure Reform Act (1997)
  - The act specified fiscal consolidation targets:
    - The ratio of fiscal deficits (central and local governments) should be reduced to less than 3% of GDP by FY2003.
    - The issuance of deficit-financing bonds should be reduced every year and discontinued by FY2003.
    - The ratio of the bond issuance to the total budget in FY2003 should be reduced, as compared with that in FY1997.

# Struggle for Fiscal Consolidation②

- The Fiscal Structure Reform Act (Continued)
    - Numerical multi-year expenditure targets were set for major categories:
      - Social security related expenditure, public investment, education, national defense, ODA, food, science and technology, energy measures, and small- and medium-sized enterprises.
-  However, the economic downturn after the Asian currency crises and the bankruptcies of large financial institutions had changed fiscal stance toward an expansionary one, and the act was finally suspended in 1998.

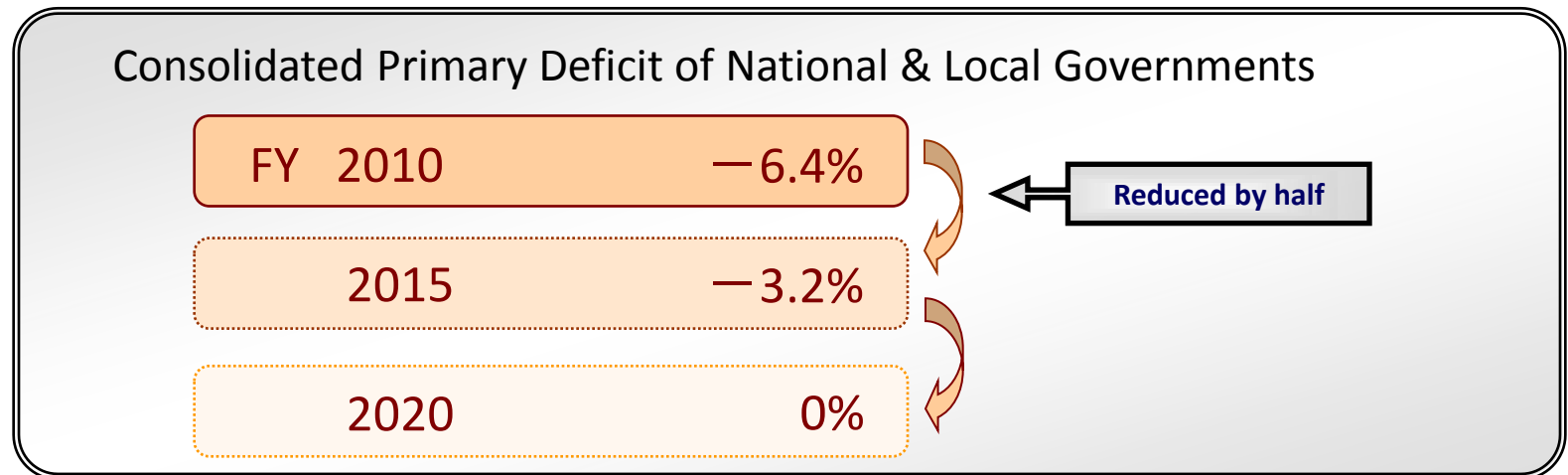
# Struggle for Fiscal Consolidation③

- Basic Policies 2006 (Cabinet decision)
    - Stipulates fiscal consolidation targets:  
FY2011 primary surplus for central and local governments
    - Numerical multi-year (5 year) expenditure targets for each spending category were set (e.g., social security and public investment, etc).
    - These targets were intended to be valid through FY2011 and indeed were valid for FY2007 and FY2008 budgets.
-  However, the targets were abandoned for FY2009 due to the global financial crisis and the change of ruling parties.

# Struggle for Fiscal Consolidation④

## Fiscal Management Strategy (Cabinet decision, 2010)

### Flow



### Stock

Steady reduction of public debt ratio to GDP from 2021

# Struggle for Fiscal Consolidation⑤

Medium-Term Fiscal Framework (Cabinet decision, August 2012)

○ Primary Expenditures from FY 2013 to FY 2015

(Unit: trillion yen)

	Overall Expenditure Limit		
	FY 2013	FY 2014	FY 2015
Primary Expenditures	71	71	71
Of which: Contingency Reserve for Economic Crisis Response and Regional Revitalization (0.9 for FY2011)	0.9	0.9	0.9

# Struggle for Fiscal Consolidation⑥

## The Comprehensive Reform of Social Security and Tax

### Maintain and Enhance the Social Security System

To maintain the current social security system where spending is rapidly increasing year after year due to population aging (to secure stable financial resources)

+

To address the problems including doctor shortage, shortage of special nursing home for elderly, and the waiting-list children etc.

### Achieving simultaneously

### Achieve the Fiscal Consolidation Targets

To get rid of the worst fiscal condition in the advanced countries  
“Halve primary deficit by FY2015, achieve primary surplus by FY2020”  
and to prevent financial crisis triggered by Japan



National Council is  
launched



Gradually raising  
the consumption tax  
rate to 10% in  
October 2015

# The Comprehensive Reform of Social Security and Tax

- **Earmarked to the social security expenditures**
  - The national consumption tax revenue will be legally earmarked to social security expenditures.
    - For the 4 social security expenditures (pension, medical care, long-term care and childcare).
    - Not for the enlargement of the bureaucracy, but for the people.
  - Local consumption tax revenue is used as financial sources for social security.
- **2-Stage increase of the consumption tax rate**
  - From 1<sup>st</sup> April, 2014     8% (national:6.3%    local:1.7%)
  - From 1<sup>st</sup> October, 2015   10% (national:7.8%    local:2.2%)

※ Including local allocation tax, local consumption tax revenue generated from this tax increase is equivalent to the consumption tax rate of 0.92% from April 1st 2014 and 1.54% from October 1<sup>st</sup>.

# **Issues to be Tackled in the Future**



# Issues to be Tackled in the Future①

- Long-term Projection under Prudent Assumptions
  - Clarification of the overall structure of fiscal conditions and showing medium- to long-term future projection for fiscal position will help the public people to understand the necessity of further fiscal consolidation.
- Reforming the Social Security System
  - Redesigning the social security system to redefine the clear relationship between benefits and burdens to improve “efficiency”, as well as redesigning the tax system from the medium-term point of view.

# Issues to be Tackled in the Future<sup>②</sup>

- Statutory Framework on Fiscal Consolidation
  - In politics, pressures for “fiscal expansion” overrides those for “fiscal austerity”.
  - So, strong political commitment from a long-term point of view is necessary for continuing fiscal consolidation.
  - Setting up a legal framework on fiscal consolidation is a crucial step to show strong political will.

# Issues to be Tackled in the Future③

- Targets and Measures for Fiscal Consolidation
  - To set forth a new target for fiscal consolidation, and put the basic principles of fiscal management into law is needed to reinforce the fiscal discipline.
  - Flexibility is necessary to adapt to economic downturns.

# **Japan's view of European situation**

# General Government Financial Balances (International Comparison)

(%)

CY	1998	1999	2000	2001	2002	2003	2004	2005
Japan	-7.0	-8.2	-8.0	-6.2	-7.5	-7.8	-6.4	-5.2
U.S.	-0.9	-0.7	-0.1	-2.2	-5.5	-6.3	-5.8	-4.6
U.K.	-0.1	0.9	3.7	0.6	-2.0	-3.7	-3.6	-3.3
Germany	-2.3	-1.6	1.1	-3.1	-3.8	-4.1	-3.8	-3.3
France	-2.6	-1.8	-1.5	-1.7	-3.3	-4.1	-3.6	-3.0
Italy	-2.9	-2.0	-0.9	-3.2	-3.2	-3.6	-3.6	-4.5
Canada	0.1	1.6	2.9	0.6	-0.1	-0.1	0.8	1.5

CY	2006	2007	2008	2009	2010	2011	2012	2013
Japan	-3.2	-2.5	-3.0	-8.8	-8.7	-9.1	-9.2	-9.0
U.S.	-3.6	-4.3	-7.8	-12.8	-11.9	-11.0	-9.3	-7.5
U.K.	-2.7	-2.8	-5.0	-10.9	-10.1	-8.3	-6.6	-6.9
Germany	-1.7	0.2	-0.1	-3.1	-4.2	-0.8	-0.2	-0.4
France	-2.4	-2.7	-3.3	-7.6	-7.1	-5.2	-4.5	-3.4
Italy	-3.4	-1.6	-2.7	-5.4	-4.3	-3.8	-3.0	-2.9
Canada	1.6	1.4	-0.4	-4.8	-5.4	-4.3	-3.5	-3.0

(Source) OECD "Economic Outlook 92" (December, 2012)

(Note) Figures represent the general government-based data (including the central/local governments and the social security funds), except for Japan and the U.S where the figures of the social security funds are excluded.

The following figures include social security.

(%)

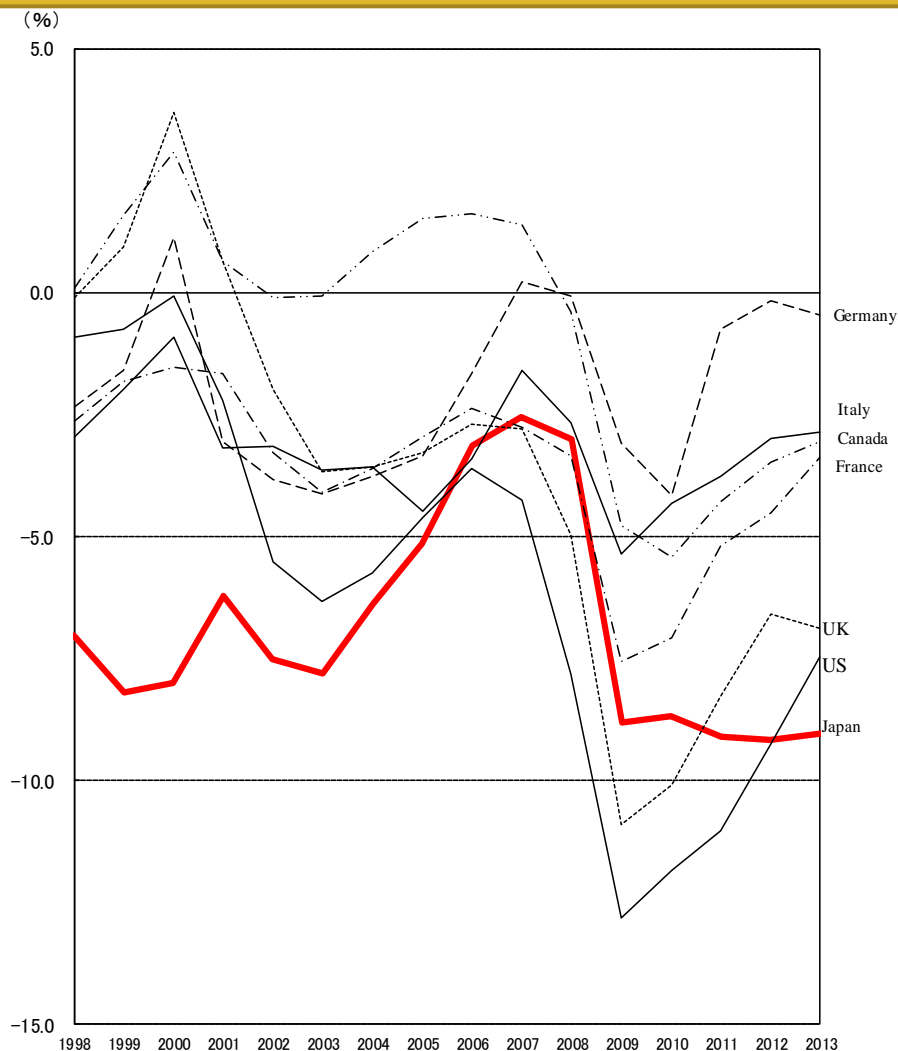
CY	1998	1999	2000	2001	2002	2003	2004	2005
Japan	-5.7	-7.1	-7.4	-6.0	-7.7	-7.8	-7.3	-5.7
U.S.	0.3	0.7	1.5	-0.6	-4.0	-5.0	-4.4	-3.3

CY	2006	2007	2008	2009	2010	2011	2012	2013
Japan	-3.3	-2.8	-3.6	-10.1	-9.5	-10.0	-10.2	-10.2
U.S.	-2.2	-2.9	-6.6	-11.9	-11.4	-10.2	-8.5	-6.8

(Source) OECD "Economic Outlook 92" (December, 2012)

(Note 1) FY2013 draft budget is not reflected in the above data.

(Note 2) Figures for Japan exclude one-off factors.



# General Government Gross Debt (International Comparison)

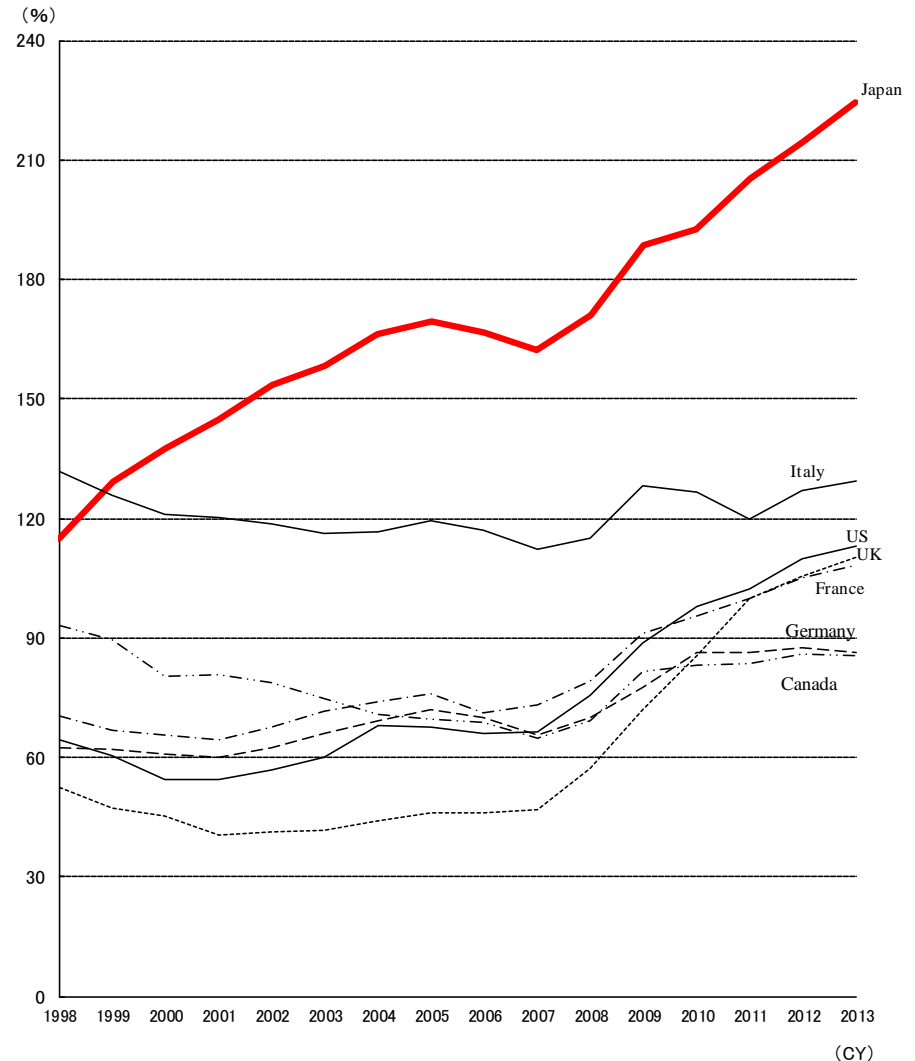
	(%)								
CY	1998	1999	2000	2001	2002	2003	2004	2005	
Japan	114.9	129.0	137.6	144.7	153.5	158.3	166.3	169.5	
U.S.	64.2	60.5	54.5	54.4	56.8	60.2	67.8	67.4	
U.K.	52.3	47.4	45.2	40.5	41.1	41.6	43.9	46.1	
Germany	62.3	61.8	60.8	60.1	62.5	65.9	69.3	71.8	
France	70.4	66.8	65.7	64.3	67.5	71.7	74.1	76.0	
Italy	131.8	125.7	120.8	120.1	118.8	116.3	116.8	119.4	
Canada	92.9	89.6	80.5	80.7	78.6	74.7	70.8	69.7	

	(%)								
CY	2006	2007	2008	2009	2010	2011	2012	2013	
Japan	166.8	162.4	171.1	188.7	192.7	205.3	214.3	224.3	
U.S.	66.1	66.5	75.4	88.8	97.8	102.2	109.8	113.0	
U.K.	45.9	47.0	57.1	72.0	85.6	99.9	105.3	110.4	
Germany	69.8	65.6	69.9	77.5	86.3	86.4	87.6	86.2	
France	71.2	73.0	79.3	91.2	95.5	100.0	105.1	108.2	
Italy	117.0	112.4	114.9	128.0	126.7	119.8	127.0	129.6	
Canada	68.6	65.0	69.2	81.5	83.0	83.4	85.8	85.5	

(Source) OECD "Economic Outlook 92" (December, 2012)

(Note1) Figures represent the general government-based data (including the central/local governments and the social security funds).

(Note2) FY2013 draft budget is not reflected in the above data.



# General Government Net Debt (International Comparison)

(%)

CY	1998	1999	2000	2001	2002	2003	2004	2005
Japan	45.4	53.0	59.7	65.5	74.5	77.6	82.4	82.2
U.S.	44.9	40.2	35.3	34.6	37.2	40.9	48.6	49.0
U.K.	32.4	29.0	26.8	23.3	23.8	24.0	26.0	26.9
Germany	36.3	34.5	33.9	36.2	40.4	43.4	47.4	49.7
France	40.6	33.6	35.2	36.8	41.9	44.4	45.4	43.4
Italy	106.4	100.5	94.9	95.8	95.2	92.3	92.0	93.3
Canada	59.3	54.7	45.3	43.2	41.6	37.7	34.3	30.2

CY	2006	2007	2008	2009	2010	2011	2012	2013
Japan	81.0	80.5	95.3	106.2	112.8	125.3	134.3	144.3
U.S.	48.4	48.0	53.6	65.9	74.3	81.6	86.5	90.1
U.K.	27.4	28.3	33.1	43.9	53.8	67.8	73.0	78.0
Germany	47.8	42.5	44.5	49.0	49.8	51.3	50.3	49.7
France	37.4	35.7	45.9	52.1	57.3	63.0	66.4	68.8
Italy	90.5	87.1	90.0	100.9	99.5	94.1	98.1	100.6
Canada	25.7	22.4	22.0	27.6	29.7	32.3	34.9	36.8

(Source) OECD "Economic Outlook 92" (December, 2012)

(Note1) Figures represent the general government-based data (including the central/local governments and the social security funds).

(Note2) FY2013 draft budget is not reflected in the above data.

