Japan's Budget at 7-Year High

— Record Drop in New Bond Issues —

By Aoki Masaru

Japan's Abe administration, inaugurated in September 2006, has submitted its first budget to the parliament now in regular session since late January. The ¥82,908.8 billion general account budget for fiscal 2007 starting April 1 is the largest in seven years, representing a 4.0% rise from the previous year for the first gain in two years. Contributing to the increase are greater expenditures on some programs such as social security and debt servicing.

New government bond issues, which cover revenue shortages and exclude refunding bonds, are planned to decline by ¥4,541 billion from the level under the initial fiscal 2006 budget (before supplementation) to ¥25,432 billion, the lowest since fiscal 1998. The decline is the largest ever, as instructed by Prime Minister Abe Shinzo, exceeding the previous record ¥4,417 billion cut in fiscal 2006. The budget also calls for repaying ¥1,732.2 billion for part of borrowings from a special account for tax grants to local governments. The borrowings have been criticized as "hidden government debt." The new bond issue reduction and the "hidden debt" repayment work to cut the amount of growth in government debt by ¥6,270 billion.

Tax revenues for fiscal 2007 are estimated to score the sharpest-ever growth of 16.5% to ¥53,467 billion, topping ¥53 trillion for the first time since fiscal 1998. Their share of total revenues will rise to 64.5%.

Of the new bond offerings, deficit-financing bonds will be down ¥4,288 billion to a six-year low ¥20,201 billion. Other bonds financing public works projects are planned to drop 4.6% to a 30-year low ¥5,231 billion. The share of the new government borrowings in total revenues will also fall by 6.9 percentage points to 30.7%, the lowest since 20.0% in the initial fiscal 1998 budget.

A primary budget deficit, which represents an excess of expenditures other than debt-servicing costs over tax and nontax revenues other than debt issues, is planned to shrink to ¥4.4 trillion from ¥11.2 trillion under the initial fiscal 2006 budget. This means a major step toward achieving a primary budget surplus by the government-set target year of fiscal 2011. The primary budget balance indicates the extent to which tax and nontax revenues other than debt issues can cover expenditures for policy implementation.

Among outlays, general expenditures tied to policy enforcement are to rise 1.3% to ¥46,978.3 billion due partly to an increase in the government's contributions to basic pension benefits. These expenditures will expand for the first time in three years. The government plans to reduce public works spending by 3.5% to ¥6,947.2 billion, the first figure below ¥7 trillion in 20 years. Official development assistance to developing countries is also to be cut by 4.0%. But social security expenses, including healthcare insurance and pension benefits, are set to increase 2.8% to ¥21,140.9 billion on the aging of the population, working to raise overall general expenditures. The share of social security expenses in general expenditures will hit an all-time high 45%.

Expenditures for small and medium-sized companies are budgeted to score a 0.6% increase, the first rise in three years, including outlays for the Abe administration's priority policy of supporting second-chance job opportunities for workers. Education, science and technology promotion expenditures are also planned to increase 0.1% as the administration is seeking to give another priority to educational reconstruction. A total ¥309.2 billion is earmarked for measures to promote economic growth strategy.

Tax grants to local governments are set to grow 2.6% to ¥14,931.6 billion, the first rise in four years. While the government has tried to cut tax grants to local governments on improvements in local public finances, these tax grants are legally fixed at a certain percentage of central government tax revenues and automatically expand on a tax revenue rise. Debt services – government bond interest payments and redemptions – are planned to post a substantial rise of 11.9% to ¥20,998.8 billion, including expenses to cover the repayment of borrowings from the special account for tax grants to local governments. Debt services will top ¥20 trillion for the first time in seven years. The government projects a long-term interest rate at 2.3% for fiscal 2007 against 2.0% in the previous year. The long-term interest rate, or the market yield on the benchmark 10-year government bond issue, is used for estimating interest payments.

The fiscal investment and loan program (FILP), which is called the second budget channeling funds to public corporations and local governments, aggregates ¥14,162.2 billion for fiscal 2007, down 5.6% from the previous year. The FILP will decline for the eighth consecutive year to the lowest level in 29 years since the ¥14,887.6 billion in fiscal 1978. As FILP reform has made progress in prompting public corporations to raise funds on their own in the market, the program size falls to some one-third the past peak of ¥40,533.7 billion reached in fiscal 1996. Outstanding fiscal investment and loans are estimated to decrease by some 10% during fiscal 2007 to ¥249.7 trillion, slipping below ¥250 trillion for the first time in 17 years.

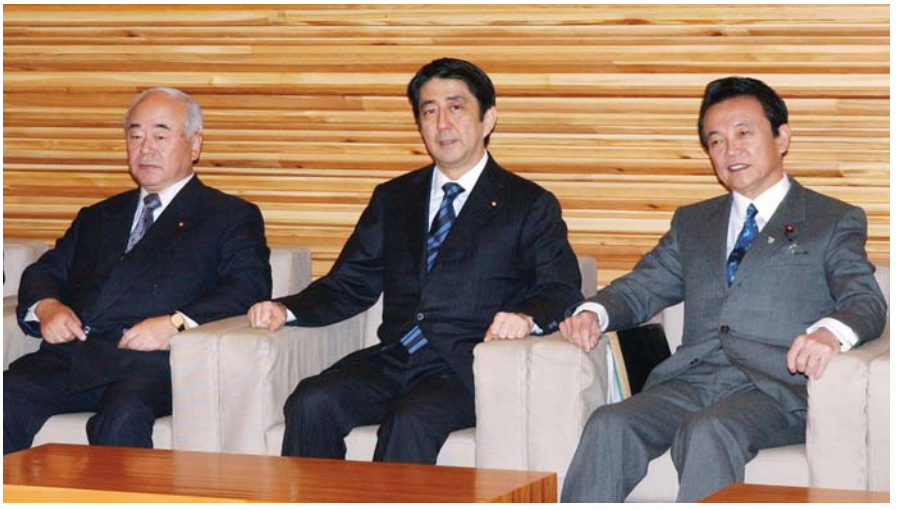
The government has incorporated ¥1.8 trillion in special account surpluses into the fiscal 2007 general account budget in line with a plan to submit to parliament a bill this year to reform special accounts that have come under fire for their lack of transparency and wasteful spending. Net special account expenditures, which exclude overlaps between accounts, total ¥175 trillion, representing a decline of ¥49.9 trillion from the previous year.

The special account reform is designed to consolidate road development and 30 other existing special accounts into 17, unify rules on account surpluses that now differ from one account to another, and allow special account surpluses to be transferred to the general account. The government is seeking to implement the reform by April after the bill's enactment. In anticipation of the reform, the fiscal 2007 budget calls for consolidating power development and five other special accounts into three and transferring ¥1.8 trillion in special account surpluses to the general account. The surpluses include ¥1,629 trillion from the special account for foreign exchange funds, ¥79.4 billion from that for industrial investment and ¥49.2 billion yen from that for trade reinsurance.

The fiscal 2007 budget also features new corporate tax incentives, including an expanded asset depreciation system, and an increased tax burden on households totaling ¥1.1 trillion stemming from the elimination of a fixed-rate income tax credit. As estimated by the Ministry of Finance, the tax credit abolition may work to increase tax contributions by ¥17,600 for a standard family of four with an annual income of ¥5 million and by ¥41,000 for a family with ¥7 million.

Supported by a record tax revenue increase of ¥7,589 billion on economic expansion, the fiscal 2007 budget is set for a record cut in new bond issues other than refunding bonds without increasing taxes. This makes a steady contribution to reducing an annual budget deficit in the first year of a five-year structural fiscal reform plan. "This is a budget that sends a strong message demonstrating the government's willingness to consolidate public finances," Prime Minister Abe told reporters as the government adopted the fiscal 2007 budget on Dec. 24, 2006.

Photo: Kyodo News



A ray of hope shines in the Abe administration's effort to restore a balanced budget as tax revenue grows on economic expansion. Photo:Prime Minister Abe Shinzo (center) at a Cabinet meeting

But Japan's outstanding government bonds are estimated to reach another record high at ¥547.1 trillion at the end of fiscal 2007. This is equivalent to some 10 years of central government tax revenues. Per capita government debt at the end of fiscal 2007 is projected at ¥4,280,000, up ¥40,000 from a year earlier. Long-term general government debt, covering both local and central government debt, is estimated to increase by ¥10 trillion to ¥773 trillion, or some 150% of Japan's gross domestic product (GDP). As a percentage of GDP, Japan's general government debt is far higher than in any other industrial nation. Given the huge outstanding government bonds, a rise of one percentage point in the long-term interest rate is expected to boost annual government bond interest payments by ¥1.6 trillion. If the economy gets on a solid growth path, the government will have to redouble expenditure-cutting efforts to offset a debt service increase on an interest rate hike.

In July 2006, the administration of then Prime Minister Koizumi Junichiro adopted "Basic Policies for Economic/Fiscal Management and Structural Reform 2006," calling for achieving a primary budget surplus on a general government basis in fiscal 2011. The government then estimated ¥16.5 trillion in additional financial resources to be required to attain the target and made a broad plan to cut spending by ¥11.4-¥14.3 trillion and increase revenues by ¥2.2-¥5.1 trillion through tax revenue growth and tax increases. The Koizumi administration indicated some revenue reform proposals, including a measure to earmark consumption tax revenues for social security expenditures. But it fell short of specifying the margin or timing of a consumption tax hike, leaving the next administration to consider these specifics.

On Dec. 26, two days after the fiscal 2007 budget was adopted, the Cabinet Office revised the estimate on additional financial resources required for a balanced budget downward from ¥16.5 trillion to ¥9.5 trillion. The downward revision reflected a faster-than-expected tax revenue increase and some progress in spending reductions. The revised estimate theoretically means that the government would no longer have to take any revenue-boosting measures such as a consumption tax hike. The latest estimate is thus expected to affect future discussions on a consumption tax hike. JS

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