Japan’s Fiscal Policy: the IMF’s View

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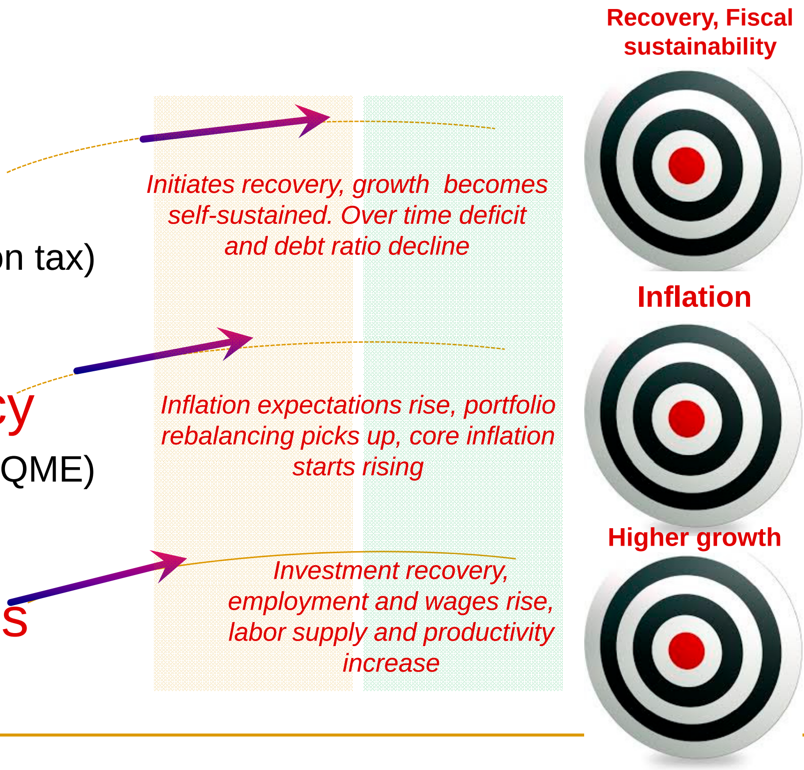
The three arrows of Abenomics

Fiscal policy
(stimulus, consumption tax)

Monetary policy
(2 percent inflation, QQME)

Growth reforms
(TPP, Diet session)



The "second arrow": flexible fiscal policy

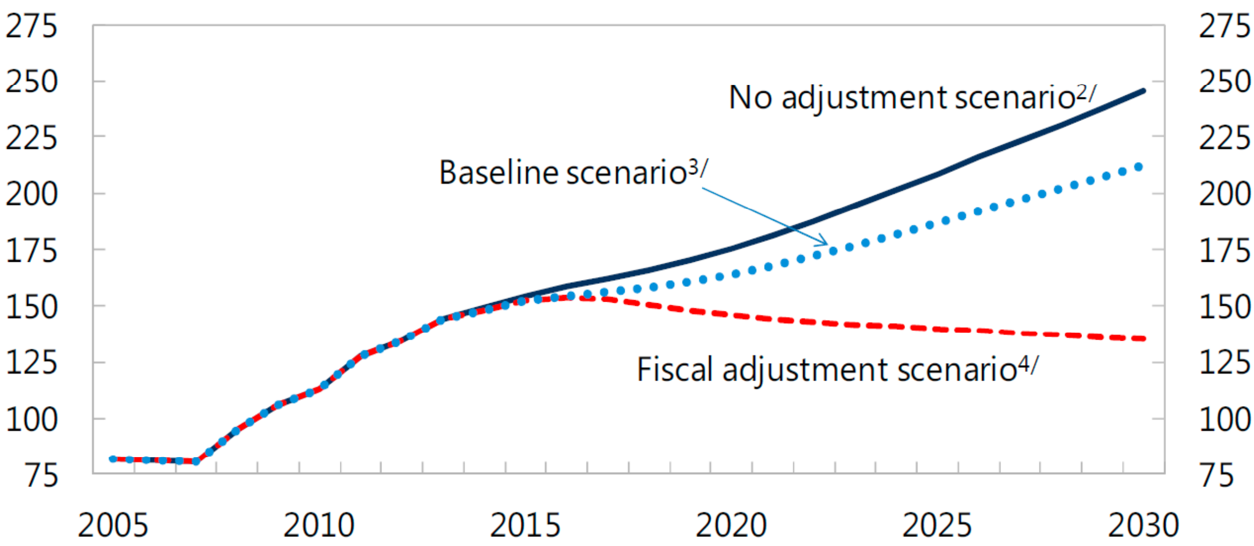
Current fiscal plans account for half of the needed adjustment (5.5 percent out of 11 percent of GDP). Decision on consumption tax increase is an important achievement

To bring public debt firmly on a downward path, an ambitious and concrete consolidation plan beyond 2015 is urgently needed

Both growth and adjustment are needed. The consolidation plan should be as growth-friendly as possible

Japan: Net Public Debt 1/

(In percent of GDP)



Sources: Cabinet Office; and staff estimates and projections.

1/ Net debt of the general government including the social security fund.

2/ No consumption tax increases but automatic withdrawal of fiscal stimulus.

3/ Consumption tax increases to 8 percent in 2014 and 10 percent in 2015.

4/ Policy adjustment scenario assumes an 11 percentage points of GDP improvement (baseline scenario + 5½ points) in the structural primary balance between 2011 and 2020.

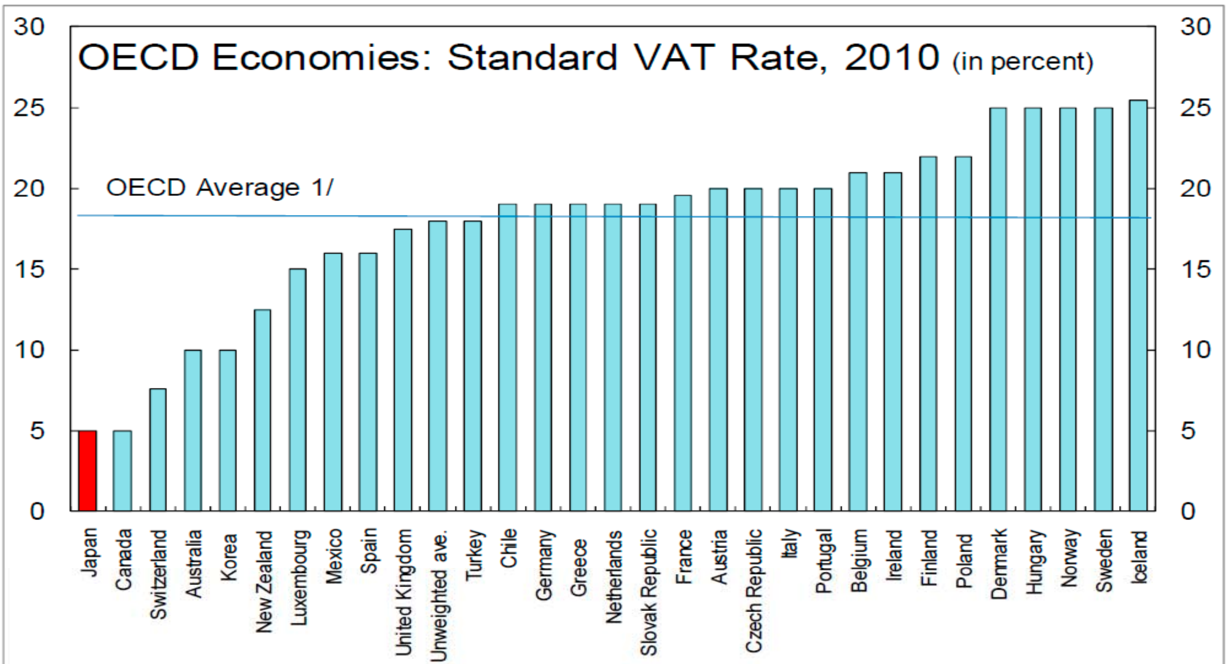
Options for Fiscal Adjustment Between end-2011 and 2020

(Excluding reconstruction spending, in percentage points of GDP)

	Staff Estimates of Authorities' Current Plan	Adjustment Options
Consumption tax rate (In percent, currently at 5 percent)	10	15
Corporate tax rate (In percent, currently at 35 percent) 1/	35	25-30
Fiscal consolidation measures		
Revenue		
Increase consumption tax	2.5	5.0
Cut corporate tax		-0.75
Broaden personal income tax base		0.75
Eliminate preferential tax treatment for pension benefit income		¼ 5/
Collect pension contributions from dependent spouses of workers covered by the Employees' Insurance		¼ 5/
Collect health insurance premiums from dependent spouses of workers covered by the Employees' Insurance		✔
Reduce pension payroll tax		-0.5
Introduce carbon tax 2/	✔	✔
Raise inheritance tax further		✔
Expenditure		
Withdraw financial crisis fiscal stimulus	1.0	1.0
Withdraw the recent stimulus	1.0	1.0
Curb growth rate of nominal non-social security spending (excluding interest payments)	1.5	2.5 3/
Limit annual nominal growth in social security spending (excluding the items below)	-0.5	1.0 4/
Raise pension eligibility age to 67 or higher		¼ 5/
Reduce benefits for wealthy retirees		¼ 5/
Total savings	5.5	11.0

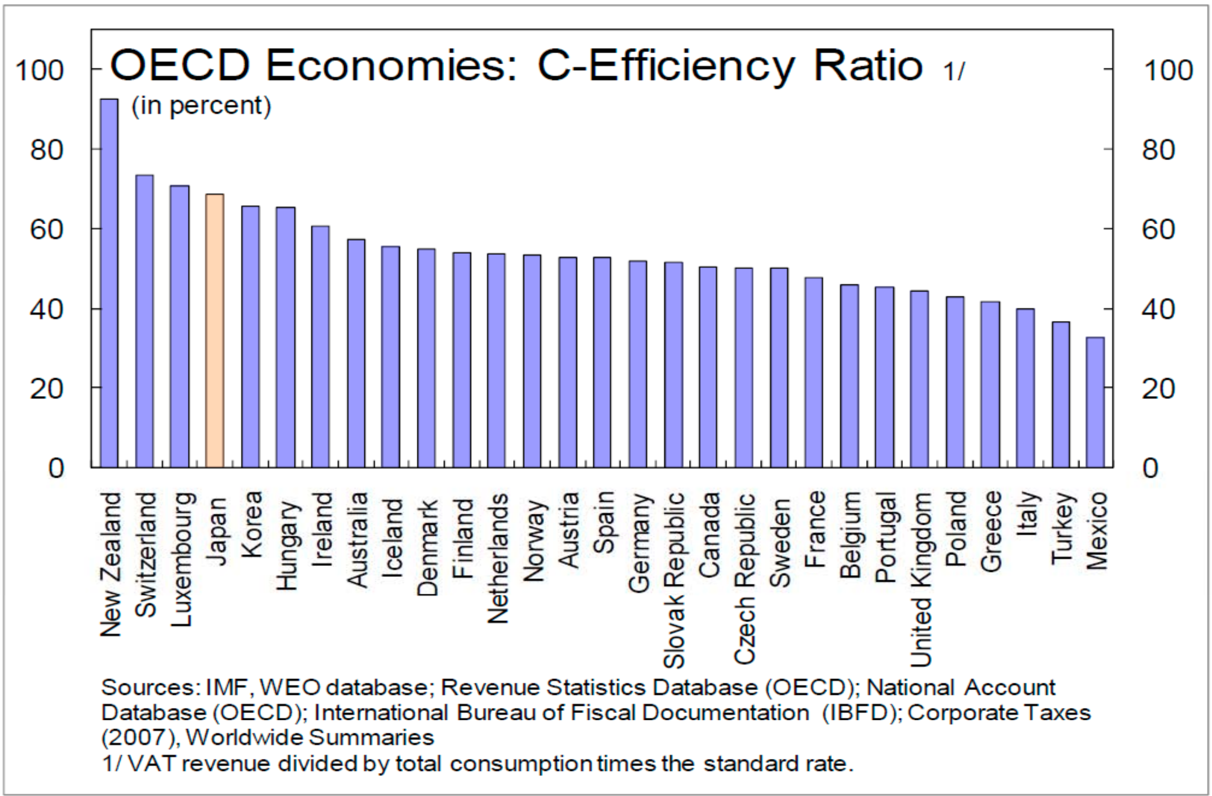
1/ Excluding the temporary tax increase for reconstruction.
2/ The fiscal savings are assumed to be around 0.1 percentage points of GDP or lower. The savings are assumed to be spent on energy saving initiatives.
3/ Freezing expenditure in nominal terms.
4/ Annual nominal growth at 1-1½ percent.
5/ Lower bound estimate of Kashiwase, Nozaki, and Tokuoka, 2012, IMF Working Paper 12/285.

International comparison of Japan's VAT



Source: OECD
1/ Average of OECD countries which have adopted VAT.

International comparison of Japan's VAT



Short-term fiscal stimulus

The additional fiscal stimulus under discussion will lower near term risks to growth, but it can also raise fiscal risks.

In any case, fiscal stimulus should be:

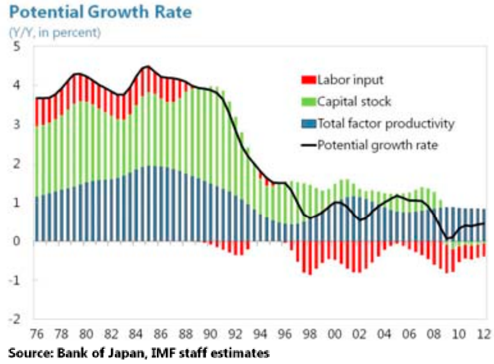
- Temporary- no permanent commitment
- Timely- fast acting
- Targeted- effective in raising demand

and combined with a concrete medium term consolidation plan

Both growth and adjustment are needed

Proceed with comprehensive growth reforms to raise potential growth

- Increase labor force participation and reduce labor market duality (IMF WP13/202) to boost long-tem growth.
- Deregulate agriculture and services
- Enhance role of the financial sector in generating growth (IMF WP 12/291)



What can be done in the short term?

- Immediate action (signature initiative) to boost growth expectations: open up a specific sector, region, market
- Consider (unconventional) short-term measures to boost wages and investment: e.g., temporary wage and investment incentives

Conclusions

There is an urgent need for a concrete medium term fiscal consolidation plan

Both growth and adjustment are needed. The medium term consolidation plan should be as growth friendly as possible

Complementary structural reforms are important to bring down the debt-to-GDP ratio

Thank you for your attention