

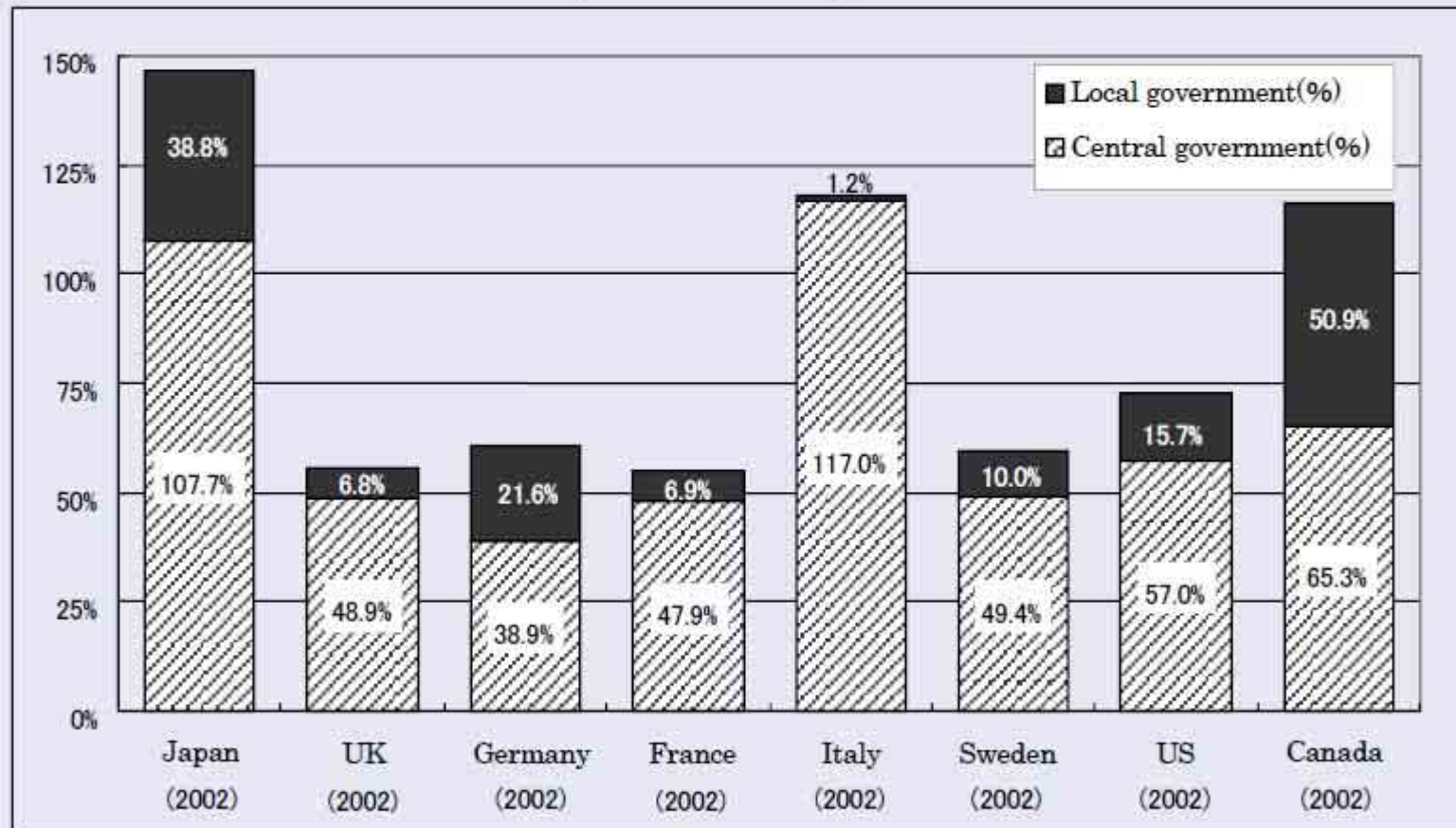
# Toward Reform of Local Bond System in Japan

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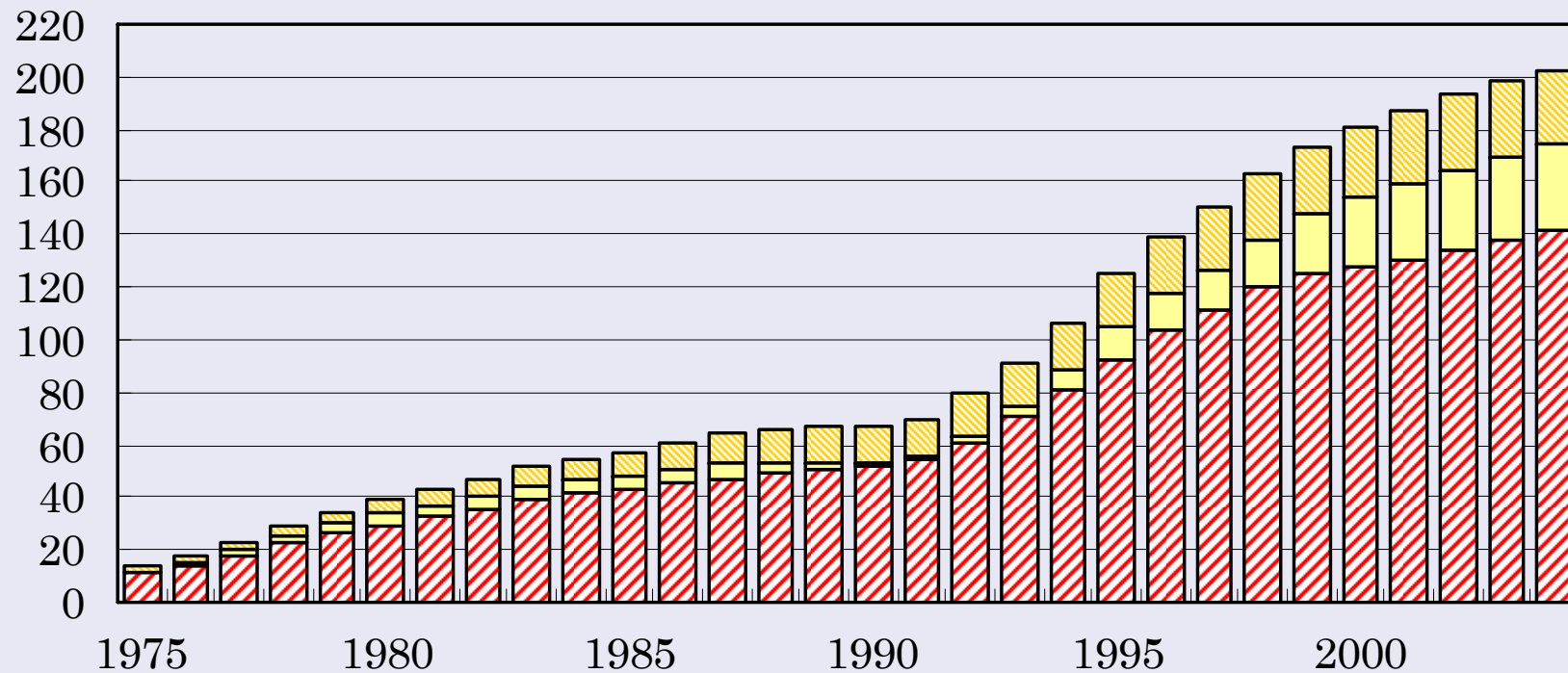
# Figure I – 1 Outstanding Debt by Level of Government (Central and Local) in Major Countries



Source) Ministry of Finance "Wagakuni no Zaisei Jijo ni Tsuite" (Japan), Sachverständigenrat Homepage (Germany), DGCL "Les Collectivités locales en chiffres" (France), US Census Bureau "Statistical Abstract of the United States" (US), SCB "Statistics Sweden" (Sweden), others from IMF "Government Finance Statistics"

# Outstanding Local Government Borrowing (Japan)

trillion yen



- Public Enterprise Bonds (borne by the ordinary account)
- Borrowing in the Special Account for Allocation and Transfer Tax
- Local Bonds

# Current Local Finance System

- Major revenue of Japanese local gov'ts  
Local Taxes, Local Allocation Tax Grants,  
National Gov't Disbursement, Local Bond

**Centralizaed**

- “Trinity Reform Package”  
Local Taxes, Local Allocation Tax Grants,  
National Gov't Disbursement

**Decentralizing**

# “Trinity Reform Package”

## The Reform of Three Major Items

- Reducing National Government Disbursement to local governments
  - Transferring some of its tax revenue sources to those local governments
  - Reviewing the Local Allocation Tax (LAT) Grants
- However, reform of local bond system is *not* included in this package

# In This Paper

- Analyze defects in the current local finance system
- Compare local bond system among industrialized countries
- Derive implications for improvement of the Japanese local bond system



## The Japanese system

# System of Local Bond Permits

- Local governments cannot freely issue local bonds
- Local governments must obtain permission from the Minister of Internal Affairs and Communications (or prefectural governor) in advance when they issue local bonds



- The permission of the central government as well as needs of local governments leads the above increase of local bonds

# Local Bond System

- Local Bond Permits

Ministry of Internal Affairs and Communications (MIC) decides lenders as well as amounts of local bonds

- Lenders of Local Bond

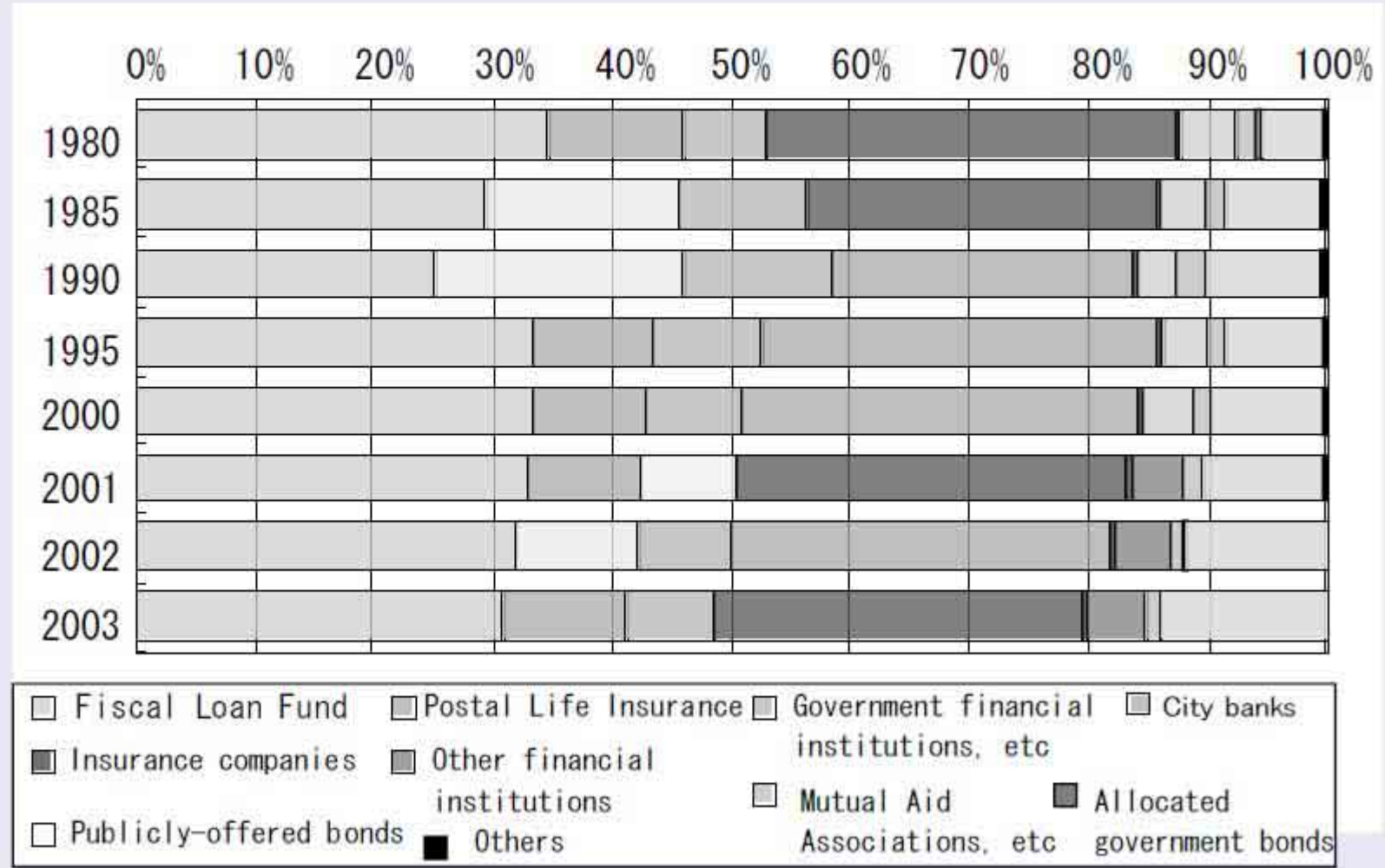
FILP Funds: 60%, Borrowing from Private Financial Institutions: 30%, Publicly-offered Funds: 10%

FILP Funds: **longer-term, lower interest rates**

- Borrowers of FILP Funds .. Decided by MIC  
local govt's with few tax revenue



# Figure II – 2 Structure of Subscribers of Local Bonds (Japan)

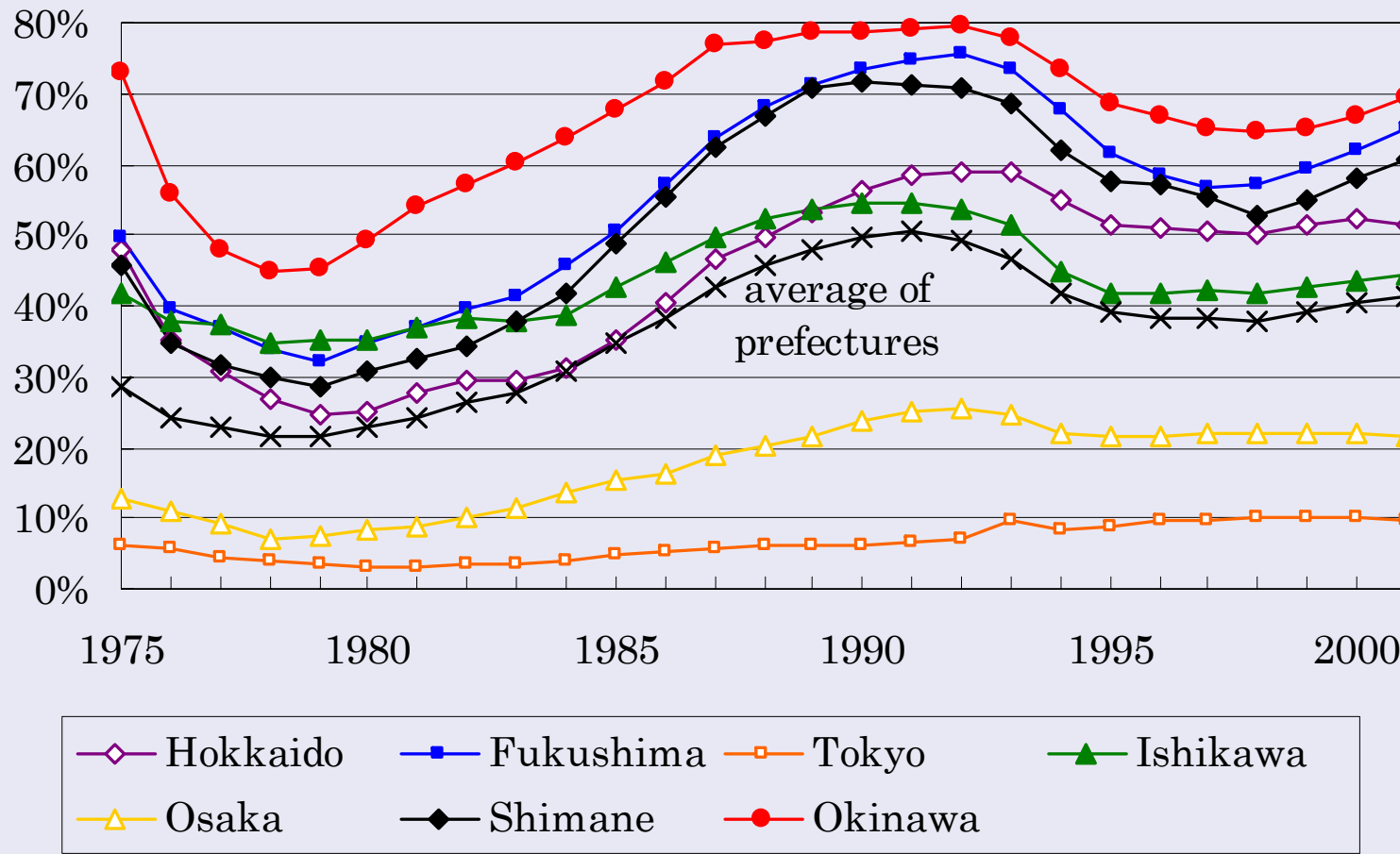


Source) Ministry of Internal Affairs and Communications, *Annual Statistical Report on Local Government Finance*

# "Implied Government Guarantee" of Local Bonds

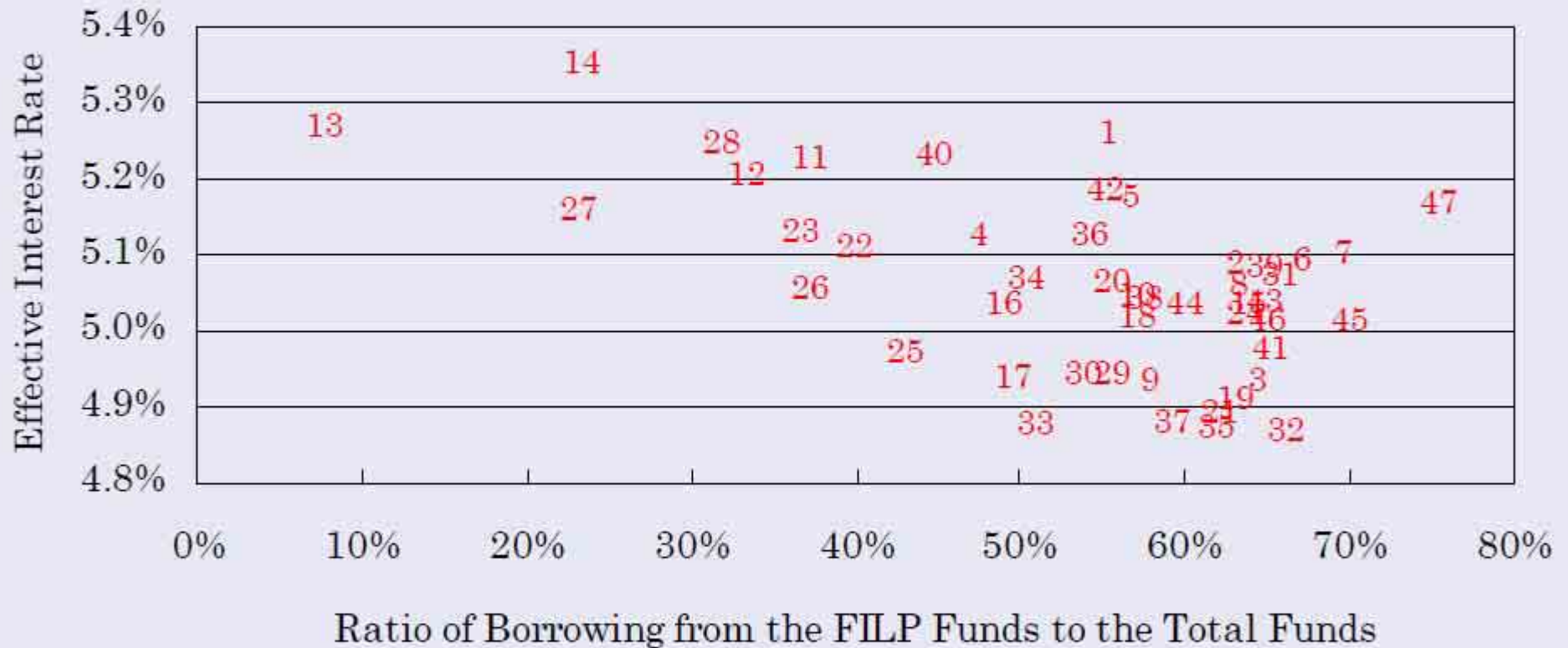
- Measures through Local Allocation Tax Grants for the Repayment of Principal and Interest of Local Bonds
  - Local Bond Permits
  - Local Public Financial Reconstruction Program
- The MIC officially says “local governments will NEVER default on debts.”

# Ratio of Borrowing from the FILP Funds to the Total Funds (Outstanding basis)



Source: Doi, T., 2002, "The System and Role of Local Bonds Permits in Japan," in Toshihiro Ihori and Masakazu Sato eds., *Government Deficit and Fiscal Reform in Japan*, pp.121-151, Kluwer Academic Publishers.

## Effective Interest Rate and Borrowing from the FILP Funds FY 1990~1997 (average)



Source: Doi, T., 2002, "The System and Role of Local Bonds Permits in Japan," in Toshihiro Ihori and Masakazu Sato eds., *Government Deficit and Fiscal Reform in Japan*, pp.121-151, Kluwer Academic Publishers.



# Local Bond System (2)

## Evaluation of the current system

### ... Doi (2002)

- The central government tends to distribute the FILP funds to a local government whose tax revenues are fewer.
- Local gov'ts in a rural area cannot issue publicly-offered bonds and doesn't face a financial discipline in security markets.
- The permission of borrowings from the FILP funds doesn't work for maintenance of fiscal discipline of local public finance.

# Local Bond System (3)

- Measure through LAT Grants for the Repayment of Principal and Interest of Local Bonds

a measure that increases LAT grant entitlements when spending on government bonds increases.