

# White Paper on Local Public Finance, 2006

**Illustrated**



Ministry of Internal Affairs  
and Communications



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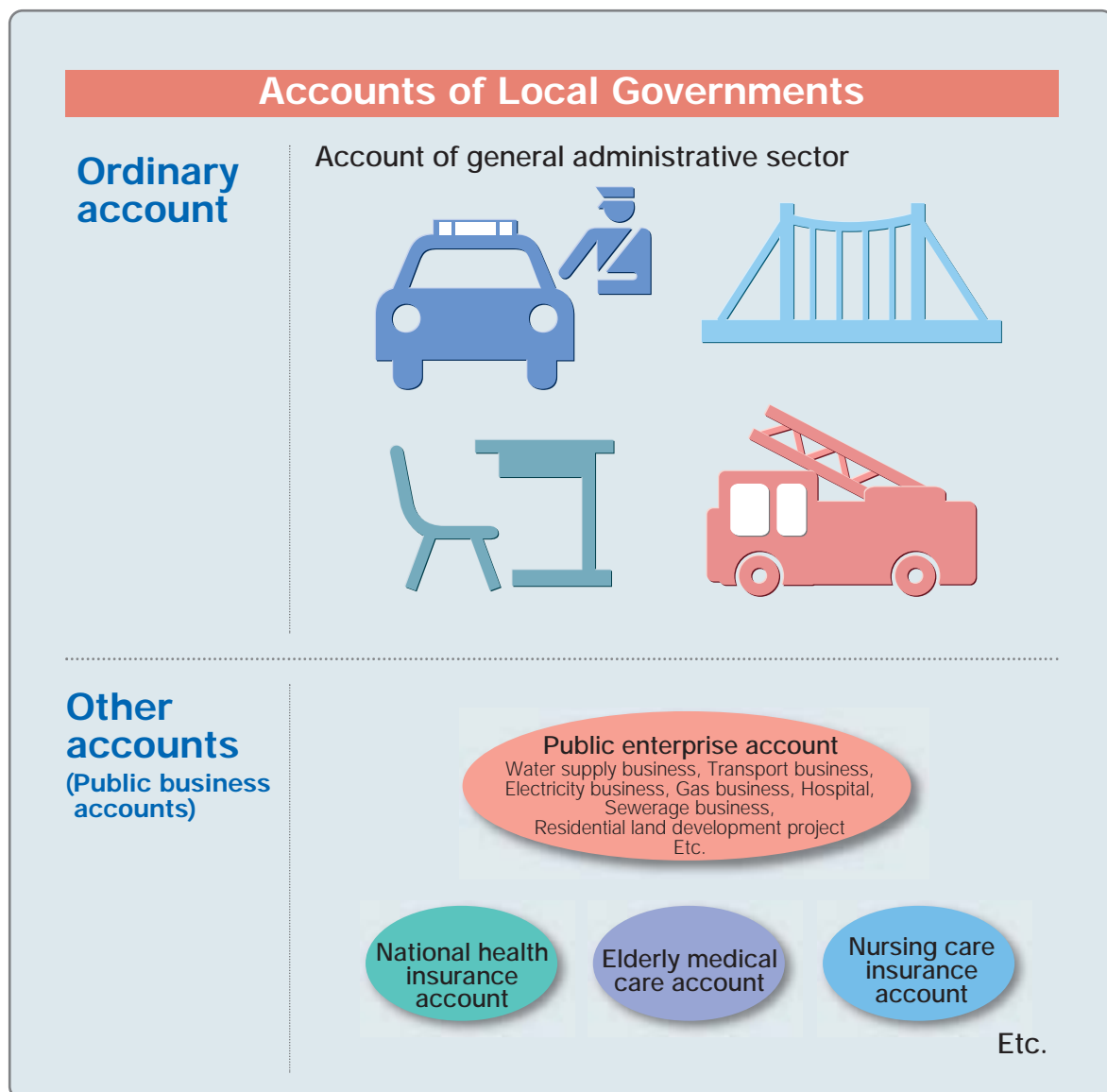
# The Role of Local Public Finance

Prefectures and municipalities (cities, towns, and villages) are principal actors in various administrative areas, including school education, welfare and public health, police and fire services, and the construction of such public works as roads and sewerage systems. They play a major role in national life.

This brochure will introduce the state of local public finance, which is an assemblage of the finances of individual local governments, with particular focus on the state of settlements for fiscal 2004 and efforts toward financial soundness of the local public entities centered on the ordinary account.

## Classification of the Accounting of Local Governments Applied in the Settlement Account Statistics

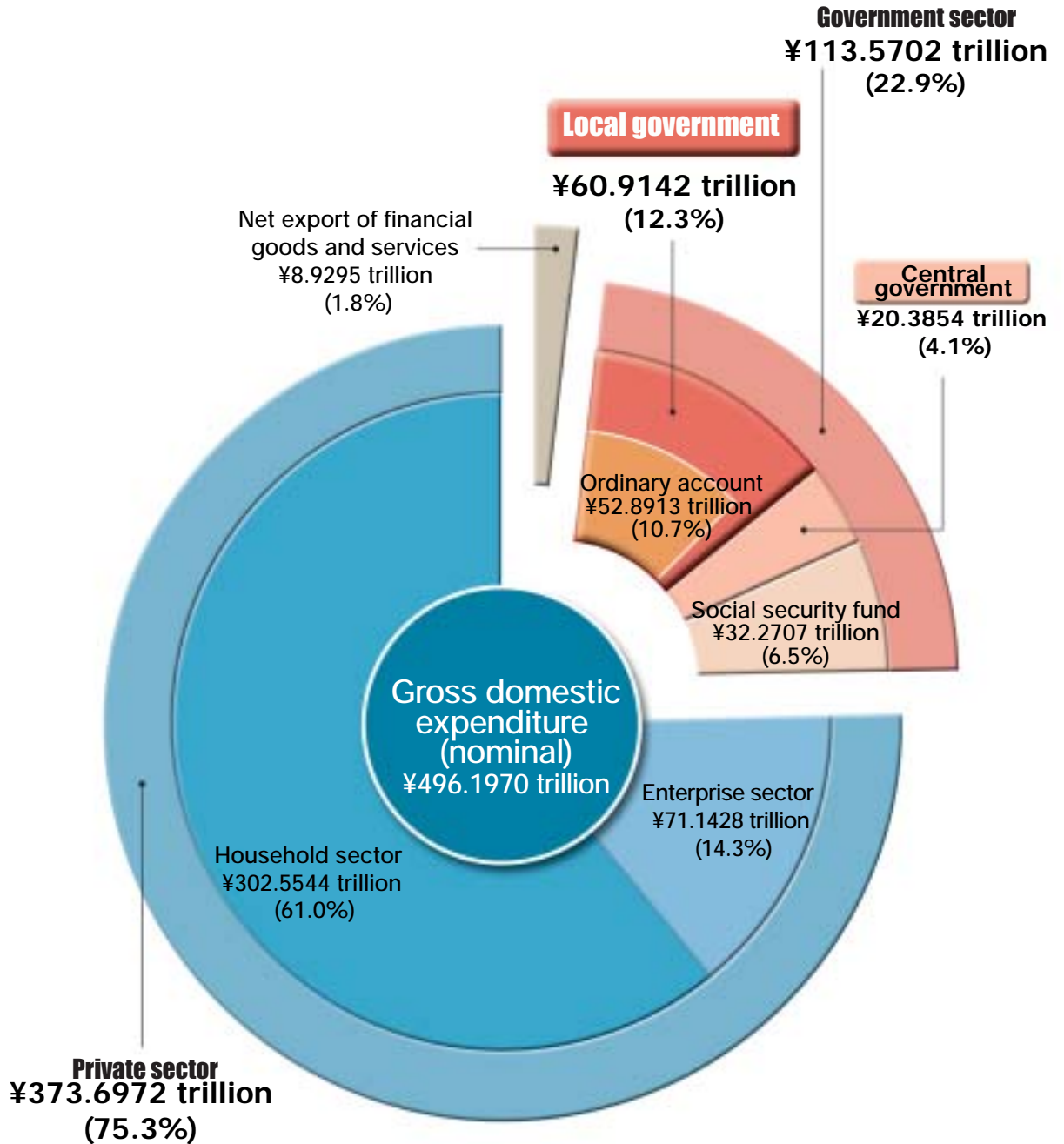
Although the accounts of local governments are divided into general accounts and special accounts, the account classification of each local government is not uniform. Therefore, we have adopted a uniform method in the settlement account statistics by classifying accounts as an ordinary account, which covers the general administrative sector, and other accounts (public business accounts). This enables us to clarify the financial condition of local governments as a whole and to make a statistical comparison among local governments.



## How large is local public finance compared with central government finance?

Looking at the scale of local public finance to gross domestic expenditure, we see that the ratio of the local government sector is 12.3%, which is about three times larger than the ratio of the central government.

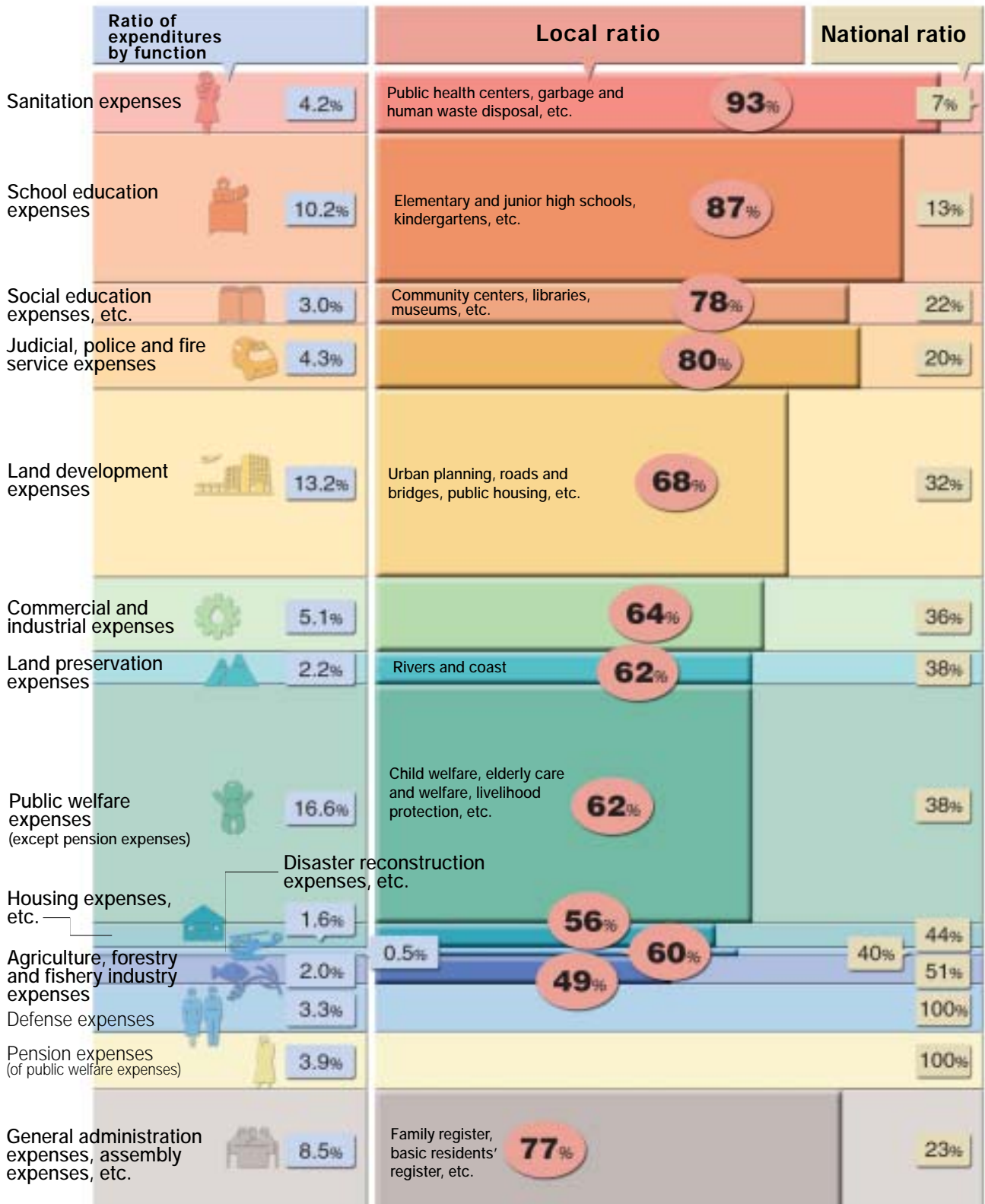
### Gross Domestic Expenditure and Local Public Finance



## In which fields are local expenditure ratios high?

Local expenditure ratios are higher in the areas that have a close relationship with our daily lives, such as public health and sanitation, school education, social education, and police and fire services.

### Shares of National and Local Governments in Main Expenditures by Function (final expenditure base)



# The State of Local Public Finance (FY2004 Settlement)

## State of FY 2004 Account Settlement: Overview

Amid increasingly severe financial conditions, efforts were made to achieve large expenditure cuts. (Expenditure has declined for five consecutive years.)

### 1. Expenditure: Acceleration and strengthening of expenditure cuts (down 1.4% from previous fiscal year)

Amid a situation in which many factors were leading to increased expenditures, such as revision of the child allowance system (raising the age of eligibility for benefits) and the frequent outbreak of disasters, efforts were made to achieve large expenditure cuts, such as in personnel expenses (down 1.2% from the previous fiscal year) and investment expenses (down 9.3%). As a result, expenditures declined by ¥1.3339 trillion compared with the previous fiscal year.

### 2. Revenue: Decline of revenue (down 1.5% from previous fiscal year)

While increases were seen in local taxes (up 2.7% from the previous fiscal year), local transfer tax (up 67.7%), and so on, there were declines in local allocation tax (down 5.8%), local bonds (down 10.3%), and so on.

### 3. Reserves: Large increase of net withdrawal

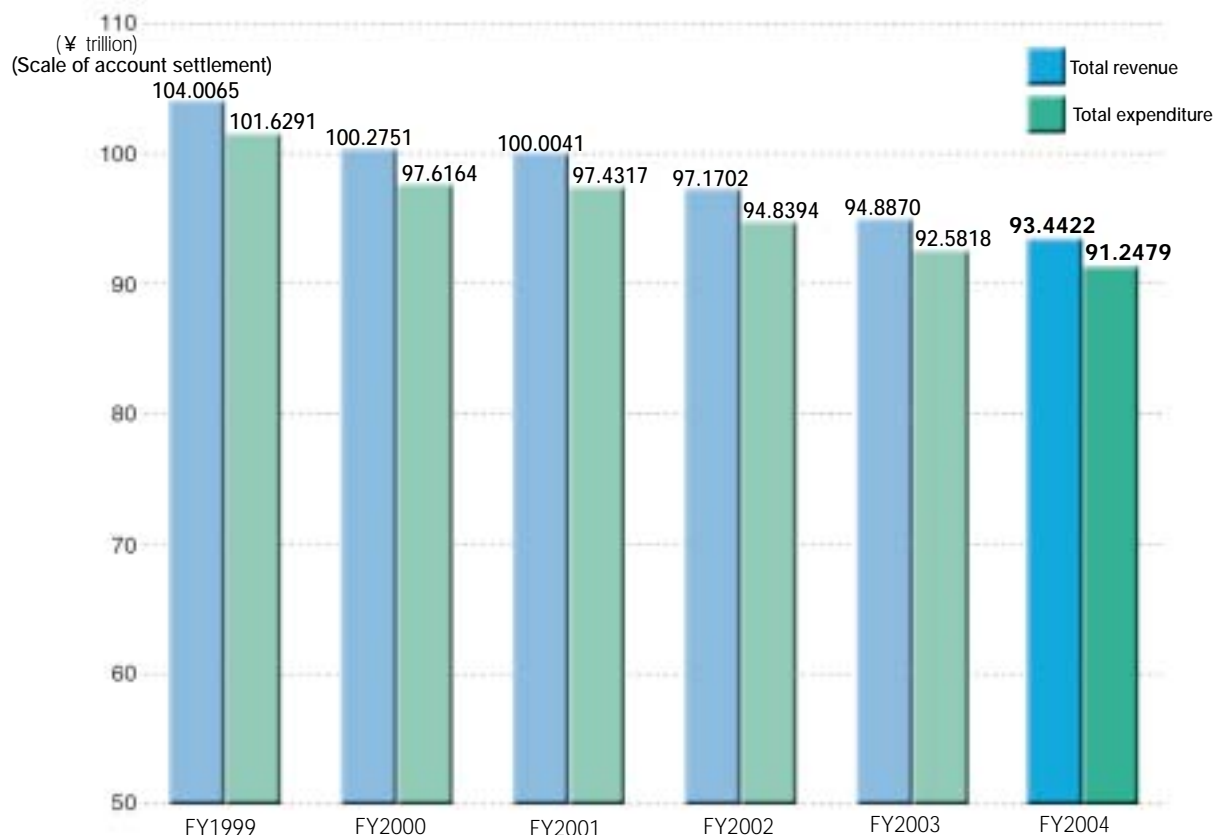
The large-scale net withdrawal from reserves (difference between withdrawals and reserves) of about ¥1 trillion exceeded the figure for the previous fiscal year.

### 4. Other: Impact of municipal mergers and natural disasters

As well as town and village expenditures shifted to cities as a result of municipal mergers, there was a striking increase in disaster restoration work expenses (up 63.0% from the previous fiscal year) as a result of the impact of, among other disasters, the Chuetsu Earthquake in Niigata Prefecture and 10 typhoons that made landfall, the largest number ever recorded.

# Scale of Account Settlement

As a result of such factors as a decline in ordinary construction project spending and personnel expenses on the expenditure side and a decrease of local taxes and local allocation tax on the revenue side, both revenue and expenditure have shrunk for five consecutive years.



## Revenue and Expenditure Settlement

Although the single fiscal year balance showed a surplus for the second consecutive year, the real single fiscal year balance registered a deficit for the first time in two years.

Category	Settlement figure		No. of deficit organizations	
	FY 2004	FY 2003	FY 2004	FY 2003
Real single FY balance	- ¥ 11.7 billion	¥ 91.8 billion	1,528 (2,498)	1,448 (2,435)
Single FY balance	¥ 127.6 billion	¥ 139.7 billion	1,330 (2,288)	1,347 (2,356)
Real balance	¥ 1220.8 billion	¥ 1204.6 billion	26	28

### Notes:

- Real single FY balance:** Calculated by adding reserves to the fiscal adjustment fund and advanced redemption of local loans to the single FY balance and subtracting the used part of the fiscal adjustment fund.  
**Single FY balance:** Calculated by subtracting the real balance of the previous fiscal year from the real balance of the fiscal year concerned.  
**Real balance:** Calculated by subtracting the revenue resources that should be carried over to the next fiscal year from the income-expenditure balance.
- The number of organizations with real single FY balance deficits or single FY balance deficits does not include partial administrative associations and wide-area local public bodies; the figures in parentheses are the number of organizations including partial administrative associations and wide-area local public bodies.
- The number of organizations with a real balance deficit excludes entities with a deficit resulting from discontinued settlement (entities with no income or expenditure in the account settlement period because of a merger, etc.).

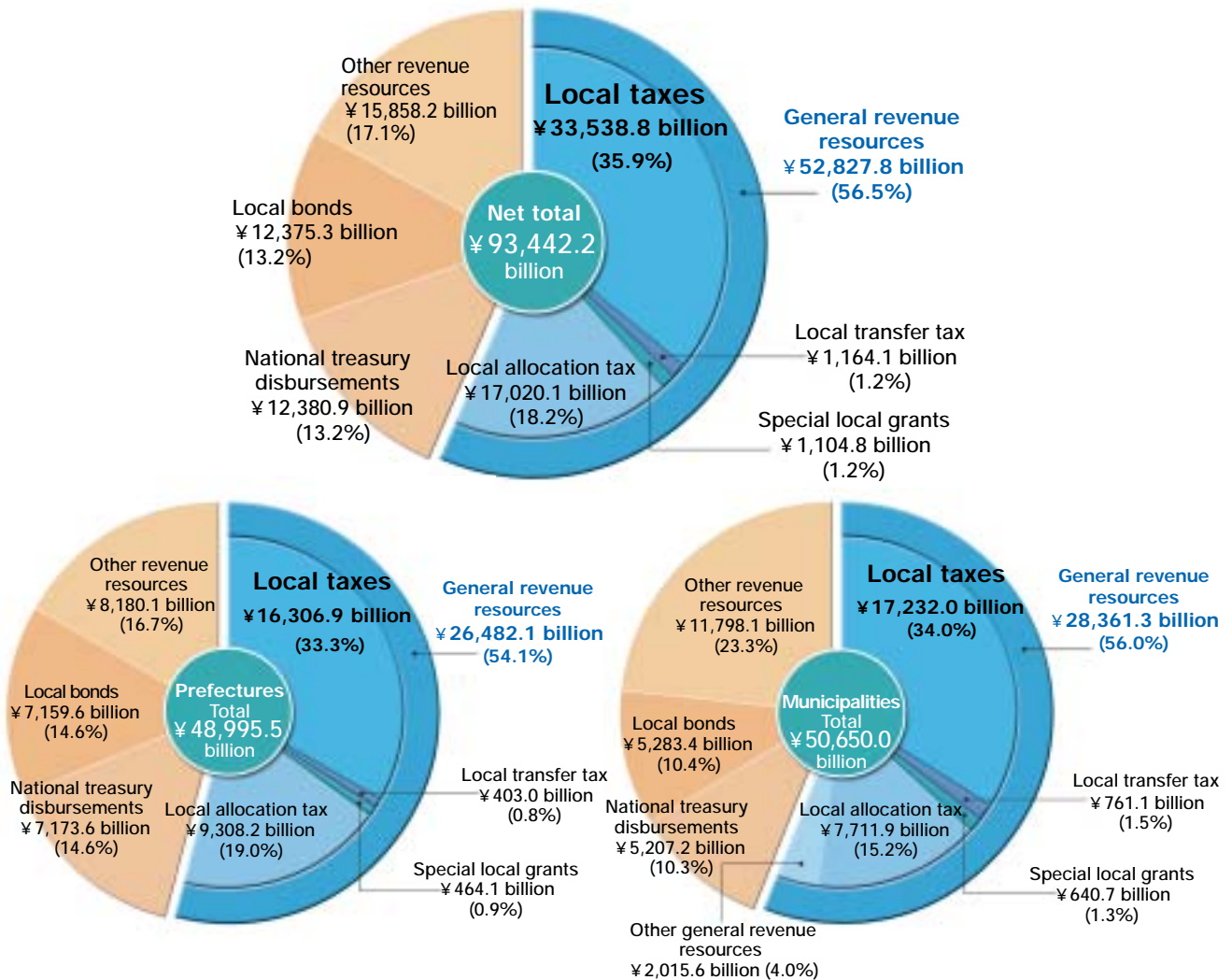
# Revenue

Where does the funds for local government activities come from?

## 1 Revenue Breakdown

Local taxes account for about one-third of the revenue of local governments, followed by the local allocation tax, national treasury disbursements, and local bonds.

### Revenue Breakdown (FY 2004 settlement)



### General Revenue Resources

Revenue resources for which the use is not specified, like local taxes and the local allocation tax, are called general revenue resources. Here, the total of local taxes, local transfer tax, special local grants, the local allocation tax, and so on is treated as the general revenue resource. It is extremely important for local governments to ensure sufficient general revenue resources in order to handle various administrative needs properly.

**Local transfer tax** Collected as a national tax and transferred to local governments. Includes local road transfer tax, etc.

**Special local grant** A revenue source with the character of a substitute for local taxes, introduced to supplement a part of the decrease of local tax caused by a tax cut since FY 1999 and grants from the central government to local governments as a result of a revision of national treasury subsidies.

**Local allocation tax** An intrinsic revenue source shared by local governments in order to adjust imbalances in tax revenue among local governments and to guarantee revenue sources so that local governments in whatever region can provide a certain level of administrative services. Calculated as a certain ratio of five national taxes. (See page 10 for details.)

**National treasury disbursements** A general name for funds disbursed from the central government to local governments for specified uses.

**Local bonds** The debts of local governments for which fulfillment continues for more than one fiscal year.

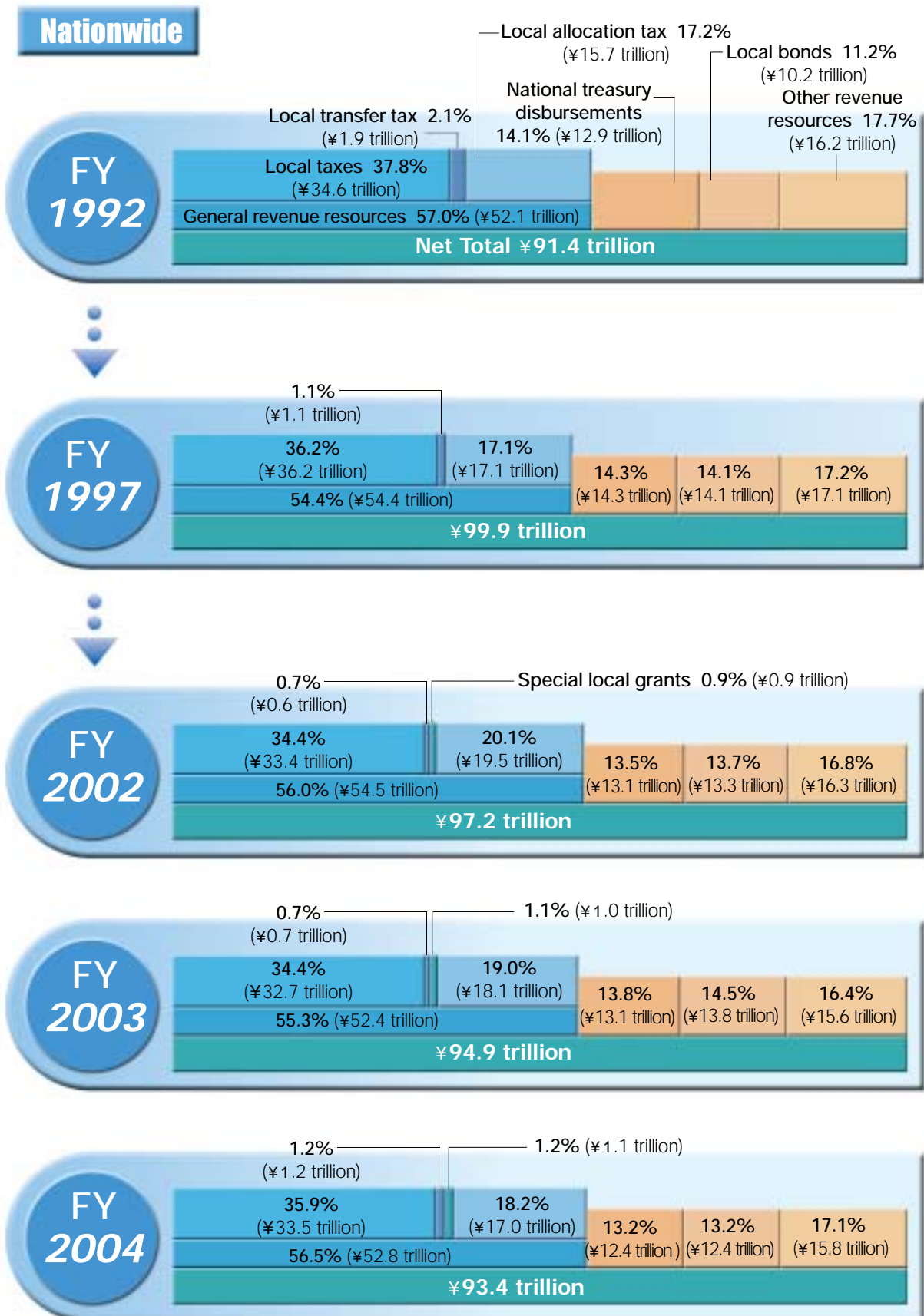
Notes:

1. The figures here are mainly for the ordinary account. (For the accounts of public enterprises, such as water supply and sewerage businesses, transportation businesses, and hospitals, see page 22.)
2. The figures for each item are rounded off under the given unit. Therefore, they do not necessarily add up exactly to the total.



## 2 Revenue Trends

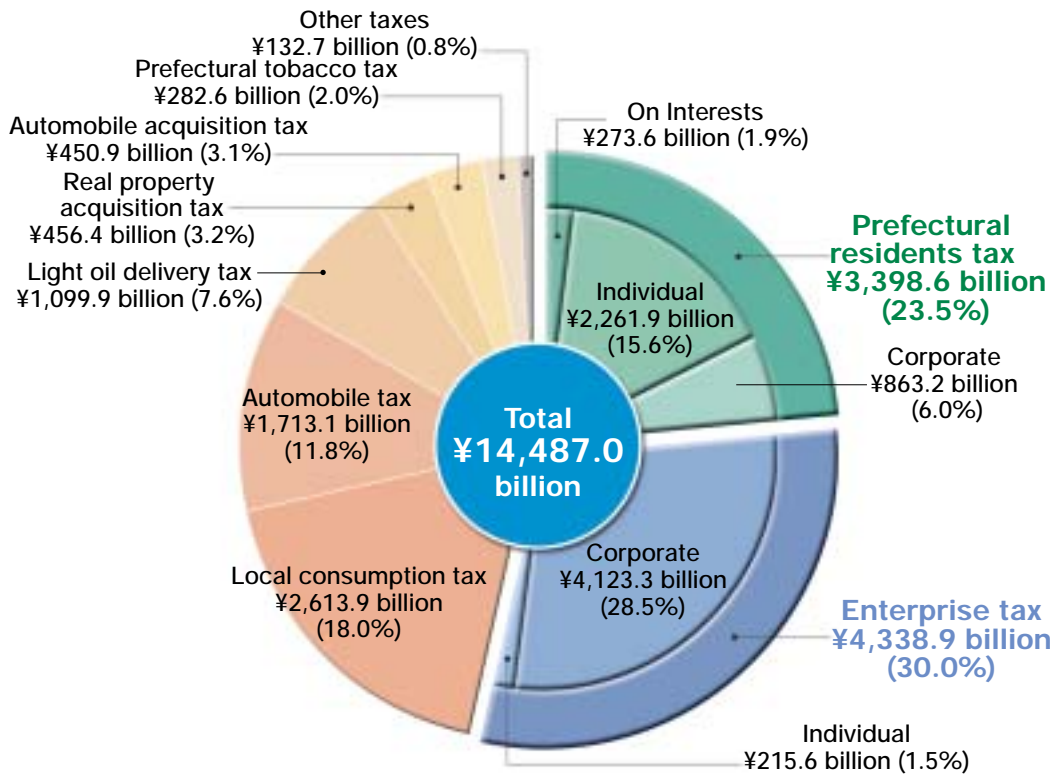
While the shares of local taxes and local transfer tax to total revenue increased, the shares of local allocation tax and local bonds are on a downward trend.



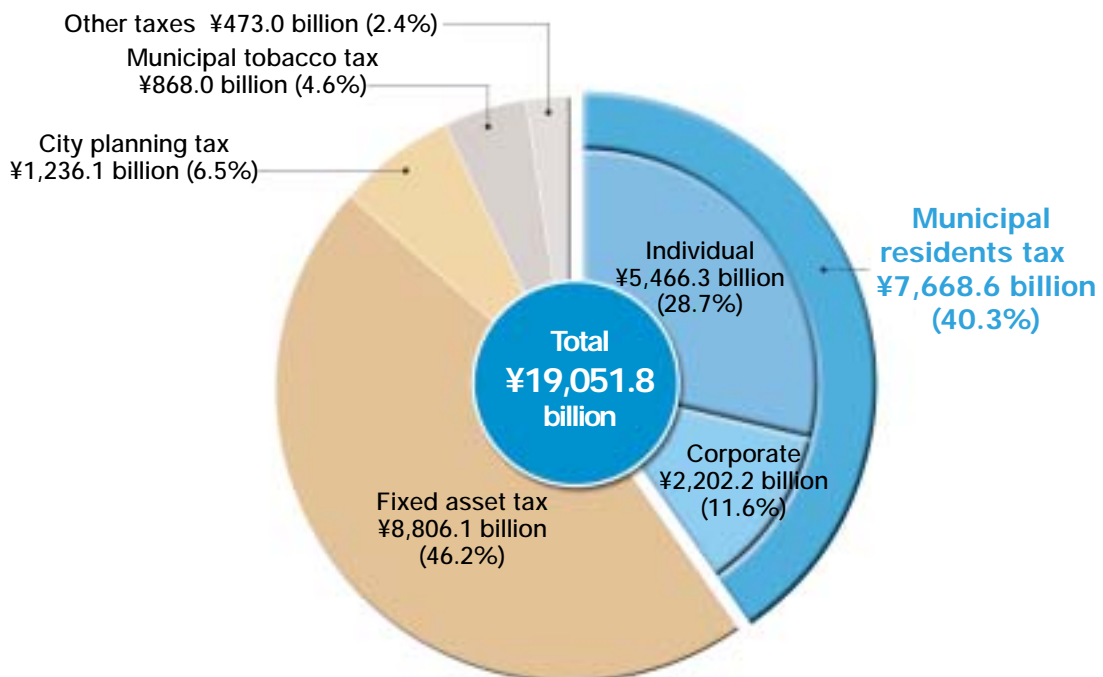
### 3 Local Taxes

Local taxes consist of prefectural taxes and municipal taxes. (In the case of the special wards of Tokyo, the Tokyo Metropolitan Government collects some municipal taxes.)

#### Composition of Revenue from Prefectural Taxes (FY 2004 settlement)



#### Composition of Revenue from Municipal Taxes (FY 2004 settlement)

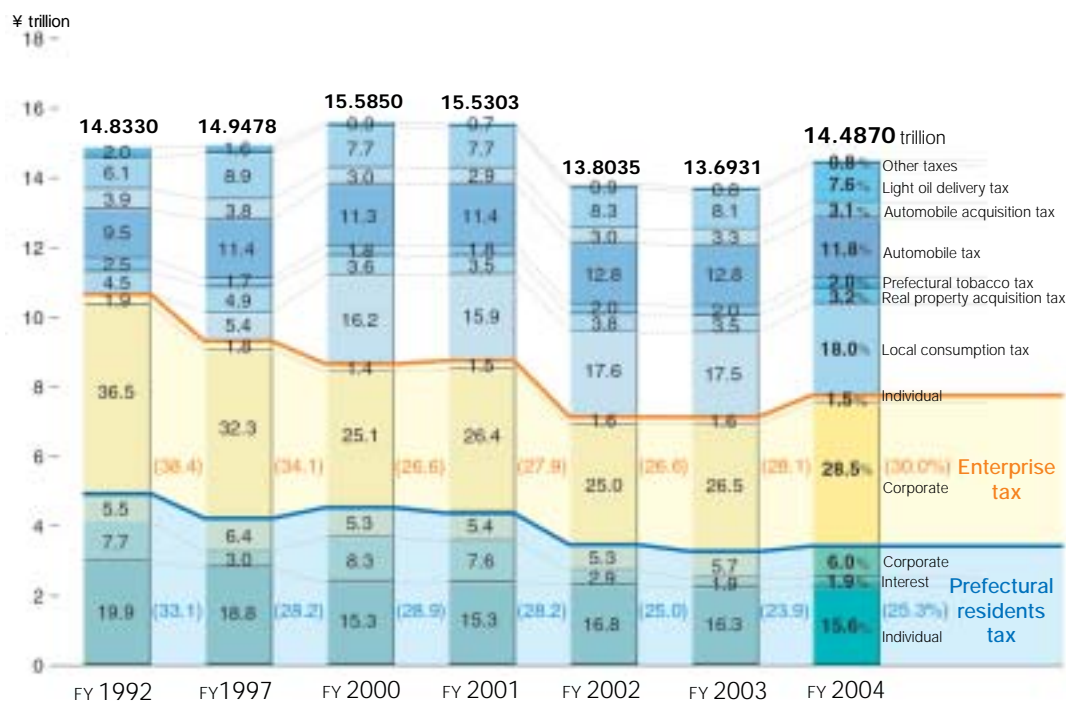


Among prefectural taxes, the ratios of the two corporate taxes (corporate business tax and corporate prefectural residents tax) are high. Among municipal taxes, the ratios of the fixed asset tax and individual municipal residents tax are high.

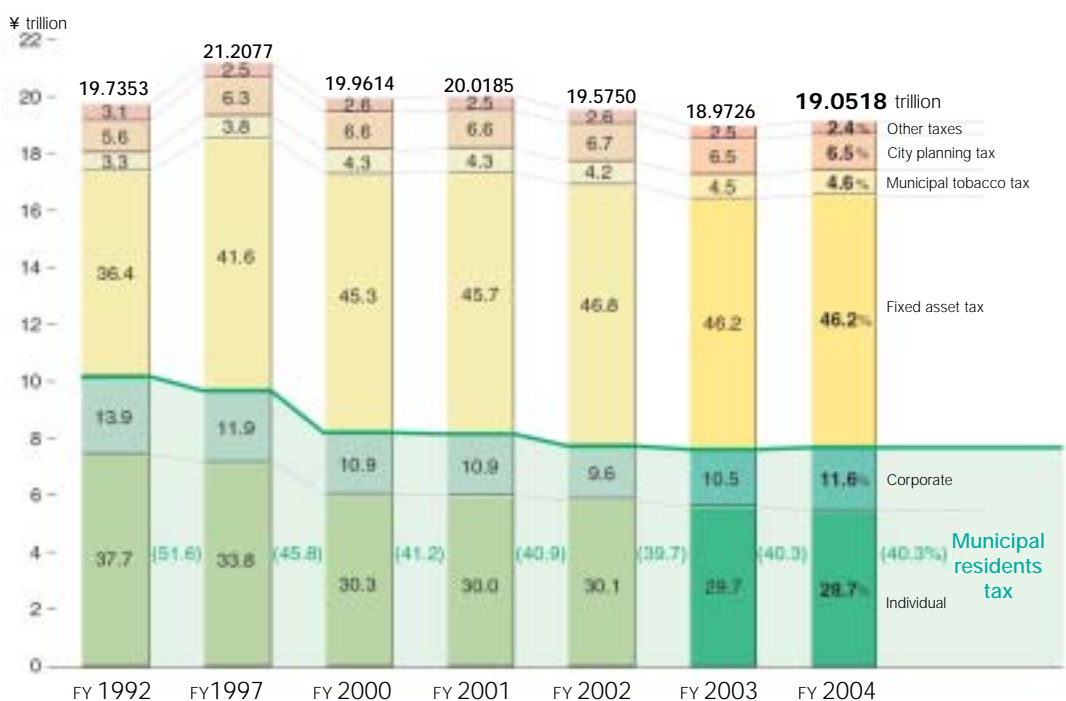
Since the two corporate taxes are easily impacted by the business cycle, the tax revenue from prefectural taxes is unstable. In fiscal 2004 the figure showed an increase for the first time in four years.

Meanwhile, although municipal tax revenue has been on a downward trend in recent years, in fiscal 2004 it showed an increase for the first time in three years.

## Prefectural Tax Revenue Trend



## Municipal Tax Revenue Trend



## 4 Local Allocation Tax

From the perspective of local autonomy, it would essentially be the ideal for each local government to ensure the revenue sources necessary for administrative activities through local taxes collected from their residents. However, there are regional imbalances in tax revenue, and many local governments are unable to acquire necessary tax revenue. Therefore, the central government collects financial resources that should fundamentally be attributable to local tax revenue through national taxation and reallocates them as the local allocation tax to local governments where financial resources are insufficient.

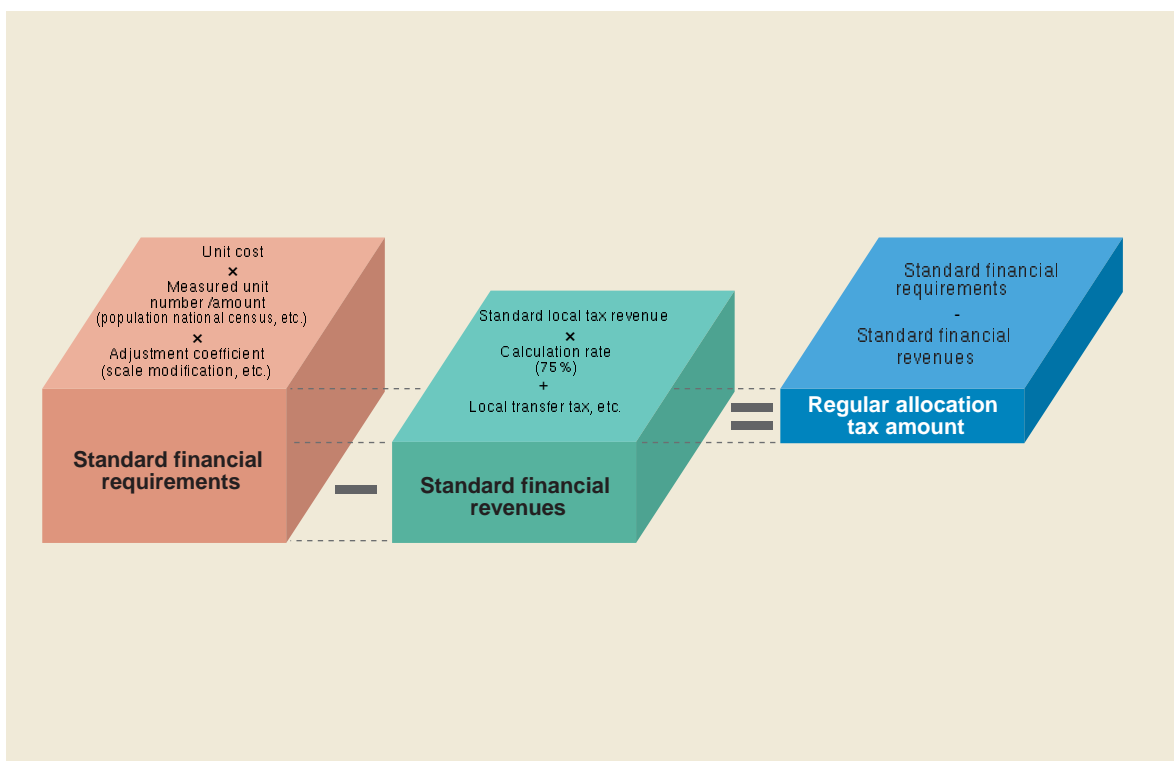
### 1 Determination of total amount of local allocation tax

The total amount of the local allocation tax is determined on the basis of certain ratios for national taxes (32% for income tax and liquor tax, 35.8% for corporate tax, 29.5% for consumption tax, and 25% for tobacco tax) as well as estimates of standard revenue and expenditure of local public finance as a whole.

The total amount of local allocation tax in fiscal 2004 was ¥17.0201 trillion, down 5.8% from the initial figure for the previous fiscal year.

### 2 Method of calculation of regular local allocation tax for each local government

The regular local allocation tax for each local government is calculated by the following mechanism:



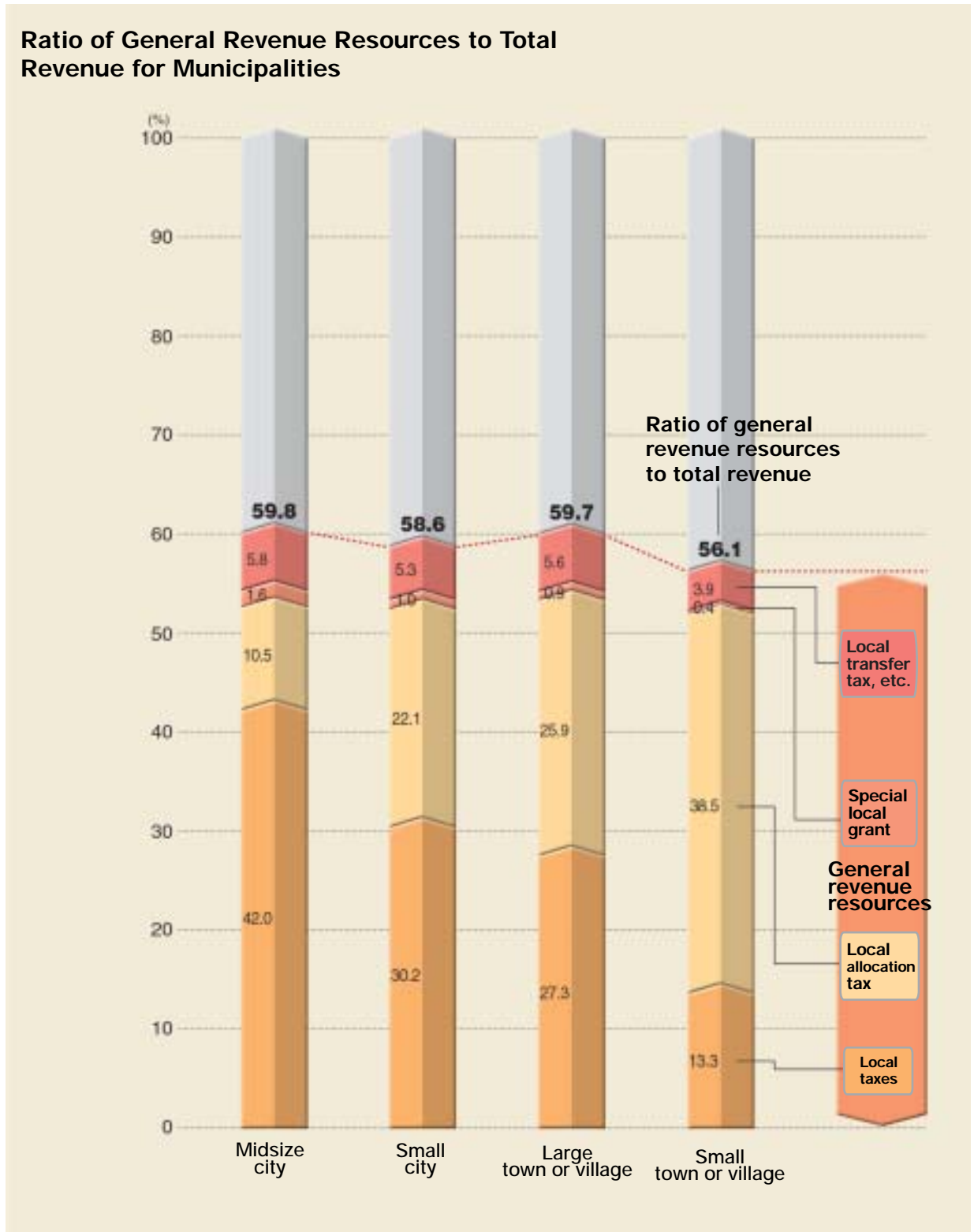
#### Notes:

1. Standard financial requirements are calculated as the financial requirements of each local government based on rational and appropriate standards. It is required to include the local share of the national treasury projects, such as compulsory education, livelihood protection, and public works, work project in calculating the standard financial requirements. From FY 2001 to FY 2006, part of the standard financial requirements is being transferred to special deficit-financing local bonds (extraordinary financial countermeasures bonds) as an exception to Article 5 of the Local Finance Law.
2. Normal local tax revenue neither includes “non-statutory ordinary taxes” and “non-statutory special purpose taxes” imposed independently by the local government nor “excess tax” that exceeds the standard tax rate stipulated in the Local Tax Law.

### 3 Function of the local allocation tax

The function of the local allocation tax is to adjust imbalances in revenue among local governments in order to guarantee revenue so that local governments can provide standard administrative services and basic social infrastructure to their residents in whatever region.

Accordingly, as a result of the revenue adjustment mechanism through the local allocation tax, few differences in such factors as size of population have been found in the ratio of general revenue resources to total revenue.



**Notes:**

1. A "midsize city" refers to a city with a population of more than 100,000 persons according to the national census of 2000; a "small city" refers to a city with a population of less than 100,000.
2. A "large town or village" refers to a town or village with a population of more than 10,000; a "small town or village" refers to a town or village with a population of less than 10,000.

# Expenditure

What is revenue being expended for?

## 1 Expenses by Function

When expenses are classified by function, we see that a lot of revenue is expended for such items as education expenses, civil engineering work expenses, and public welfare expenses. In prefectures it is mainly expended for education expenses, civil engineering work expenses, and debt servicing, in that order. In municipalities it is primarily expended for public welfare expenses, civil engineering work expenses, and debt servicing, in that order.

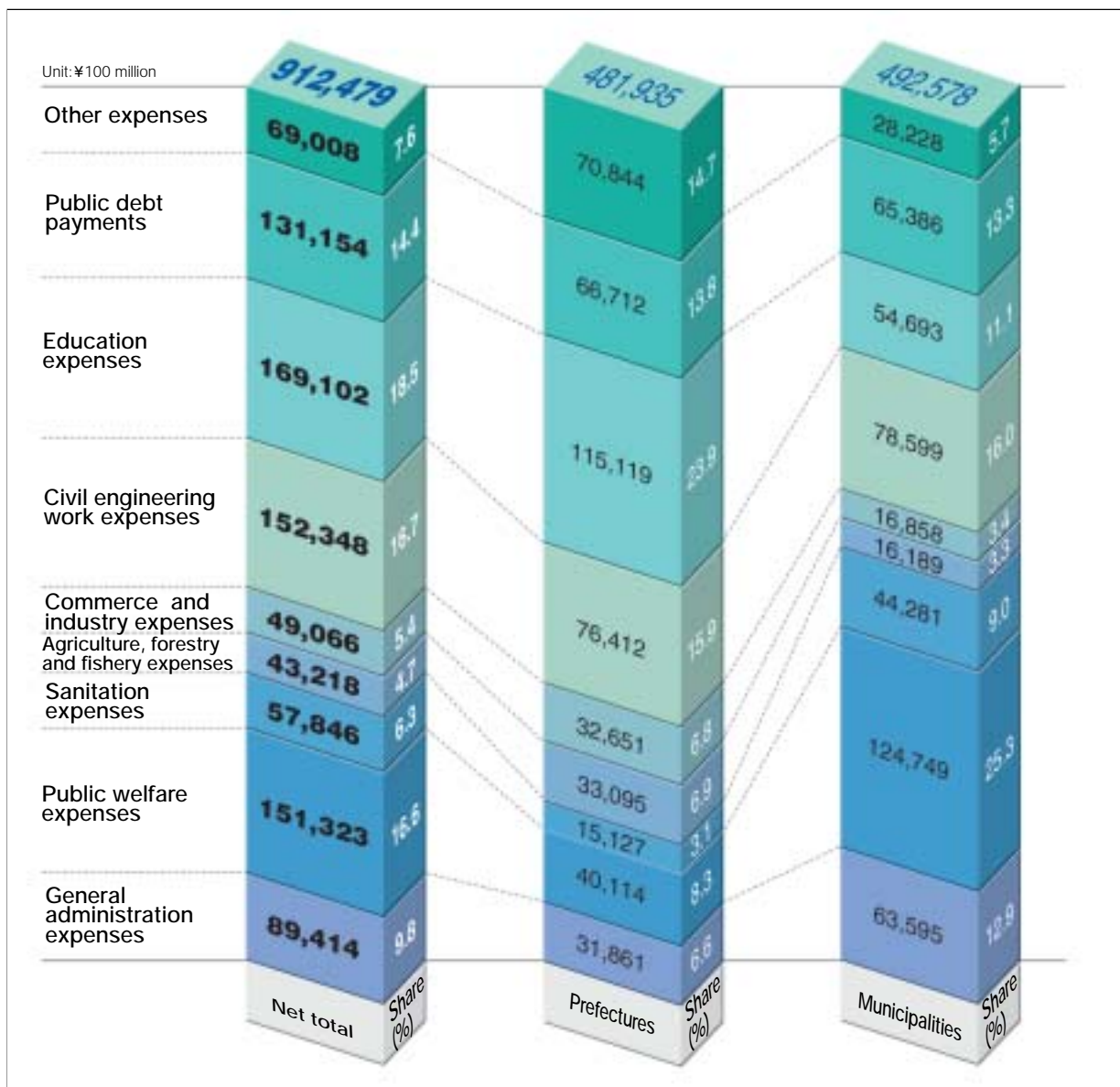
**Education expenses:** Expenses for school education, social education, etc.

**Civil engineering work expenses:** Expenses for the construction and improvement of public facilities, such as roads, housing and parks.

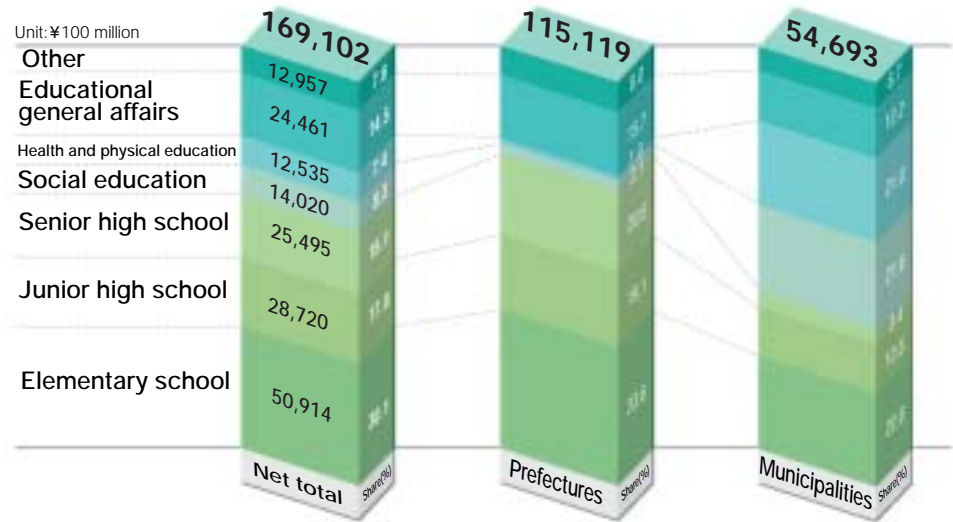
**Public welfare expenses:** Expenses for the construction and operation of welfare facilities for children, the elderly, the mentally and physically disabled, etc. and for the implementation of livelihood protection, etc.

**Public debt payment:** Expenses for the payment of principal, interest, etc. on debts.

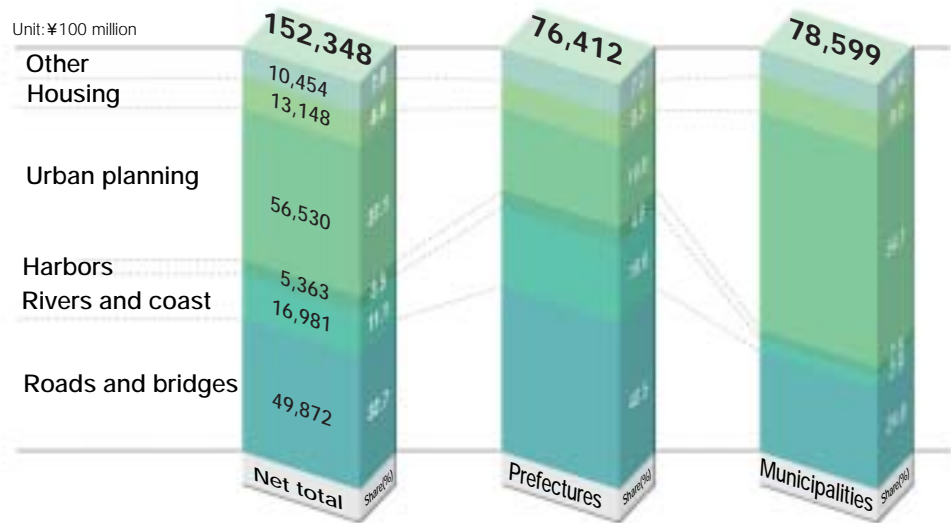
### Composition of Expenditure by Function (FY 2004)



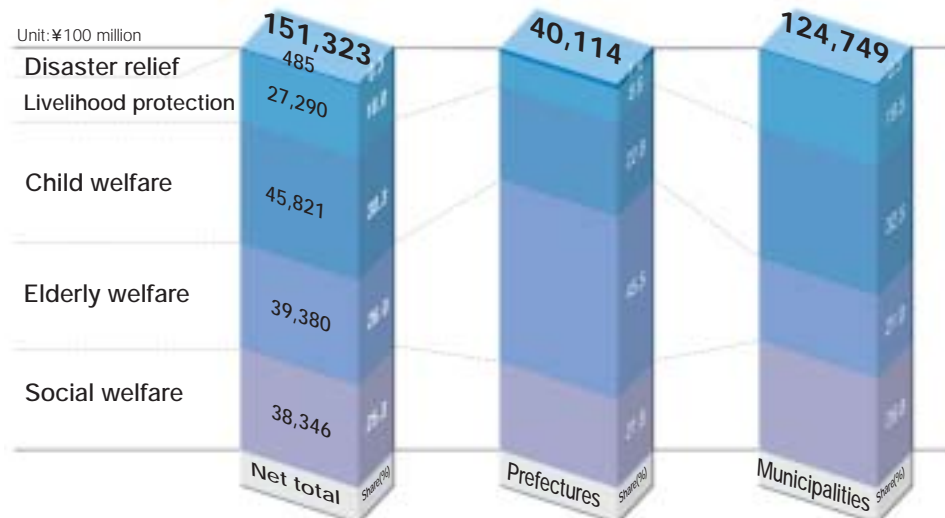
## Breakdown of Educational Expenses by Purpose



## Breakdown of Civil Engineering Work Expenses by Purpose



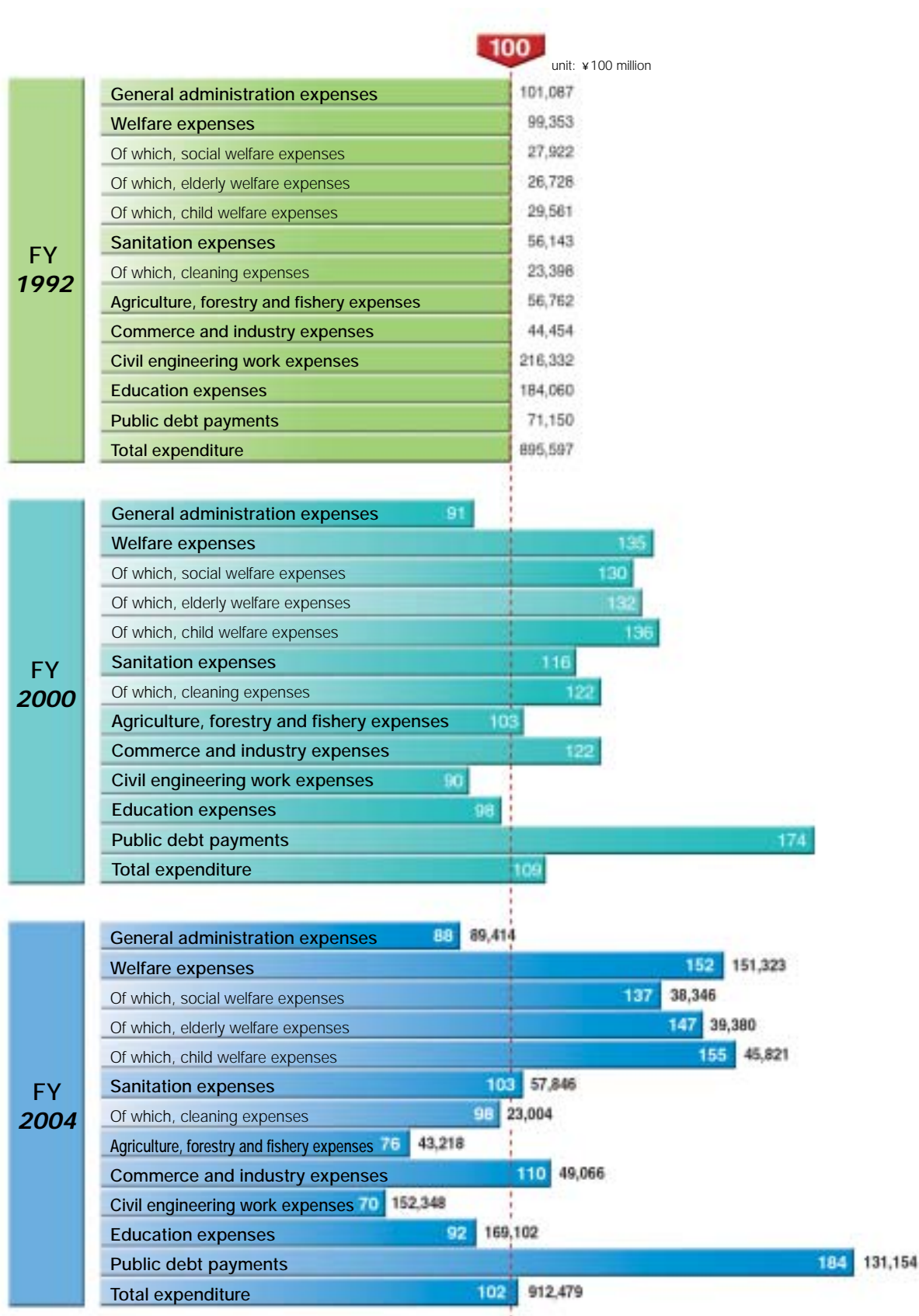
## Breakdown of Public Welfare Expenses by Purpose



In recent years, while there has been a decline in such items as agriculture, forestry and fishery expenses, welfare expenses, public debt payments and so on have been increasing.

## Trends in Expenditures by Function (ordinary account net total)

Unit: Ratio with FY 1992 as 100.



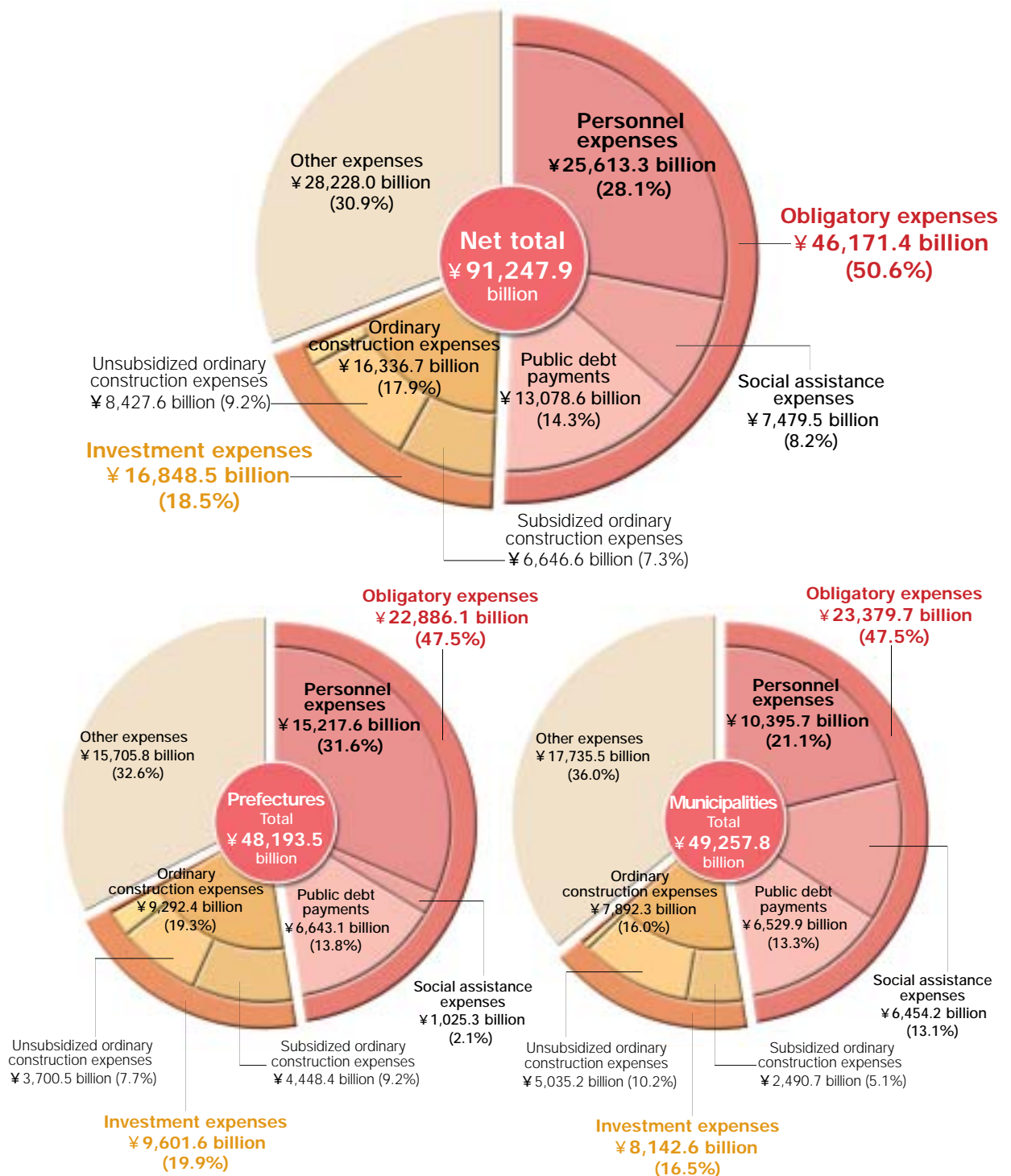


## What are expenses for?

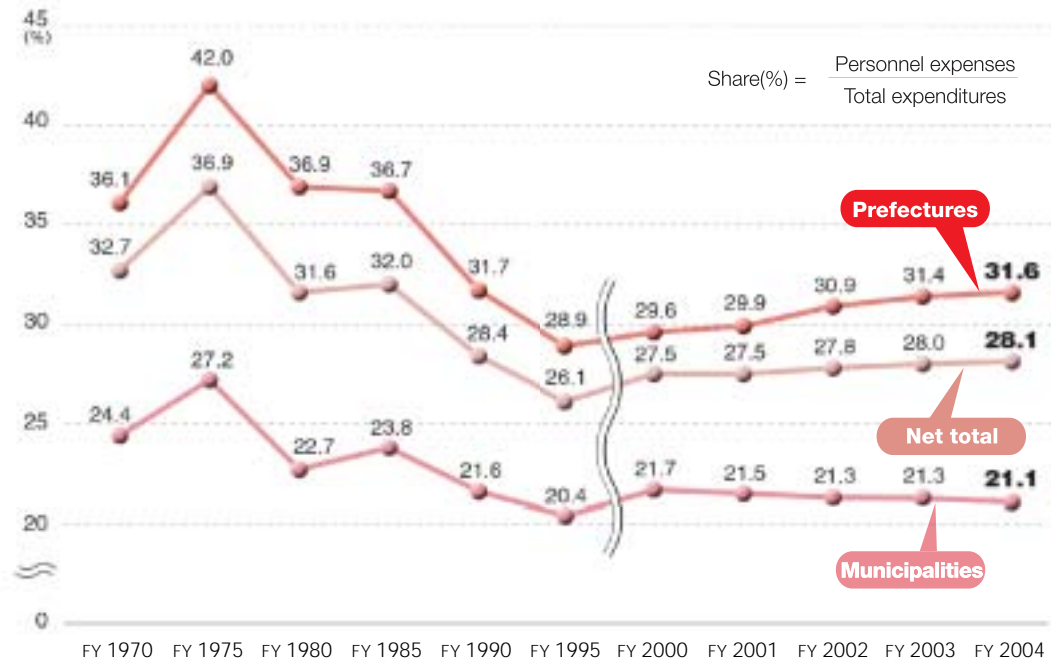
### 2 Expenses by Character

Classified by character, expenses can be divided into "obligatory expenses" (personnel expenses, social assistance expenses and public debt payments), which are mandatory and difficult to cut down at the discretion of individual local governments; "investment expenses," including ordinary construction expenses, etc.; and "other expenses."

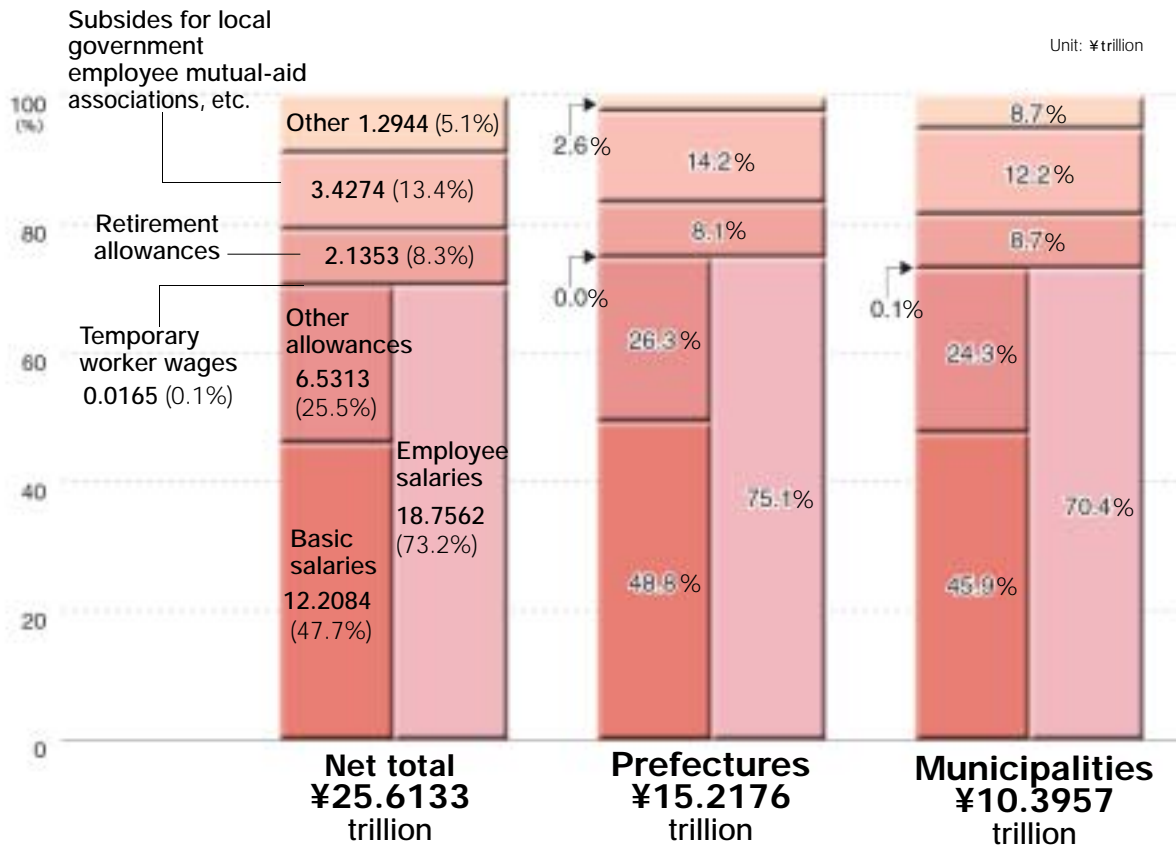
#### Expenditure by Character (FY 2004 settlement)



## Trends in Personnel Expenses



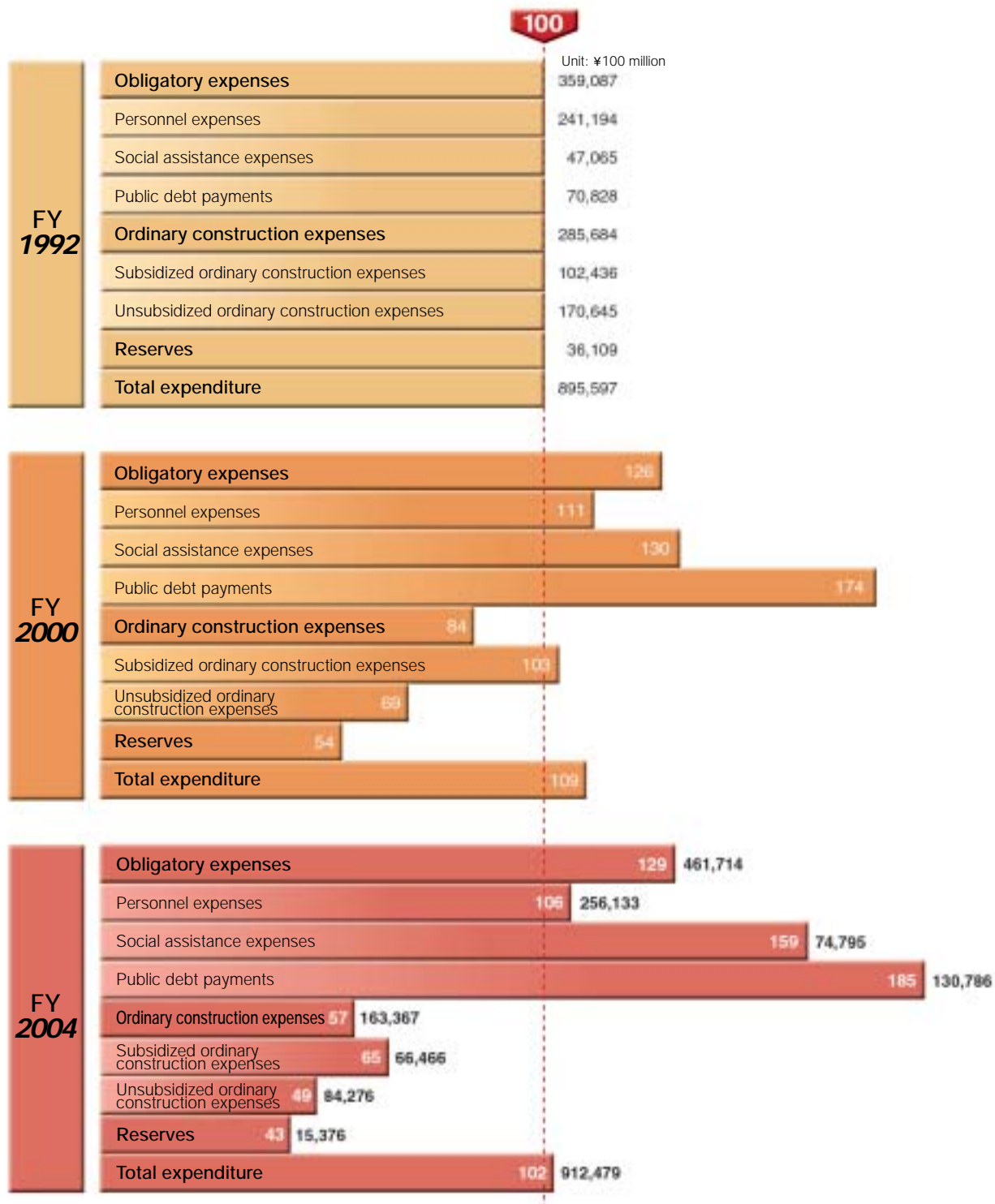
## Breakdown of Personnel Expenses by Item



In recent years, while there has been a decline in such items as ordinary construction expenses, social assistance expenses, public debt payments and so on have been increasing.

## Trends in Breakdown of Expenditures by Character (ordinary account net total)

Unit: Ratio with FY 1992 as 100.



### Social assistance expenses

Expenses which include child welfare expenses, livelihood protection expenses, etc., aimed at assisting the needy, children, the elderly, mentally and physically disabled, etc., as a part of the social security system.

### Ordinary construction expenses

Expenses necessary for the construction of social capital, such as roads, bridges, parks, schools, etc.

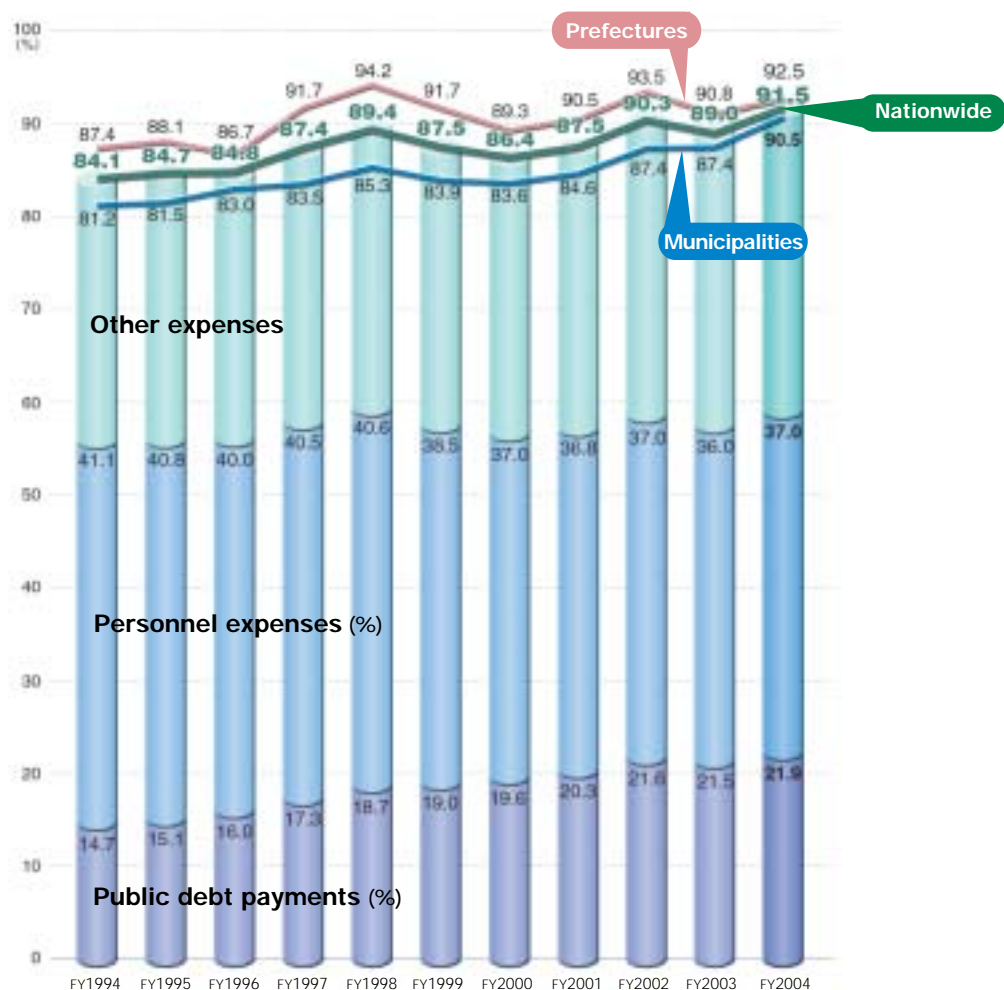
# Flexibility of the Financial Structure

How can local finance respond to the demand toward local governments?

In addition to revenue sources allocated to obligatory expenses required every year, it is necessary for local governments to ensure revenue sources for measures to respond properly to social and economic trends and changes in the demand of the residents. The extent to which these revenue resources can be ensured is called the flexibility of the financial structure.

## 1 Ordinary Balance Ratio

Because of such factors as an increase in social assistance expenses and declines in the ordinary allocation tax and extraordinary financial countermeasures bonds, the national average of the ordinary balance ratio (the ratio of ordinary revenue allotted to expenses recurring every fiscal year to the total of ordinary revenue recurring every fiscal year, centered on local taxes and the local allocation tax, as well as tax reduction supplementary bonds and extraordinary financial countermeasures bonds [see note]) registered the highest figure since the compilation of statistics began (in fiscal 1969).



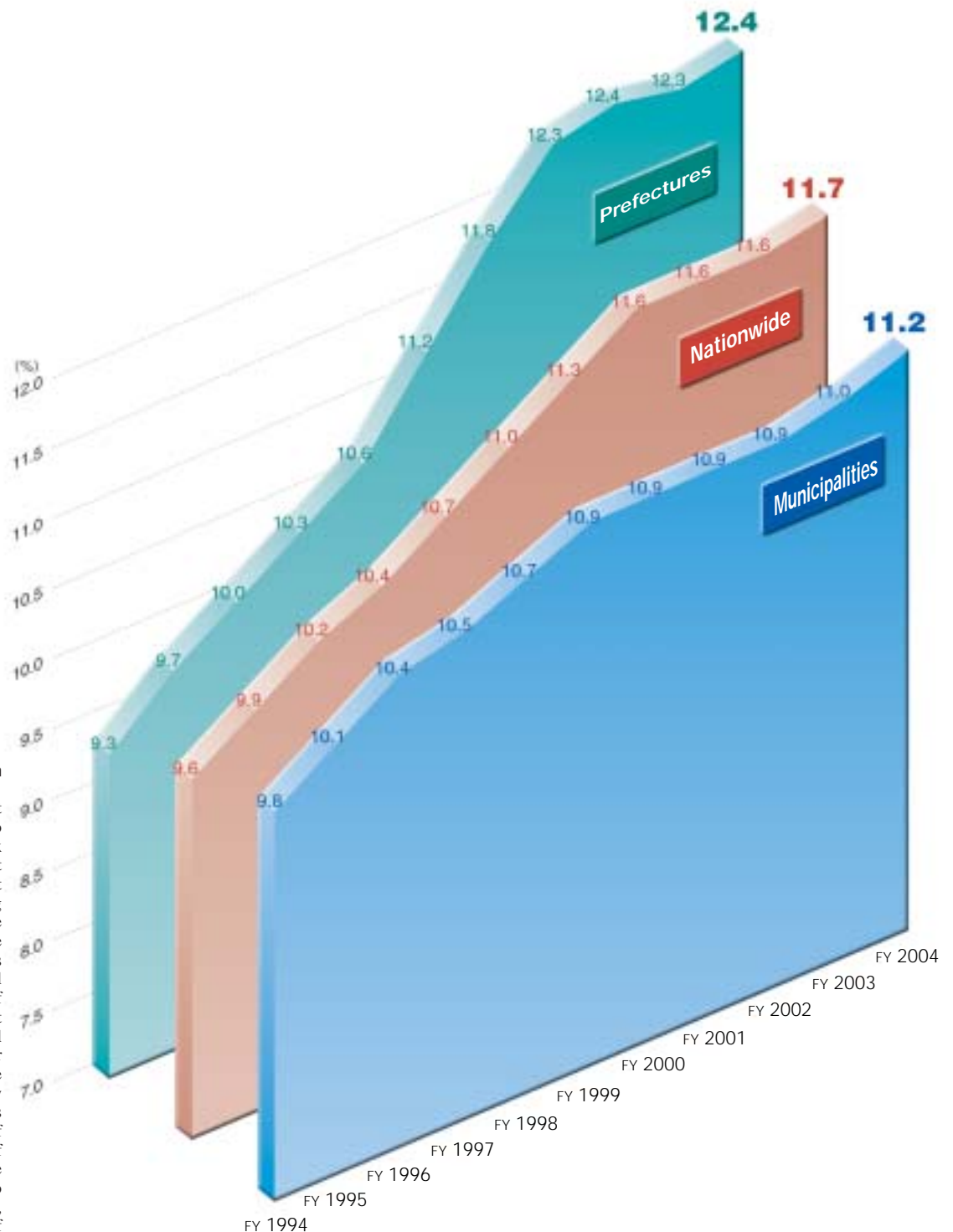
Note:  
Tax-reduction supplementary bonds and extraordinary financial countermeasures bonds have been added since fiscal 2001.

## 2 Debt Service Payment Ratio Used for Permission to Issue Local Bonds

It is necessary to keep a close watch on trends in public debt payments at all times, since public debt payments, payments of principal and interest on the debts of local governments, are expenses especially lacking flexibility.

The national average of the debt service payment ratio used to restrict the issue of local bonds, which is an index that takes into consideration the local allocation tax calculated for debt payments and indicates the actual degree of debt payment burden, rose by 0.1 point compared with the previous fiscal year and continues to maintain a high level.

### Trends in the Debt Service Payment Ratio Used for Permission to Issue Local Bonds



Debt service payment ratio used for permission to issue local bonds  
 The debt service payment ratio used for permission to issue local bonds is an index showing the ratio of local debt principal and interest repayment (excluding advanced redemption and the amount of general revenue resources calculated for this purpose that includes the local allocation tax) to the total of standard financial amount (excluding the amount of local allocation tax calculated for service payment) and possible issue of extraordinary financial countermeasures bonds. This index is one of the criteria to limit the issue of local bonds. In principle, the issue of local bonds relating to general unsubsidized projects, etc. is prohibited in the case of local governments with a ratio of 20% or over.

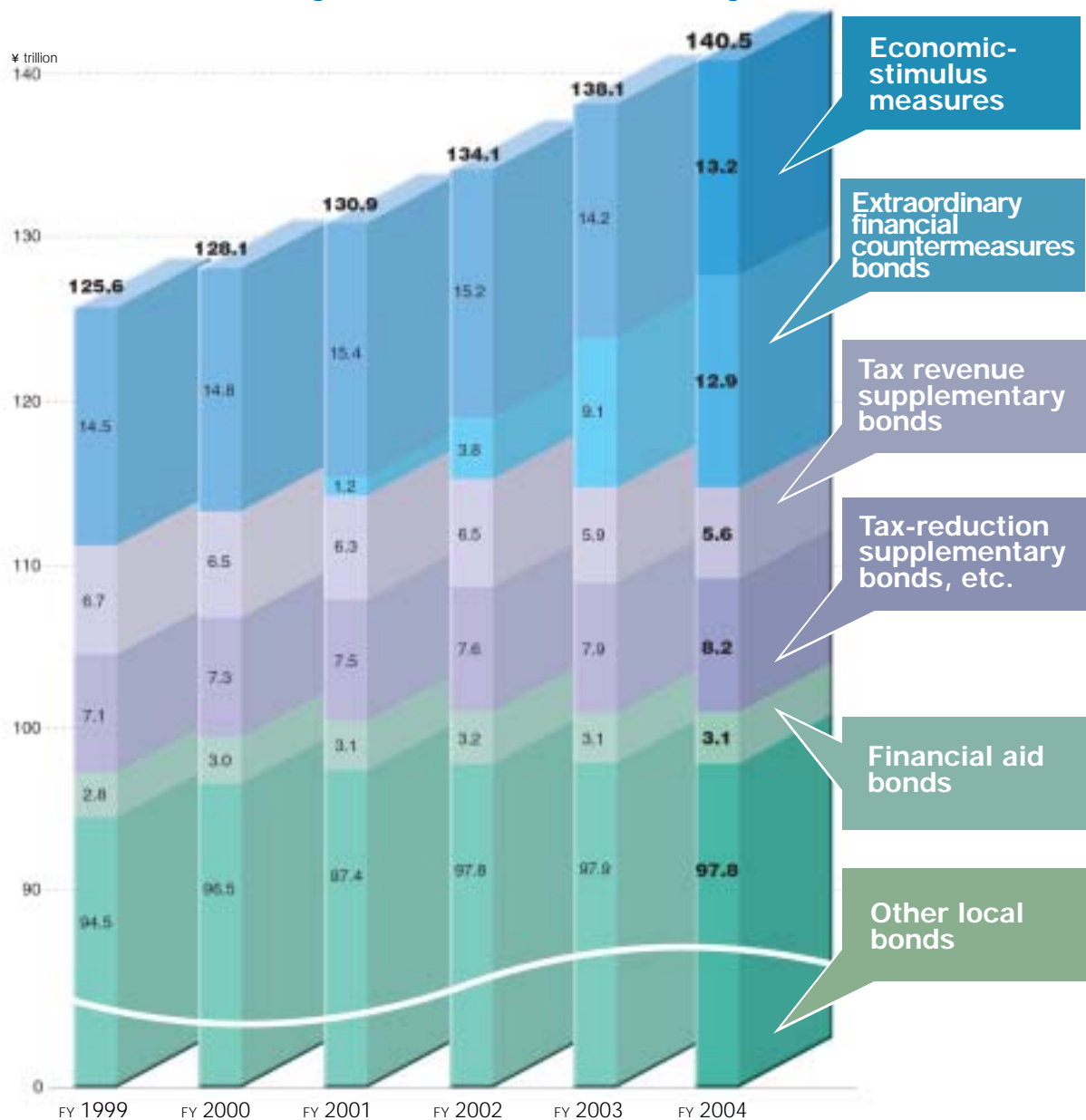
# Outstanding Local Government Borrowing (Ordinary Account)

What is the state of debts in local public finance?

## 1 Trends in Outstanding Local Government Borrowing

Outstanding local government borrowing, the debts of local governments, amounted to approximately ¥141 trillion at the end of fiscal 2004. This figure has been increasing in recent years because of such factors as the need to supplement tax revenue as a result of tax cuts, the added public investment by economic-stimulus measures, and the issue of extraordinary financial countermeasures bonds. The figure is 1.5 times larger than total revenue and about 2.7 times larger than the total sum of general revenue resources, such as local taxes and local allocation tax.

Trends in Outstanding Local Government Borrowing



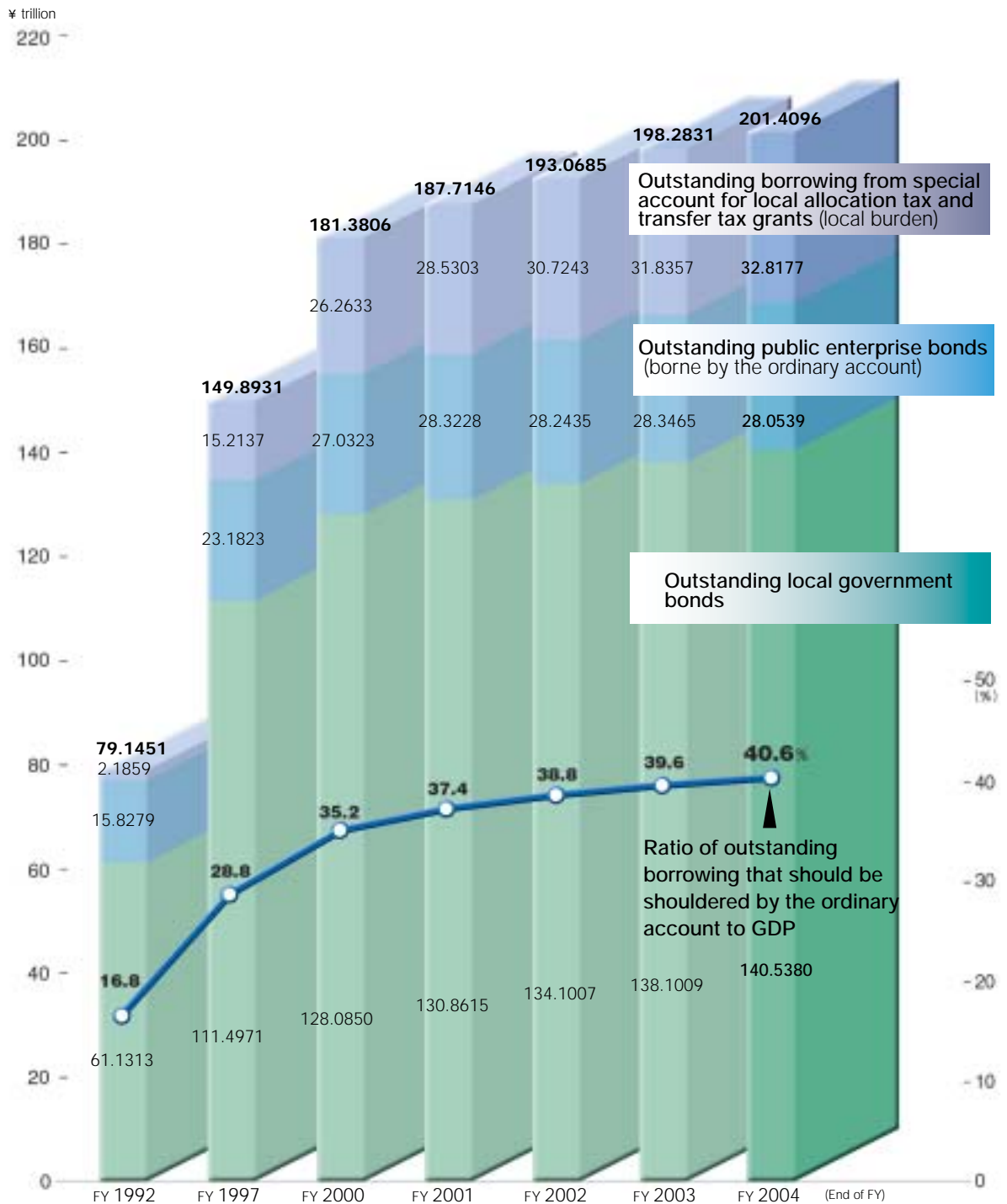
Notes:

1. Outstanding local government borrowing excludes special fund public investment bonds.
2. Economic-stimulus figures are estimates.

## 2 Outstanding Borrowing of Local Finance

The outstanding borrowing of local finance, including the local burden of borrowing from the special account for local allocation tax and transfer tax grants and those public enterprise bonds borne by the ordinary account, as well as current outstanding local government bonds, has been increasing sharply in recent years. The figure reached about ¥201 trillion at the end of fiscal 2004 and is expected to reach ¥204 trillion at the end of fiscal 2006.

### Trends in Outstanding Borrowing That Should Be Shouldered by the Ordinary Account and Ratio of Outstanding Borrowing to Gross Domestic Product



**Notes:**

1. Outstanding local government borrowing excludes special fund public works bonds and special fund public investment bonds.
2. Outstanding public enterprise bonds (borne by the ordinary account) are estimates based on settlement statistics.

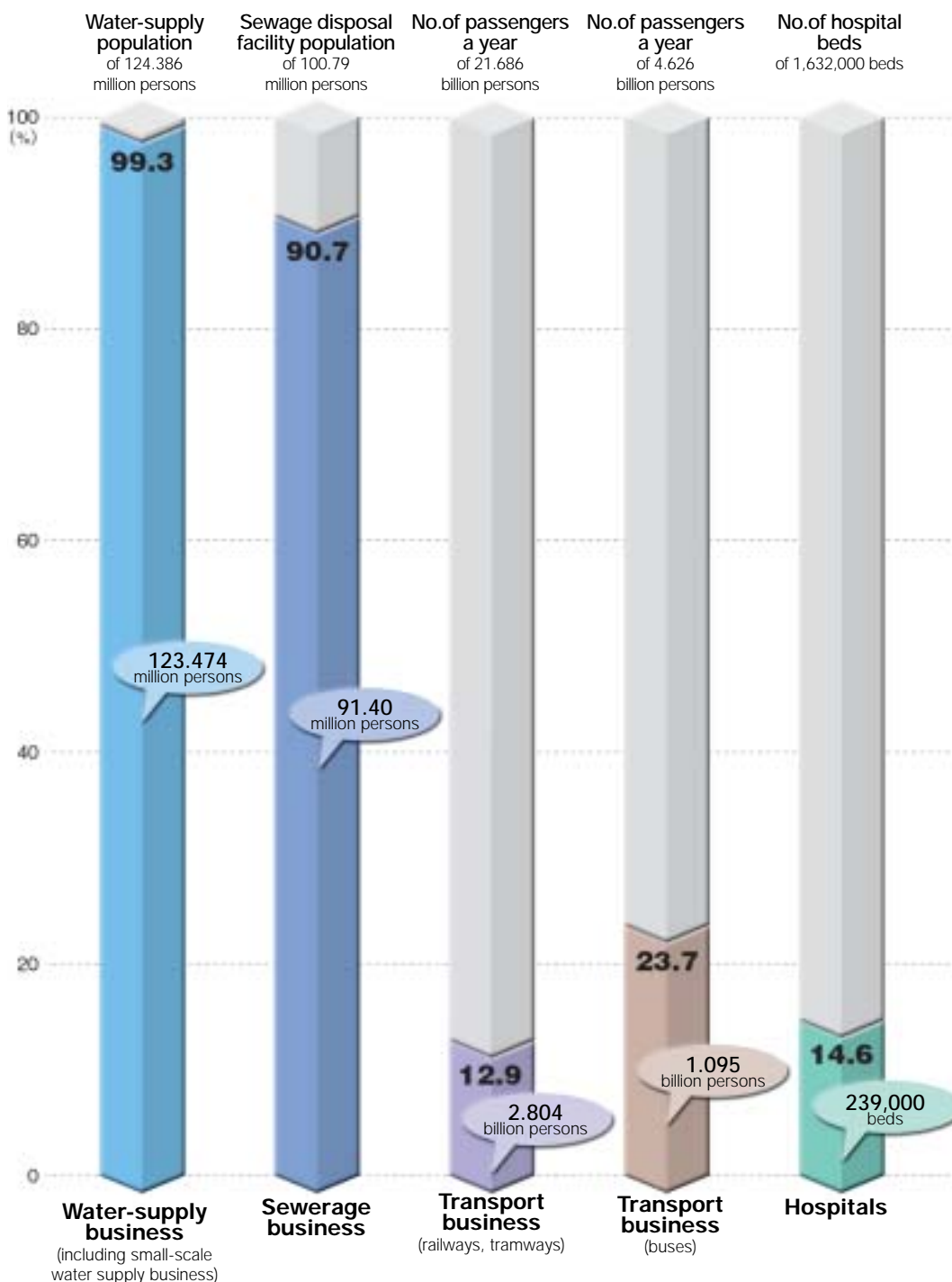
# Local Public Enterprises

## What is the state of local public enterprises?

Local public enterprises are managed directly by local governments for the purpose of social and public benefit. They provide social infrastructure and services indispensable for local residents and the development of the community, including water supply, sewerage, transport and hospitals.

### 1 Ratio of Local Public Enterprises

Local public enterprises play a major role in improving the standard of living of residents.



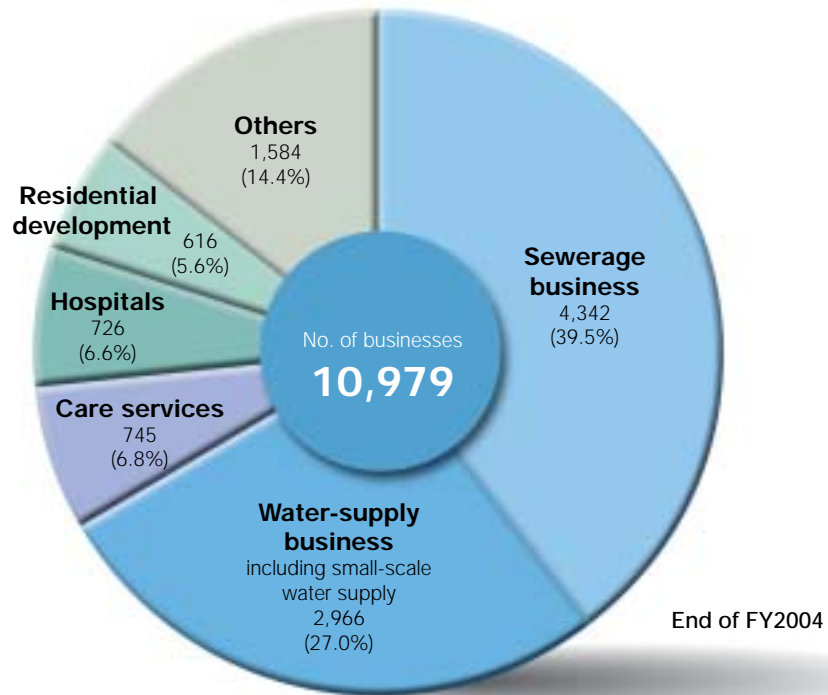
\*The graph shows the ratio of local public enterprises when the total number of business entities nationwide is taken as 100.

\*Figures for the total number of enterprises nationwide are compiled from statistical materials of related organizations; figures for local public enterprises are compiled from figures for the total number of enterprises and settlements for the previous fiscal year.



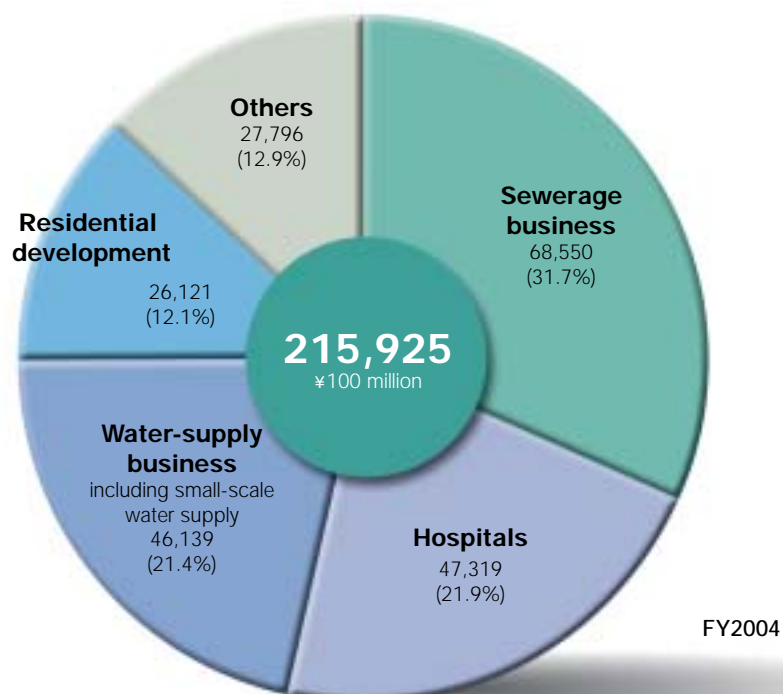
## 2 Number of Businesses Operated by Local Public Enterprises

The number of businesses is 10,979. By type of business, sewerage accounts for the largest ratio, followed in order by water supply, care services, and hospitals.



## 3 Scale of Financial Settlement

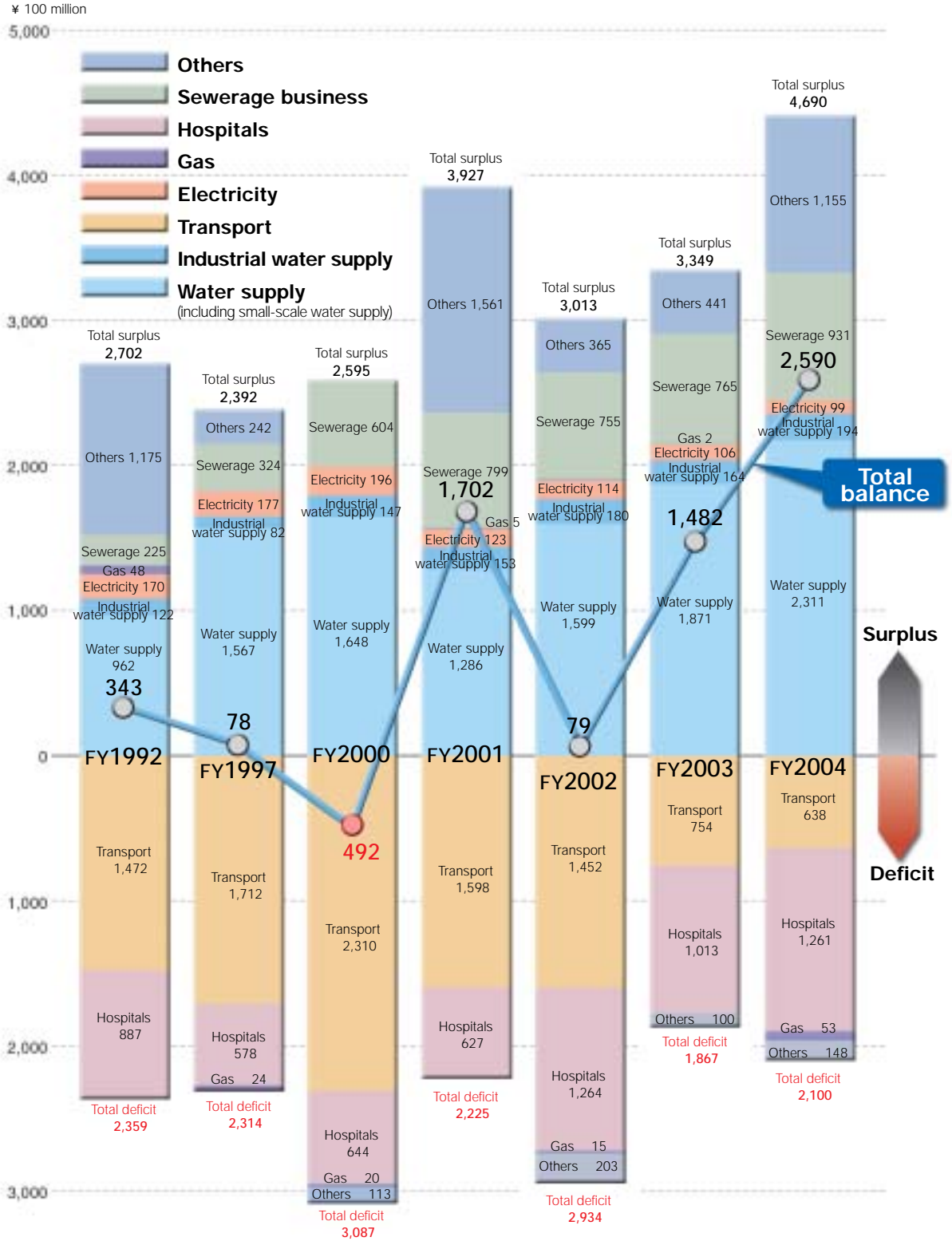
The total financial settlement scale is ¥21.5925 trillion. By type of business, sewerage accounts for the largest ratio, followed in order by hospitals, water supply, and Residential development.



## 4 Management Conditions

Local public enterprises had a surplus of ¥259.0 billion. By type of business, while water supply, industrial water supply, electricity, and sewerage showed a surplus, transport and hospitals are continuing to register a deficit.

### Trends in Management Conditions of Local Public Enterprises



# Efforts Toward Sound Financial Conditions

## What efforts have been made toward sound local finance?

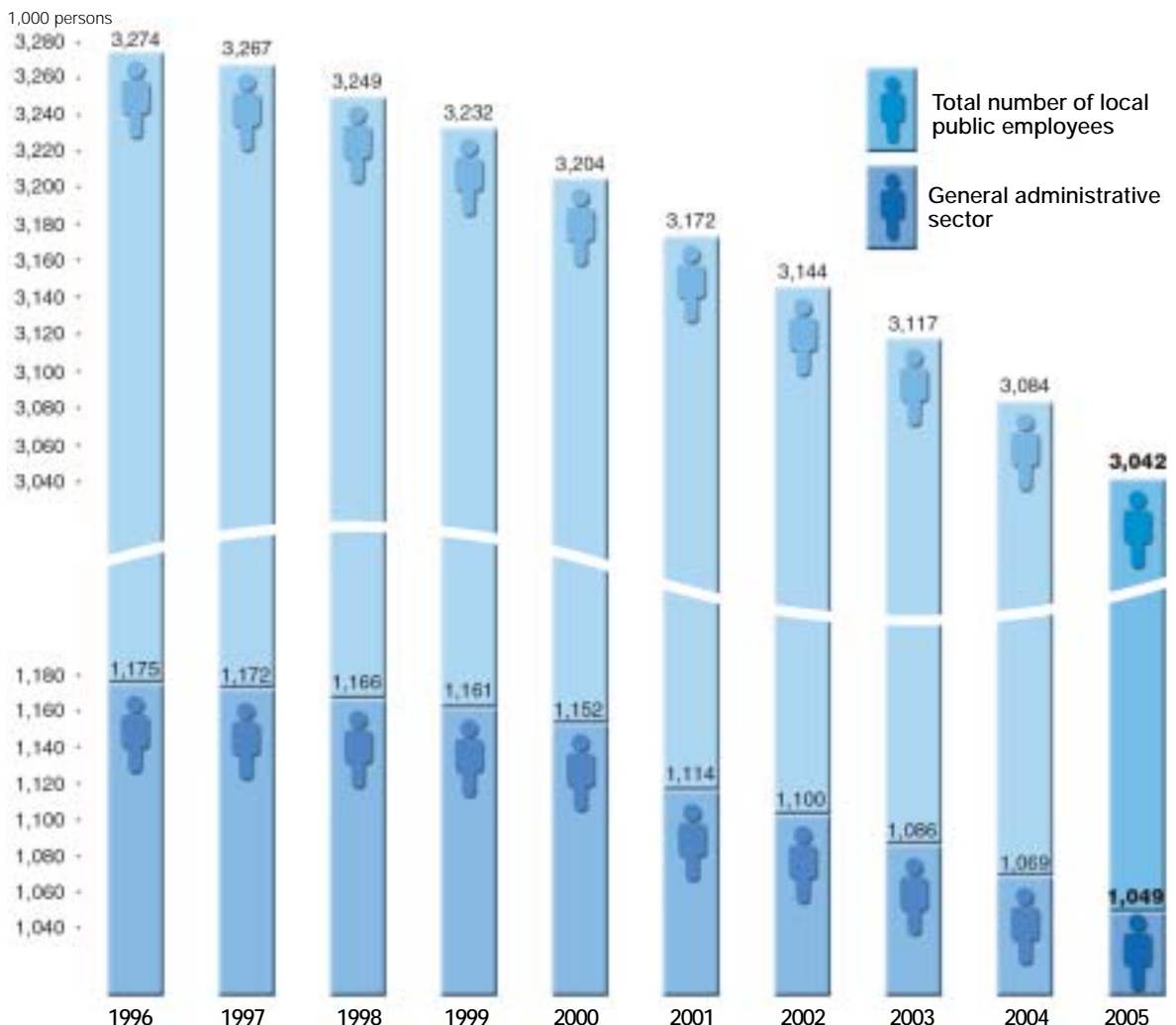
While local public finance is certainly in an extremely severe situation, the role of the local government, which is clarified as the comprehensive administrative entity of the region, is becoming increasingly important. For this reason, various efforts for administrative reform are being made with the aim of making administrative organizations simpler, more efficient and more responsible to new administrative issues.

### 1 Number of Public Employees

The number of local public employees has declined for 11 consecutive years since 1995. The number of employees has fallen for 10 consecutive years in the general administrative sector and 4 consecutive years in the public enterprise sector.

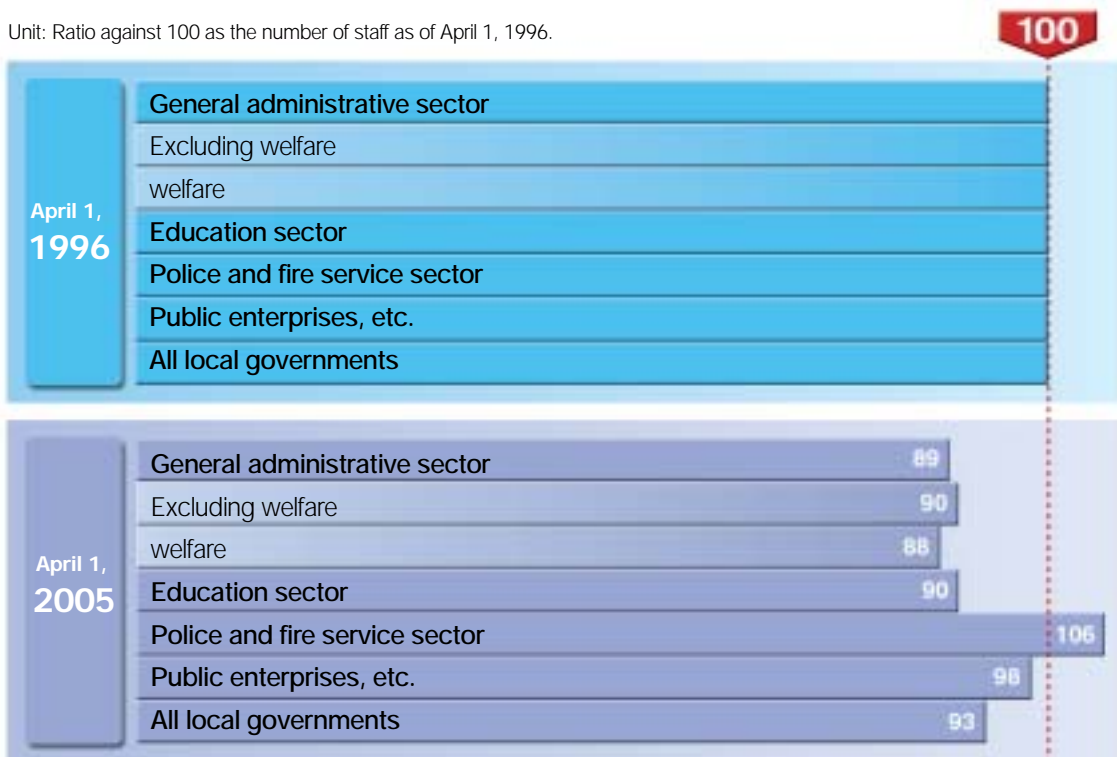
The reason for these declines is that, although the number of staff in the police and fire service sectors is increasing due to such factors as the enhancement of public security and disaster-prevention measures, efforts are being made to reduce the number of staff as a whole by, for example, setting numerical targets for personnel management and implementing cuts in other sectors on the basis of scrap-and-build policies

#### Number of Local Public Employees



## Trends in the Number of Staff in Local Governments by Sector

Unit: Ratio against 100 as the number of staff as of April 1, 1996.

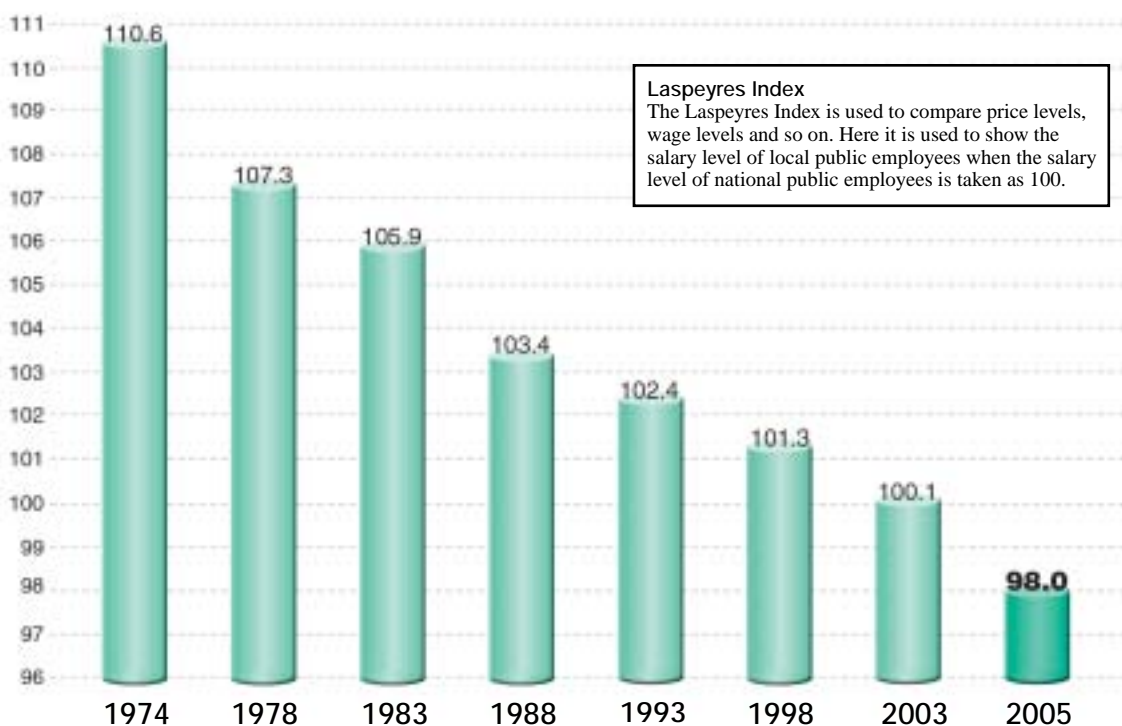


## 2 Salary Level

When the salary level of local public employees is shown on the Laspeyres Index, the average for all local governments is 98.0.

In fiscal 2004 a total of 444 local governments adopted measures to correct wage levels, such as the revision of salary scales, and a total of 1,965 local governments implemented the revision of various allowances and retirement allowances.

### Trends in the Laspeyres Index (Trends in the Average for All Local Governments)



### 3 Promotion of Local Administrative Reform Through the New Local Administrative Reform Guidelines

In order to solidly promote local administrative reform, the Ministry of Internal Affairs and Communications compiled the New Guidelines for the Promotion of Administrative Reform in Local Governments (the New Local Administrative Reform Guidelines) and notified local governments of them on March 29, 2005.

As a result, local governments have compiled and disclosed intensive reform plans indicating specific efforts, such as the reorganization and arrangement of administrative work and projects and the promotion of private-sector consignment, to be undertaken in general until fiscal 2009.

#### Specific Examples of Intensive Reform Plans

##### Prefecture A

###### Reduction of number of employees

- Reduction of 7.8% (about 2,800 persons) in the six years from FY 1999 to FY 2004
- Reduction of 6.9% (about 2,300 persons) in the five years from FY 2005 to FY 2009

###### Restraint of salary expenses

- Pay-rise period extension measure (12-month extension)  
Period: FY 1999-2003
- Salary-cut measure (7% for department heads and bureau heads, 5% for office heads, 3% for other staff)  
Period: FY 2004-2006

###### Promotion of private-sector consignment, etc.

- Fundamental revision of all nonclerical work (17 businesses, 361 persons)  
Private-sector consignment, etc. of security work, road inspection work, kitchen work, telephone operator work, etc.
- Introduction of designated manager system  
FY 2005: 19 facilities, FY 2006: 131 facilities (of which, prefectural housing: 118 facilities)

###### Reduction of internal management expenses

- Reduction of facility management expenses by 25% compared with the initial budget for FY 2003 by FY 2006
- Reduction of administrative expenses by 40% compared with the initial budget for FY 2003 by FY 2006

###### Reduction of ordinary construction project expenses, etc.

Planned reduction of public works

- Reduction of both subsidized and unsubsidized public works (construction) by 20% compared with the initial budget for FY 2003 by FY 2006
- Reduction of unsubsidized public works (maintenance) by 10% compared with the initial budget for FY 2003 by FY 2006
- Reduction of direct obligations by 10% compared with the initial budget for FY 2003 by FY 2006

Reduction of investment expenses other than public works in a planned manner by 20% compared with the initial budget for FY 2003 by FY 2006

Standardization of projects and progress adjustment

##### City B

###### Reduction of number of employees

- Reduction of number of employees by about 1,700 persons (about 11.5%) through efforts in the five years from FY 2005 to FY 2009 (reduction of 324 persons in FY 2006 due to efforts in FY 2005)

###### Formation of new salary system

- Revision of pay scale in response to work stages and shift to salaries that reflect job and work responsibility

###### Formation of new personnel system

- Promotion of personnel system reform to make maximum use of the abilities of employees through the operation of a new personnel evaluation system, compilation of a human resource development plan, etc. (full-fledged implementation of new personnel evaluation system from April 2006)

###### Promotion of private-sector consignment, etc.

- Promotion of shift to method of providing public services through utilization of the private sector through utilization of the designated manager system, etc. (system introduced at about 170 facilities as of April 2006)

###### Promotion of equity corporation reform

- Clarification of new reform targets for equity corporations, including their integration and abolition, and steady promotion of reform (one corporation abolished in FY 2005)

###### Promotion of soundness of public enterprises

- Regarding the four projects for the full operation of the Local Public Enterprise Law, compilation of individual new medium-term management plans and promotion of efforts toward establishment of financial structure to enable management through independent settlement

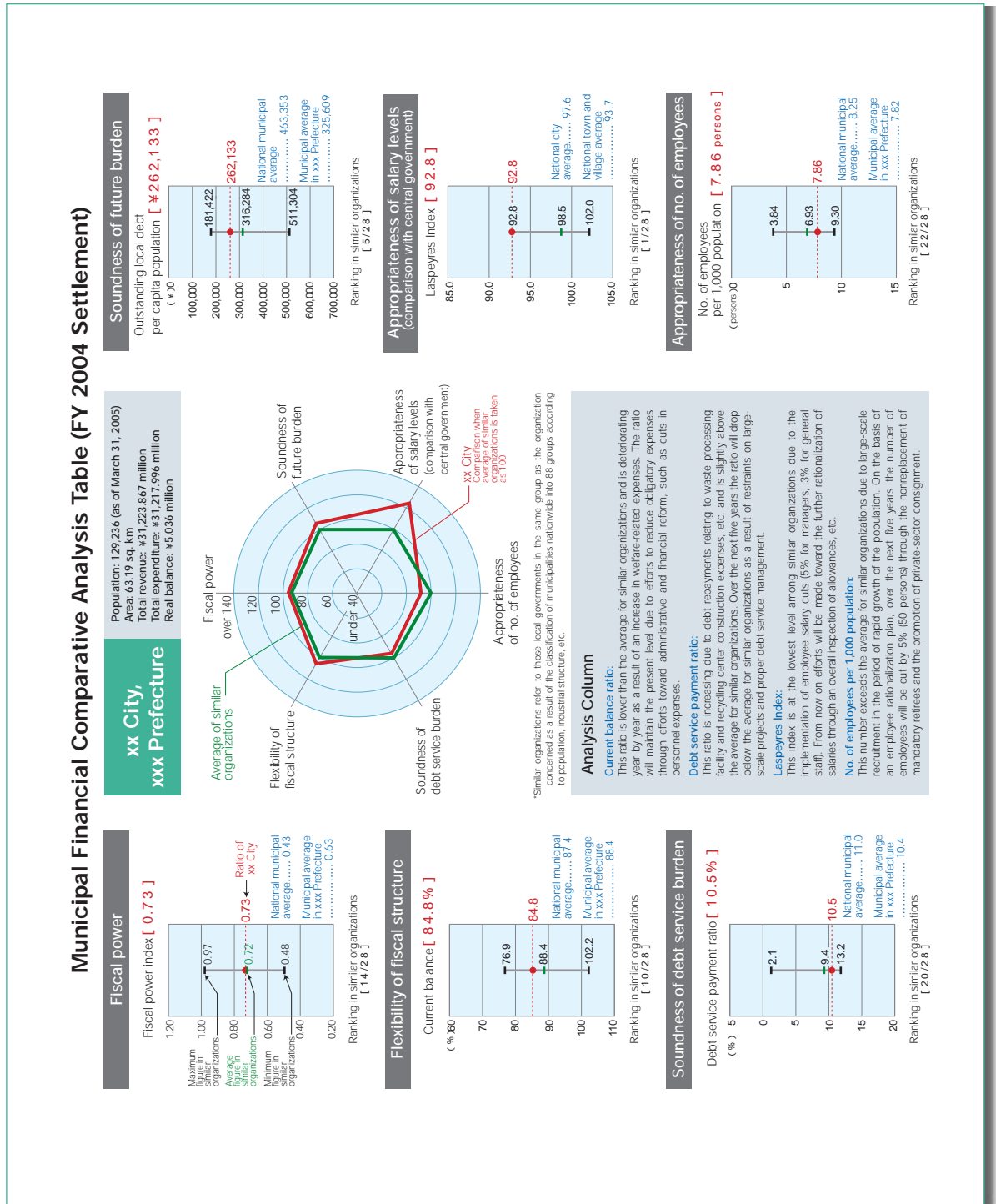
###### Efforts toward financial soundness

- Efforts to build a sustainable financial structure to achieve an account balance without borrowing from the sinking-fund in FY 2009

# 4 Administrative Transparency

Amid the increasing severity of local public finance, various efforts are being made to fulfill accountability. In order for each local government to promote financial soundness while gaining the understanding and cooperation of residents, etc., the Ministry of Internal Affairs and Communications has compiled financial comparative analysis tables and posted them on its homepage with the aim of disclosing information to residents, etc. in an easy-to-understand manner based on indicators that are comparable with those of other local governments. In the fiscal 2004 settlement, the ministry conducted a comparative analysis of the principal financial indicators, etc. among similar organizations and analyzed the efforts, etc. of each organization toward the improvement of the indicators, etc.

## Example of a Financial Comparative Analysis Table





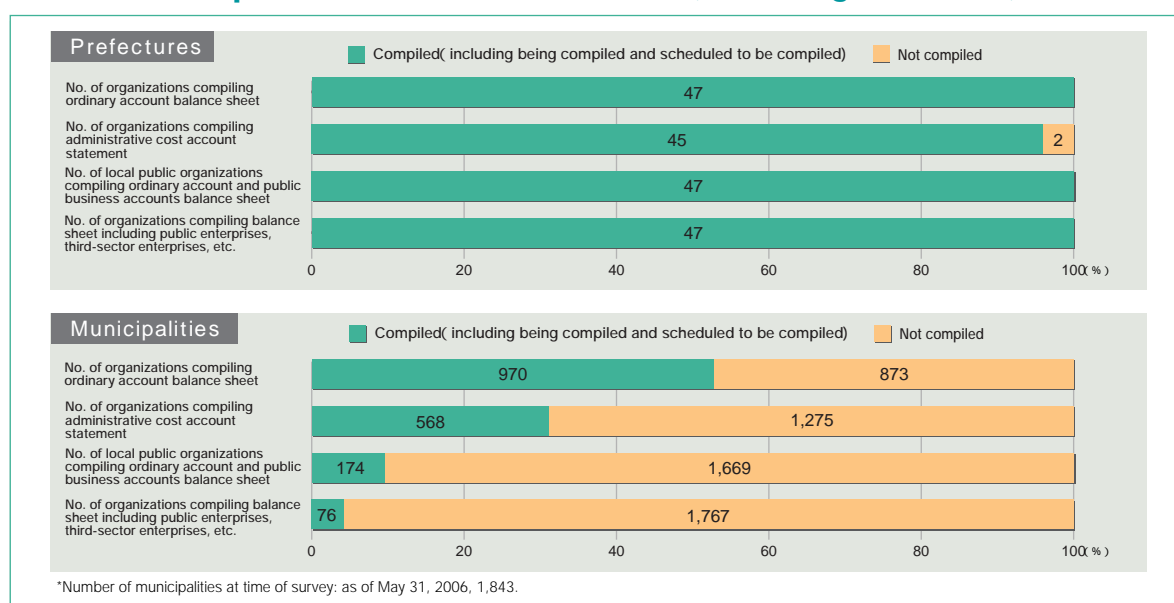
Meanwhile, in recent years an increasing number of local governments have been compiling ordinary account balance sheets and so on as a means of disclosing and analyzing financial conditions in order to grasp the state of their assets and liabilities in a comprehensive manner.

### Example of Balance Sheet (City A)

FY 2004 Ordinary Account Balance Sheet		(As of March 31, 2005; unit: ¥1,000)	
Debit		Credit	
<b>(Assets)</b>		<b>(Liabilities)</b>	
<b>1. Tangible fixed assets</b>		<b>1. Fixed liabilities</b>	
(1) General administration related	9,007,617	(1) Local government bonds	23,576,365
(2) Welfare related	1,793,997	(2) Contract authorization	
(3) Sanitation related	4,988,530	(1) Purchase of property, etc.	0
(4) Labor related	82	(2) Guarantee of obligation or loss compensation	0
(5) Agriculture related	361,589		Total 0
(6) Commerce and industry related	21,602	(3) Retirement allowance reserve	6,714,249
(7) Civil engineering work related	42,103,951	(4) Others	0
(8) Fire service related	1,006,957	<b>Total</b>	<b>30,290,614</b>
(9) Education related	28,690,758	<b>2. Liquid liabilities</b>	
(10) Others	9,389	(1) Scheduled redemption in next fiscal year	2,138,259
	Total 87,984,472	(2) Appropriation made in advance	0
(of which, land	26,849,262)	<b>Total</b>	<b>2,138,259</b>
<b>Total</b>	<b>87,984,472</b>	<b>Total liabilities</b>	<b>32,428,873</b>
<b>2. Investment, etc.</b>		<b>(Net assets)</b>	
(1) Investment and equity funds	2,078,024	1. National treasury disbursements	10,240,749
(2) Loan	84,000	2. Prefectural disbursements	1,388,985
(3) Funds		3. General revenue sources, etc.	55,026,788
(1) Special purpose funds	1,341,424	<b>Total net assets</b>	<b>66,656,522</b>
(2) Land development funds	0		
(3) Fixed-in investment	12,755		
	Total 1,354,179		
(4) Retirement allowance cooperative reserve fund	2,354,419		
<b>Total</b>	<b>5,870,622</b>		
<b>3. Liquid assets</b>			
(1) Cash, deposits			
(1) Adjustment fund for finance	1,323,000		
(2) Sinking funds	940,000		
(3) Cash in yearly account	1,731,817		
	Total 3,994,817		
(2) Receivables			
(1) Local taxes	1,166,545		
(2) Others	68,939		
	Total 1,235,484		
<b>Total</b>	<b>5,230,301</b>		
<b>Total assets</b>	<b>99,085,395</b>	<b>Total of liabilities and net assets</b>	<b>99,085,395</b>

Information relating to contract authorization  
 (1) Matters relating to the purchase of property, etc. 1,399,187  
 (2) Matters relating to guarantee of obligation and loss compensation 2,701,762  
 (3) Matters relating to compensation for paid interest, etc. 0

### State of Compilation of Balance Sheets (no. of organizations)





Furthermore, relating to their fiscal 2004 settlements, prefectures and ordinance-designated cities endeavored to compile consolidated balance sheets in order to clarify the state of their assets and liabilities including local independent administrative organizations, public enterprises, corporations in which they have certain invested capital, and so on.

## Example of Consolidated Balance Sheet (City A)

<b>FY 2004 Consolidated Balance Sheet</b>		(As of March 31, 2005; unit: ¥ million)	
<b>(Assets)</b>		<b>(Liabilities)</b>	
<b>1. Tangible fixed assets</b>		<b>1. Fixed liabilities</b>	
(1) Ordinary account	87,984	(1) Ordinary account bonds	23,576
(2) Public enterprise account	38,076	(2) Public enterprise bonds	17,864
(3) Partial administrative associations	1,140	(3) Partial administrative association local bonds	19
(4) Three local public corporations	1,459	(4) Long-term borrowing of three local public corporations	1,045
(5) Third sector	11	(5) Reserves	6,990
		(of which, retirement allowance reserve)	6,741
		(other reserves)	249
<b>Total of tangible fixed assets</b>	<b>128,670</b>	<b>Total of fixed liabilities</b>	<b>49,494</b>
<b>2. Investments, etc.</b>		<b>2. Current liabilities</b>	
(1) Investments and equity funds	1,799	(1) Scheduled redemption in next fiscal year	3,570
(2) Loans	84	(2) Other	282
(3) Endowments	3,832	<b>Total of current liabilities</b>	<b>3,852</b>
(4) Other	2	<b>Total of liabilities</b>	<b>53,346</b>
<b>Total of investments, etc.</b>	<b>5,717</b>	<b>(Asset/liability difference)</b>	
<b>3. Current assets</b>		1. National treasury disbursements	13,201
(1) Cash and deposits	7,978	2. Prefectural disbursements	1,480
(2) Accounts receivable	2,496	3. Other organization and private-sector equity portion	2
(3) Other	101	4. General revenue sources, etc.	76,933
<b>Total of current assets</b>	<b>10,575</b>	<b>Total of asset/liability difference</b>	<b>91,616</b>
<b>Total of assets</b>	<b>144,962</b>	<b>Total of liabilities and asset/liability difference</b>	<b>144,962</b>

\*1. Scheduled expenditure relating to purchase of property, etc. ¥1,399 million  
(of which, items for consolidation-applicable corporations ¥xxx million)

\*2. Limit on contract authorization relating to guarantee of obligation and loss compensation ¥2,702 million  
(of which, items for consolidation-applicable corporations ¥2,702 million)

# Issues of Local Finance

## 1 The Trinity Reform

### Background of the Reform

Amid a situation in which local finance is suffering a severe shortage of resources, in order to further promote decentralization, under the principle of “entrusting to local governments what they can do,” it is necessary to increase the degree of freedom of local governments in terms of both income and expenditure and to foster the true independence of the regions. From this perspective, it was decided to mutually connect, study, and revise, in a uniform manner, the reform of national treasury subsidies, the distribution of tax resources, including the transfer of tax resources, and the local allocation tax.

Realization of an income structure based mainly on local taxes  
 → Further clarification of correspondence between benefit and burden of administrative services  
 Reduce the gap between the expenditure scale and tax revenue of local governments as much as possible.

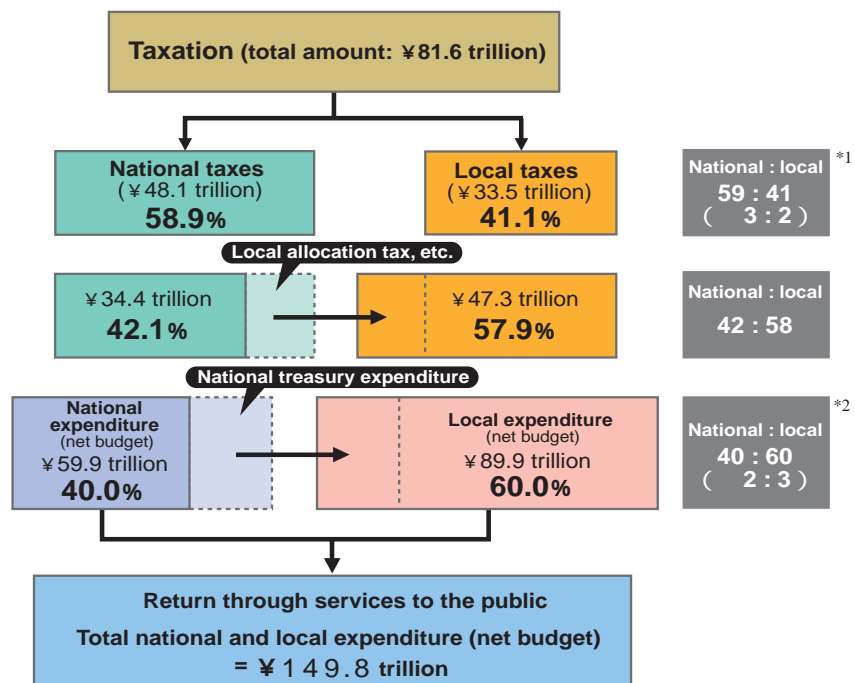
Tax revenue    state : local = 3 : 2 \*1  
 Expenditure    state : local = 2 : 3 \*2

Revision of involvement of the central government through national treasury subsidies, legislation, etc.  
 Promotion of administrative reform and fiscal structure reform in the national and local governments

### The Trinity Reform

#### Reference

#### Distribution of Financial Resources Between the National and Local Governments (FY 2004)



## Overall Picture of the Trinity Reform and Results up to FY 2006

### Reform of national treasury subsidies

Bearing in mind successive basic policies and the agreements reached between the government and the ruling parties in 2004 and 2005, a reform of national treasury subsidies exceeding ¥4 trillion was implemented by fiscal 2006.

#### Reform of national treasury subsidies linked to the transfer of tax resources

Items related to tax resource transfers in FY 2006  
 ..... ¥709.3 billion

Items related to the government-ruling parties agreements on the overall picture  
 ..... ¥1,753.9 billion

Items related to the FY 2005 government-ruling parties agreement  
 ..... ¥654.4 billion

#### Other national treasury assistance and subsidy reforms

Reforms for streamlining  
 ..... ¥988.6 billion

Reforms for increased grants  
 ..... ¥794.3 billion

**Overall picture of national treasury subsidy reform**  
 ..... **¥4,666.1 billion**  
 (excluding the FY 2003 reform portion of ¥234.4 billion)

### Revision of tax resource distribution, including the transfer of tax resources

#### Results of reform

In the fiscal 2006 revision of the tax system, the transfer of tax resources of a scale of ¥3 trillion from income tax to individual resident's tax was implemented (from the fiscal 2007 income tax and the fiscal 2007 individual resident's tax). The full transfer amount was incorporated into the income transfer tax in fiscal 2006.

(FY 2006)

#### Income transfer tax

Prefectures ..... ¥2,179.4 billion

Municipalities ..... ¥830 billion

Total ..... ¥3,009.4 billion

### Reform of the local allocation tax

#### Results of reform

Restraint on the total amount of the local allocation tax and extraordinary financial countermeasures bonds

FY 2004-06: ¥5.1 trillion

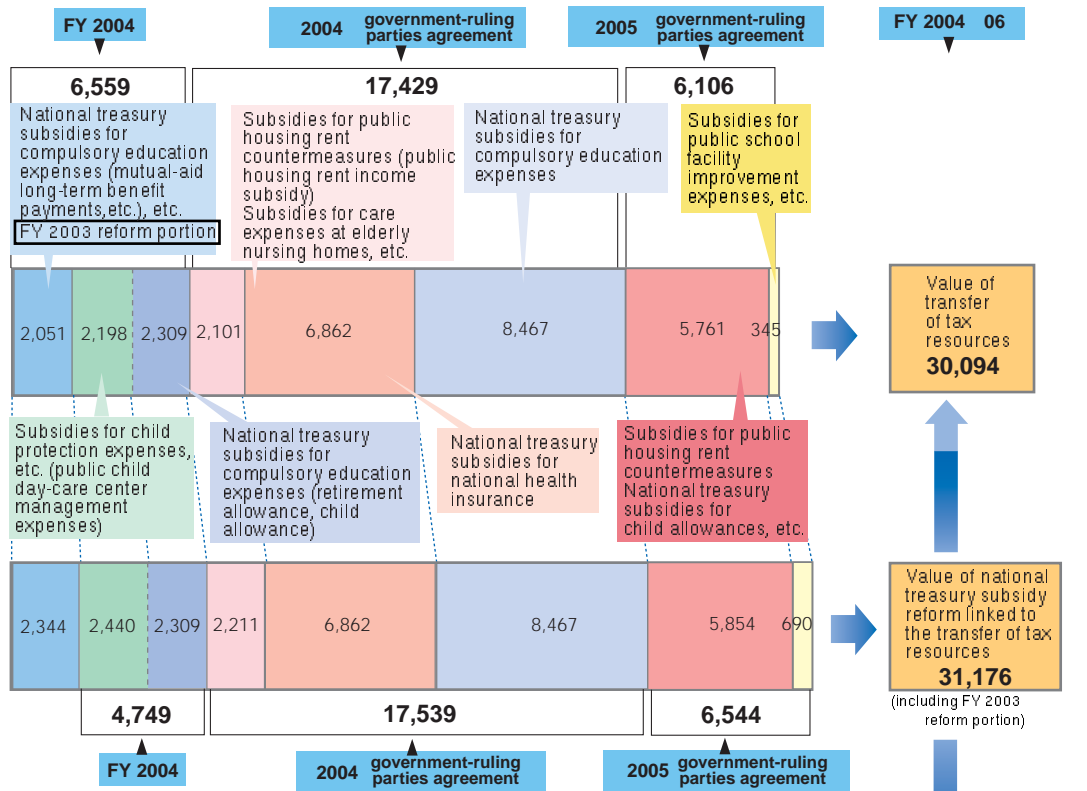
Creation and expansion of the Administrative Reform Incentive Assessment

Simplification of assessment

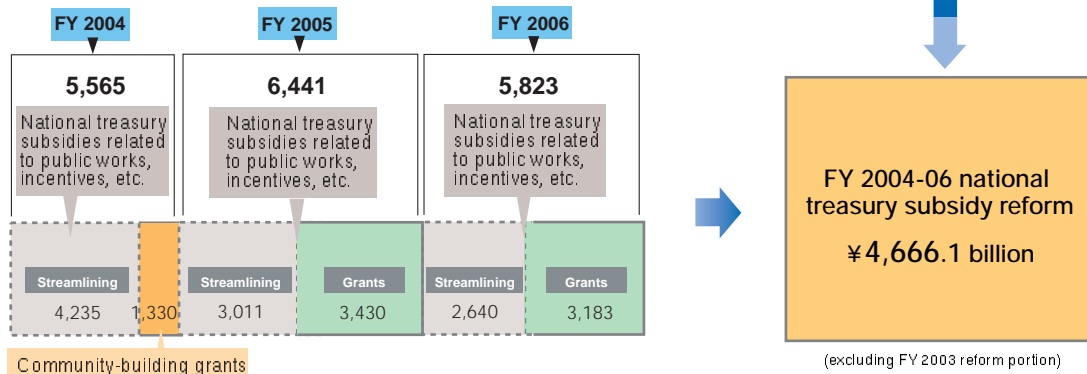
Proper response to widening gap in financial power  
 (100% inclusion of tax resource transfer portion in standard financial revenue amount [tentative measure])

### Image of National Treasury Subsidy Reform Linked to the Transfer of Tax Resources

(unit: ¥100 million)



(Reference)  
Other national treasury subsidy reforms



## 2 Shift to Local Bond Consultation System

### Outline of the Local Bond Consultation System

Following the enforcement of the Comprehensive Decentralization Law, from the viewpoint of further enhancing the independence of local governments, regarding the approval system for local bonds, from fiscal 2006 there was a shift to a system of consultation with the minister of internal affairs and communications and the prefectural governor aimed at ensuring the smooth issue of local bonds, guaranteeing local financial resources, and ensuring the soundness of local finances.

#### (1) Consultations on local bonds, etc.

- (a) Consultations  
When issuing local bonds, local governments must consult with the minister of internal affairs and communications or the prefectural governor (hereinafter "the minister, etc.").
- (b) Allotment of public funds for agreed local bonds  
Regarding only local bonds agreed by the minister, etc. in consultations, local governments shall be able to borrow public funds in connection with the said agreement.
- (c) Inclusion of principal and interest repayments for agreed local bonds in the local financial plan  
Principal and interest repayments for local bonds agreed by the minister, etc. will be included in the local financial plan.
- (d) Report to assembly in the case of issuing non-agreed local bonds  
When issuing local bonds without obtaining the agreement of the minister, etc. the head of the local government must report to the assembly beforehand.
- (e) Agreement criteria and local bond plan  
Each fiscal year the minister of internal affairs and communications will compile and disclose agreement criteria and a local bond plan.

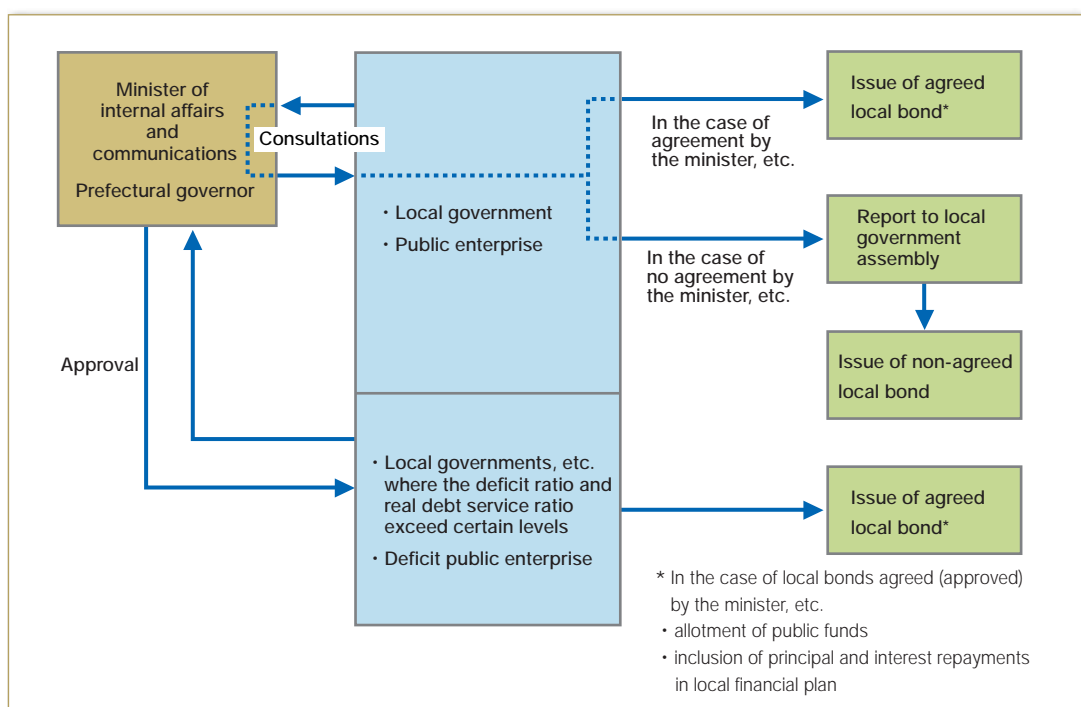
#### (2) Special cases of involvement regarding local bonds

- (a) Deficit organizations, organizations with a high real debt service ratio, etc. must obtain approval from the minister, etc. when issuing local bonds.
- (b) When issuing local bonds that will be the financial resource for expenses incurred in construction work for public facilities, etc. (Article 5, No. 5), organizations with less than standard tax rates must obtain approval from the minister, etc.

#### (3) Switchover period

The switchover to the consultation system will take place from fiscal 2006.

### Mechanism of the Local Bond Consultation System

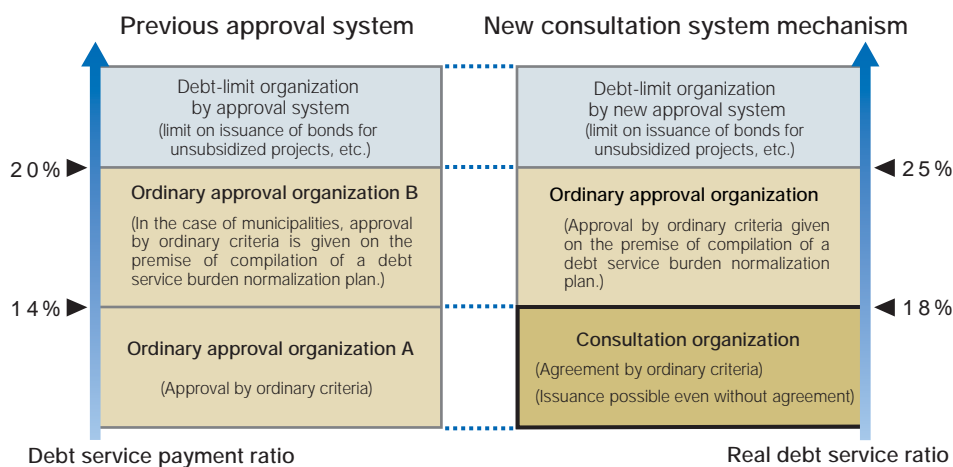


## Mechanism of Early Correction Measure in the Local Bond Consultation System

Certain revision of the index for measuring the ratio of debt service expenses to the standard scale of ordinary financial resources from the viewpoint of increased severity and transparency  
→ introduction of the real debt service ratio

In the case of organizations with a real debt service ratio of 18% or higher, approval is given on the premise that they compile a debt service burden normalization plan.

In the case of organizations with a real debt service ratio of 25% or higher, limits are placed on local bonds relating to unsubsidized projects, such as regional vitalization projects.



### Real debt service ratio

- The real debt service ratio is calculated as follows. (Article 5-4-1-2 of the Local Finance Law)

$$\frac{(A + B) - (C + D)}{E - D}$$

A: Principal and interest repayments on local bonds (excluding advanced redemption, etc.)

B: Equivalent of principal and interest repayments on local bonds

C: Specific financial resources allotted to principal and interest repayment, etc.

D: The amount included in the standard financial requirement used to calculate the ordinary allocation tax sum as the expense necessary for principal and interest repayments for local bonds and the amount included in the standard financial requirement used to calculate the ordinary allocation tax sum necessary for quasi principal and interest repayments.

E: Standard financial scale (standard tax revenue amount + ordinary allocation tax amount + issuable extraordinary financial countermeasures bond amount)

### Idea of the real debt service ratio

- In order to measure the level of principal and interest repayments, from the viewpoint of ensuring market confidence and fairness, transparency, clarity, and so on, a new indicator with certain revisions is used for the current debt service payment ratio.

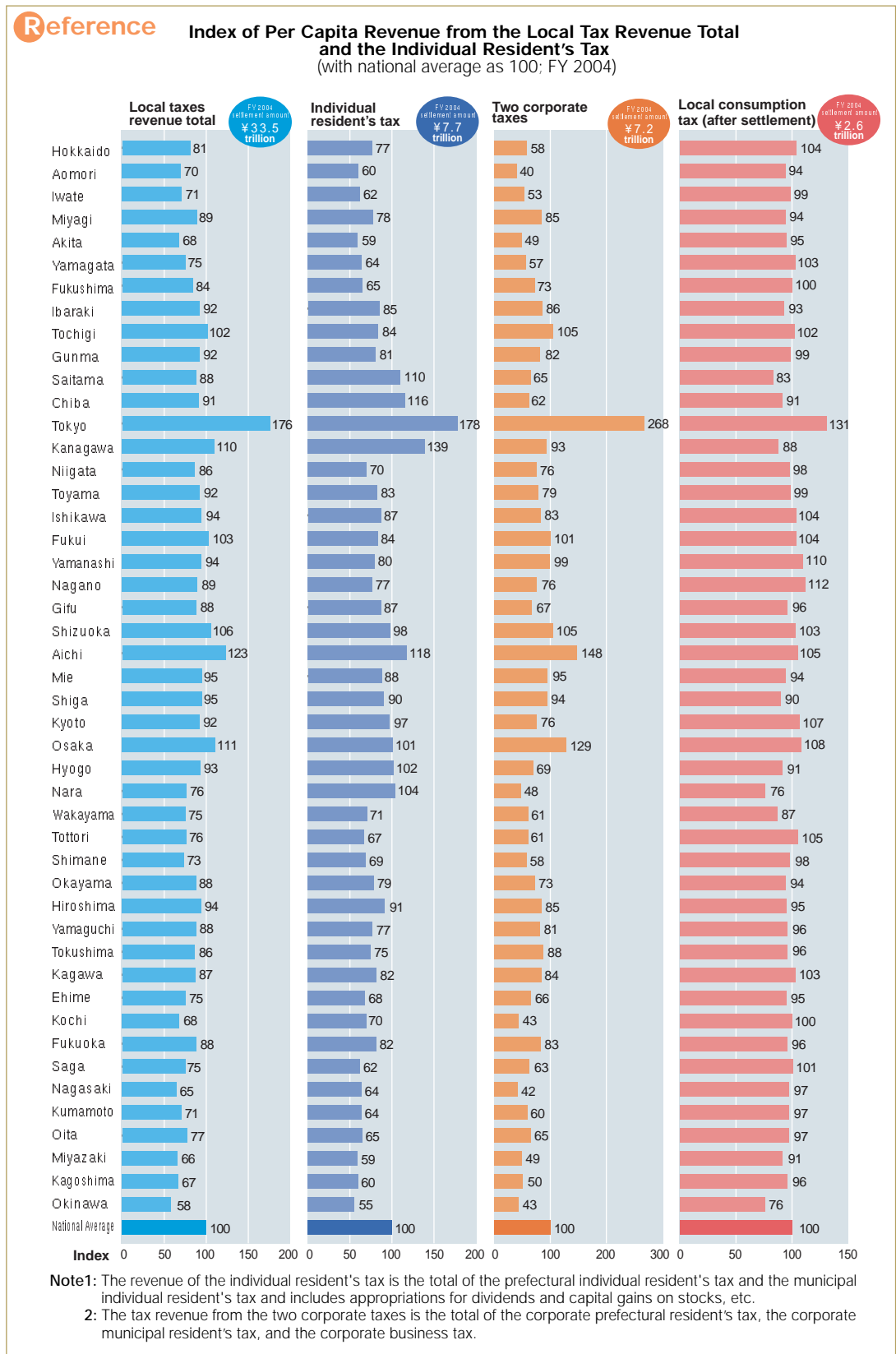
### 【Revision points】

- Unification of reflective rules in the sinking-fund reserve ratio for local bonds with lump-sum repayment upon maturity
- Reflection in the sinking-fund reserve shortage ratio for local bonds with lump-sum repayment upon maturity
- Introduction in principle of debt service similar expenses, such as subsidies, for the debt service expenses of PFI and partial administrative associations
- Inclusion of withdrawals from the general account for principal and interest repayments of public enterprises

### 3 Expansion of the Financial Base

#### Local Taxes

In order for local governments to provide administrative services in response to local needs with responsibility and at their own discretion, it is necessary to expand and secure local taxes so as to build a local tax system in which the uneven distribution of tax sources is limited and the stability of tax revenue is ensured.

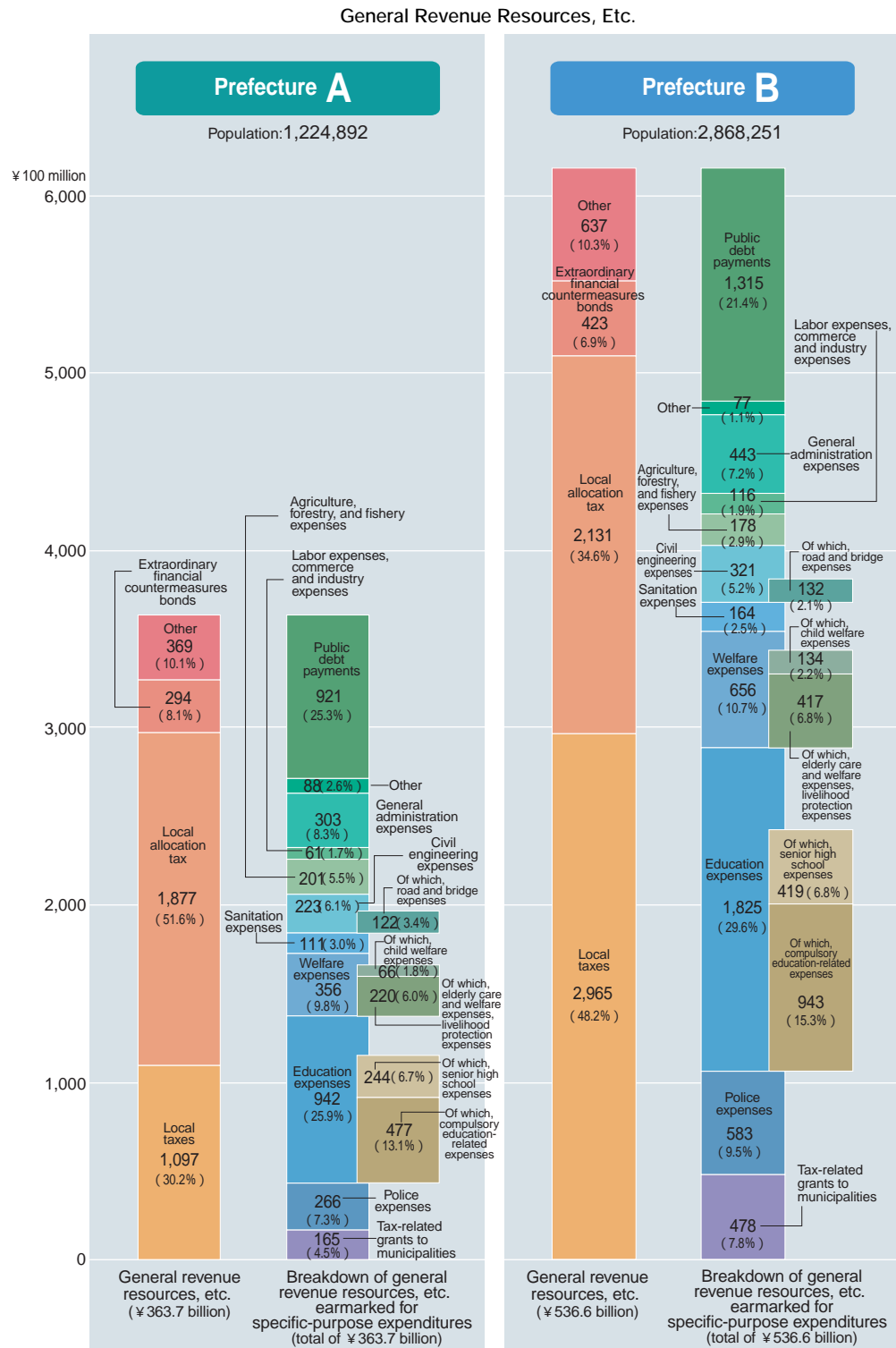


## Local Allocation Tax

The local allocation tax fulfills an extremely important role in view of the fact that there are differences in economic strength and financial strength among the regions and that in Japan, with regard to a large part of domestic administrative affairs, local governments are required through legislation, etc. to ensure a certain administrative level in the regions.

### Reference

State of Financial Resource Guarantees (Micro) through the Local Allocation Tax (Prefectural Examples) FY 2004 settlement

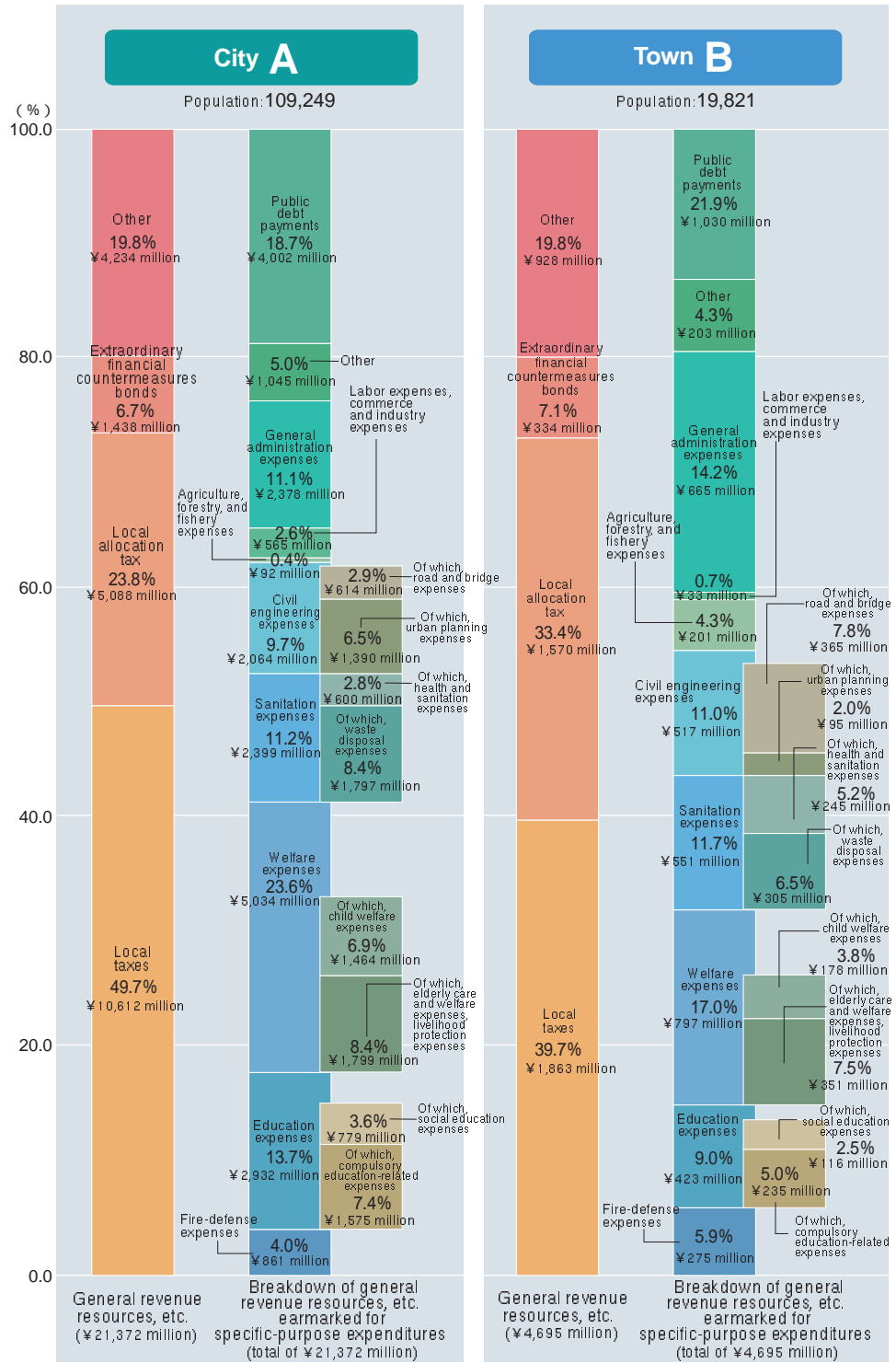




Reference

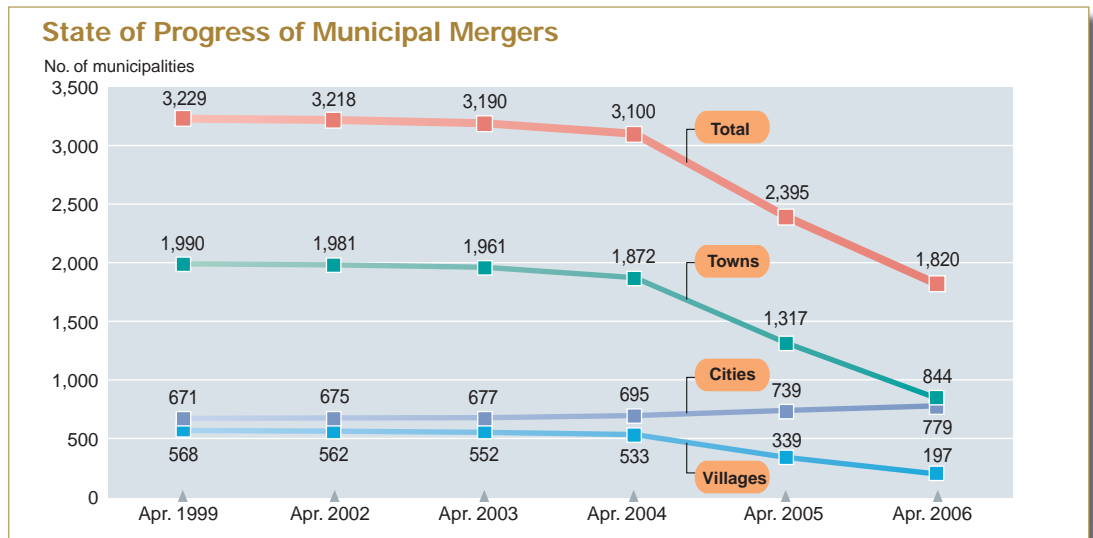
State of Financial Resource Guarantees (Micro) through the Local Allocation Tax (Municipal Examples) FY 2004 settlement

General Revenue Resources, Etc.



## 4 Promotion of Municipal Mergers

As the role of the municipality becomes increasingly important amid the advance of decentralization, in order to strengthen the administrative and financial bases of municipalities and to maintain and improve the administrative services of municipalities even in the present condition of severe fiscal conditions both centrally and locally, it is necessary to expand administrative scale and efficiency through municipal mergers.



### State of Progress of Municipal Mergers by Prefecture

Prefecture	No. of municipalities on April 1, 1999				No. of municipalities on April 1, 2006				Rate of decline (%)
	Breakdown				Breakdown				
	Cities	Towns	Villages		Cities	Towns	Villages		
Hokkaido	212	34	154	24	180	35	130	15	15.1
Aomori	67	8	34	25	40	10	22	8	40.3
Iwate	59	13	30	16	35	13	16	6	40.7
Miyagi	71	10	59	2	36	13	22	1	49.3
Akita	69	9	50	10	25	13	9	3	63.8
Yamagata	44	13	27	4	35	13	19	3	20.5
Fukushima	90	10	52	28	61	12	33	16	32.2
Ibaraki	85	20	48	17	44	32	10	2	48.2
Tochigi	49	12	35	2	33	14	19	0	32.7
Gunma	70	11	33	26	39	12	17	10	44.3
Saitama	92	43	38	11	71	40	30	1	22.8
Chiba	80	31	44	5	56	36	17	3	30.0
Tokyo	40	27	5	8	39	26	5	8	2.5
Kanagawa	37	19	17	1	35	19	15	1	5.4
Niigata	112	20	57	35	35	20	9	6	68.8
Toyama	35	9	18	8	15	10	4	1	57.1
Ishikawa	41	8	27	6	19	10	9	0	53.7
Fukui	35	7	22	6	17	9	8	0	51.4
Yamanashi	64	7	37	20	29	13	9	7	54.7
Nagano	120	17	36	67	81	19	25	37	32.5
Gifu	99	14	55	30	42	21	19	2	57.6
Shizuoka	74	21	49	4	42	23	19	0	43.2
Aichi	88	31	47	10	63	35	26	2	28.4
Mie	69	13	47	9	29	14	15	0	58.0

Prefecture	No. of municipalities on April 1, 1999				No. of municipalities on April 1, 2006				Rate of decline (%)
	Breakdown				Breakdown				
	Cities	Towns	Villages		Cities	Towns	Villages		
Shiga	50	7	42	1	26	13	13	0	48.0
Kyoto	44	12	31	1	28	14	13	1	36.4
Osaka	44	33	10	1	43	33	9	1	2.3
Hyogo	88	22	66	0	41	29	12	0	54.9
Nara	47	10	20	17	39	12	15	12	17.0
Wakayama	50	7	36	7	30	9	20	1	40.0
Tottori	39	4	31	4	19	4	14	1	51.3
Shimane	59	8	41	10	21	8	12	1	64.4
Okayama	78	10	56	12	29	15	12	2	62.8
Hiroshima	86	13	67	6	23	14	9	0	73.3
Yamaguchi	56	14	37	5	22	13	9	0	60.7
Tokushima	50	4	38	8	24	8	15	1	52.0
Kagawa	43	5	38	0	17	8	9	0	60.5
Ehime	70	12	44	14	20	11	9	0	71.4
Kochi	53	9	25	19	35	11	18	6	34.0
Fukuoka	97	24	65	8	69	27	38	4	28.9
Saga	49	7	37	5	23	10	13	0	53.1
Nagasaki	79	8	70	1	23	13	10	0	70.9
Kumamoto	94	11	62	21	48	14	26	8	48.9
Osaka	58	11	36	11	18	14	3	1	69.0
Myazaki	44	9	28	7	31	9	19	3	29.5
Kagoshima	96	14	73	9	49	17	28	4	49.0
Okinawa	53	10	16	27	41	11	11	19	22.6
<b>Total</b>	<b>3,229</b>	<b>691</b>	<b>1,990</b>	<b>568</b>	<b>1,820</b>	<b>779</b>	<b>844</b>	<b>197</b>	<b>43.7</b>

Note: The number of cities includes ordinance-designated cities but excludes special wards.

## Effects of Municipal Mergers ~ Effects appear in various ways ~

What effects have appeared through the merger of municipalities? The following are some specific examples.

### Improvement in the convenience of residents!

Through mergers, it has become possible to go beyond municipal boundaries and use child day-care centers that have vacancies. (Niigata City, Niigata Prefecture)

In order to facilitate the efficient use of libraries, library systems have been integrated so that it is now possible at any library to search the books stocked at other libraries and to request, borrow, and return them. (Tahara City, Aichi Prefecture)



### Upgrading and diversification of administrative services!

A clinic was opened for the first time in about 30 years in the mountainous district of Besshiyama, which previously did not have a doctor. (Niihama City, Ehime Prefecture)

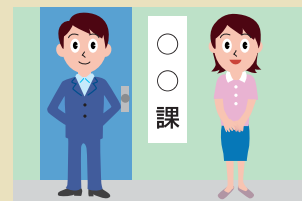
As a result of the expansion of the regular fire-service area following a merger, a fire station branch was opened, increasing the safety and security of local residents. (Gojo City, Nara Prefecture)



### Wide-area community development!

As a result of a merger, the town came to have the leading plum production quantity in Japan. The town is now promoting community building as the "number one plum town in Japan" and has established a "plum section" to undertake development and experimental research relating to plums. (Minabe Town, Wakayama Prefecture)

Following a merger, the town established two sections that it was not able to have before --- a Child Future Section for the strengthening of child-raising assistance and declining birthrate countermeasures and a Town Building Section for the promotion of community development and gender equality --- and has become able to implement more specialized services. (Chikuzen Town, Fukuoka Prefecture)



### Greater administrative and financial efficiency!

As a result of a survey of 557 local governments that merged between April 1999 and March 2006, it is estimated that after fiscal 2016 (that is, about 10 years after the merger) efficiency will amount to about ¥1.8 trillion a year. (Of this, personnel expenses will be reduced by about ¥540 billion [the equivalent of about 127,000 employees.])

**White Paper  
on  
Local Public  
Finance  
2006**

FY 2004 Settlement

**Illustrated**

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