

# Japanese Local Government Bonds

*A Safe Investment*

Japan Local Government Bond Association

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# Safety of Japanese Local Government Bonds

Japanese local government bonds are issued under the following conditions. Default is considered almost inconceivable. Japanese local government bonds presume a credit risk weight of 0% under BIS regulations.

## 1、 Resources for Redemption of Local Government Bonds Secured

- ( 1 ) Can ensure tax revenue based upon own authority to tax
- ( 2 ) Public debt payments (redemption of principal and interest for local government bonds) are noted as expenditures in Local Governments Finance Program (LGFP) of the national government each fiscal year
- ( 3 ) Local Allocation Tax from the national government to the local governments are secured in order to balance expenditures (including debt payments) and revenue in LGFP
- ( 4 ) A portion of funds necessary for principal/interest repayment is included in basic financial needs when calculating local tax allocations from the central government for each local government.



The national government secures funds necessary for redemption of local government bonds

## 2、 Promotion of Decentralization and Local Government Bonds

Japanese national government has revised its laws and ordinances with regard to the local government bond since 1999 to increase local governments discretion of autonomy. Accordingly, local government bond Issuance switched from the approval system to the inform and consult system in FY06.

### ( 1 ) The Inform and Consult System

Until FY05, local governments could not issue bonds without the approval of the national government or prefecture. However, under the new inform and consult system introduced in FY06, local governments may issue bonds without such approval. The new system is outlined below.

#### ① Consultation

Local governments must consult with the minister of Internal Affairs and Communications (in the case of prefectures and designated cities) or the prefectural governor (in the case of municipalities or special wards)

#### ② Allocation of public funds for local government bonds with consult.

Only local government bonds with consent or approval by the MIC minister or the prefectural governor may borrow public funds.

#### ③ Redemption and interest payment amounts for bonds with consent or approval included in LGFP

Redemption and interest payment amounts for bonds with consent or approval by the MIC minister or the prefectural governor are included in LGFP by the national government.

#### ④ Local governments must report issuance of the bonds without consent or approval to their assembly

The head of the local governments must report to the assembly in order to issue the bond without the consent or approval of the MIC minister or the prefectural governor.

#### ⑤ Criteria for consent or approval and Local Government Bond and Loan Program by the national government

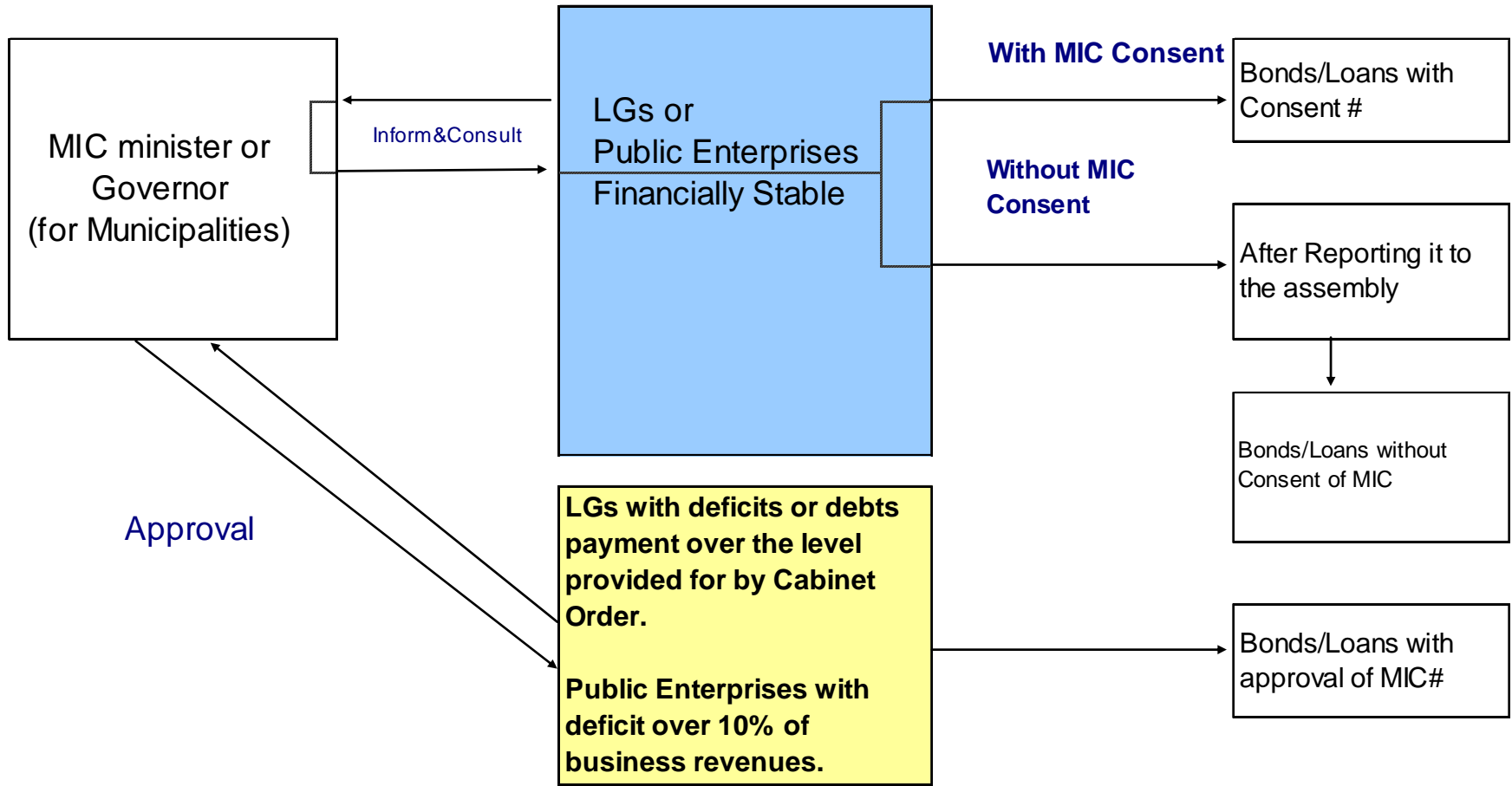
The MIC minister releases the criteria for consent and Local Government Bond and Loan Program every fiscal year.

After the switch from approval system to the inform and consult system, local governments described below must be overseen by the national government.

( 2 ) Approval must be required for local government bond issuers as in the past depending on fiscal conditions, as outlined below (Section 3 for details)

- ① Issuers in deficit, issuers with high real debt payment ratios, and public enterprises in deficit exceeding given point.  
Must receive approval of the MIC minister or the prefectural governor in order to issue local government bonds
- ② Issuers with tax rate lower than the standard rate  
Must receive the approval of the MIC minister or the prefectural governor in order to generate revenue for construction of public facilities

# Local Government Bond Consultative System



# Only the bonds/loans which obtained the consent or approval of MIC, LGs may borrow from the Government funds or JFM

### 3、 Approval as the Early Warning System in the Inform & Consult System

Japanese Government established fiscal early warning system in the inform and consult system in order to maintain local government bond creditworthiness. Local government bond issuers whose redemption expenditures and balance deficit are worse than a set limit are required to obtain approval for bond issuance.

#### ( 1 ) Approval still required if real debt payments ratio is 18% or more

Issuers with real debt payments ratio between 18% ~ 25% must first draft a debt management plan and obtain approval of the MIC minister, based upon general approval criteria. Issuers with the ratio of 25% or more are restricted in terms of use for certain types of projects by local government.

##### Real debt payment ratio

This is an objective indicator of an issuer's fiscal burden from debt expenditures, and is used as the criteria to specify issuers that require approval to issue bonds. Specifically, it is the ratio of general revenue resources allocated to debt expenditures, to the standard financial amount (current general revenue added to local tax allocations) .

#### ( 2 ) Approval still required for local bond issuers with real deficit exceeding a certain point

The real deficit limit for local government bond issuers is set incrementally based on the issuer's standard fiscal size. The limit is 2.5% for prefectures ,designated cities and municipalities with standard general revenue of 50.0bn yen or above; 5% for municipalities with standard general revenue of 20.0 bn yen ; and 10% for municipalities with standard general revenue of less than 5.0 bn yen.

## 4、 Legal Framework Ensuring Fiscal Consolidation of Local Governments around the Nation

### ( 1 ) The Law Relating to the Fiscal Consolidation of Local Governments

The Law Relating to the Fiscal Consolidation of Local Governments was enacted as a new system for early warning or revitalization of fiscal conditions (promulgated June 22, 2007). Financial indicators are more widely calculated and disclosed under the new law. They face greater scrutiny of the assembly and citizens. Local government bond issuances might be greatly curtailed depending on the financial conditions. The law ensures that local government bond redemptions and interest repayments continue to be made on time.

(Note) Financial indicators will start to be released from FY07 results, and other regulations will be implemented from April 2009. The Issuance Approval System, as Item 3 above, will be implemented together with this new law.

### ( 2 ) Disclosure of the Financial Indicators for Judging Financial Soundness

Local governments must report the following ratios every year after receiving assessment by auditors, to the assembly, and disclose those to the public.

- ① Real deficit ratio
- ② Consolidated real deficit ratio (ratio of real deficit in all accounts against standard fiscal size)
- ③ Real debt payment ratio
- ④ Future burden ratio (the ratio of real debt of the local government including burdens of public enterprises and equity-stake corporations against the standard fiscal size)

### ( 3 ) Early Fiscal Consolidation

- ① Fiscal Consolidation Plan

The local governments must draft fiscal consolidation plan if any of its four financial indicators are worse than criteria set by the



national government.

② Procedures for Drafting Fiscal Consolidation Plan

Fiscal consolidation plan should be drafted with the approval of the assembly, disclosed promptly to the public. Rules must be made with regard to the submission of the plan to the MIC minister and the prefectural governor and disclosure of the situation nationwide. A progress report must be made to the assembly and released every fiscal year.

③ National Government Recommendations etc

If early warning of financial conditions is considered extremely difficult based on actual conditions in the fiscal consolidation plan, the MIC minister or the prefectural governor may make necessary recommendations.

## ( 4 ) Fiscal Revitalization

① Fiscal Revitalization Plan

If any of the financial indicators (4-(1)-①②③) is worse than national criteria, fiscal revitalization plan must be drafted.

② Fiscal Revitalization Plan: Compilation and National Government Consent

**a Fiscal revitalization plan finalized after assembly approval, immediately disclosed.**

**b Consultation to the MIC minister and approval of fiscal revitalization plan may be sought**

**c Local government with fiscal revitalization plan has to report the situation to their assembly and disclose it to the public each year**

③ Local Bond Issuance Limits

Local governments with any financial indicators worse than the national criteria will not be allowed to issue bonds without the approval by the MIC minister . (Excluding bonds for disaster management projects.)

④ Exception to the Local Government Finance Law Article 5

Fiscal revitalization local governments whose fiscal revitalization plans have been approved may issue bonds with maturities within the term of the plan in order to cover the balance shortfall. This would be with the approval of the MIC minister and is regardless of the Local Government Finance Law Article 5.

- ⑤ National government recommendations, considerations, etc.
- a If the fiscal operations of the fiscal revitalization local governments should not meet the fiscal revitalization plan, the MIC minister may advise on necessary changes in the budget.
  - b The national government and the local government shall make necessary arrangements for special revitalization bonds and the smooth implementation of the fiscal revitalization plan as appropriate.