

Up-to-date Documents on Local Autonomy in Japan No.7

**The New System for Promoting Soundness
in Local Finances in Japan**

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Foreword

The Council of Local Authorities for International Relations (CLAIR) and the National Graduate Institute for Policy Studies (GRIPS) have been working since FY 2005 on a “Project on the overseas dissemination of information on the local governance system of Japan and its operation”. On the basis of the recognition that the dissemination to overseas countries of information on the Japanese local governance system and its operation was insufficient, the objective of this project was defined as the pursuit of comparative studies on local governance by means of compiling in foreign languages materials on the Japanese local governance system and its implementation as well as by accumulating literature and reference materials on local governance in Japan and foreign countries.

In FY 2009, we continued to compile “Statistics on Local Governance (Japanese/English)”, “Up-to-date Documents on Local Autonomy in Japan”, “Papers on the Local Governance System and its Implementation in Selected Fields in Japan” and “Historic Development of Japanese Local Governance”. We also continued to conduct a search for literature and reference materials concerned with local governance in Japan and overseas to be stored in the Institute for Comparative Studies in Local Governance (COSLOG).

If you have any comments, suggestions or inquiries regarding our project, please feel free to contact the Council of Local Authorities for International Relations (CLAIR) or the Institute for Comparative Studies in Local Governance (COSLOG) of the National Graduate Institute for Policy Studies (GRIPS).

February 2010

Michihiro Kayama
Chairman of the Board of Directors
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Preface

This booklet is one of the results of research activities conducted by the Institute for Comparative Studies in Local Governance (COSLOG) in FY 2009 as one part of a project that started in FY 2005 entitled “Project on the overseas dissemination of information on the local governance system of Japan and its operation”, in cooperation with the Council of Local Authorities for International Relations (CLAIR). For the purpose of implementing this project, a “Research committee for the project on the overseas dissemination of information on the local governance system of Japan and its operation” has been set up, and a chief and deputy chiefs with responsibility for the project have been designated from among the members concerned with each research subject.

“Up-to-date Documents on Local Autonomy in Japan” (2009, Volumes 6,7) were written under the responsibility of the following two members:

(Chief)

Kiyotaka Yokomichi, Professor of the National Graduate Institute for Policy Studies

Yoshihiko Kawato, Associate Professor of Takasaki City University of Economics

This booklet, the 7th Volume in the series, was written on the subject of the new system for promoting soundness in local finances in Japan.

The content of this paper provides a summary explanation of the significance, the content and the formation process of the new system of financial soundness in local governments that has emerged in recent years.

Finally, I would like to express my appreciation to Associate Professor Kawato, and also to other members of the research committee for their opinions and advice. Furthermore, I would like to thank Mr. Maurice Jenkins for his English translation.

February 2010

Hiroshi Ikawa

Chairperson

Research committee for the project on the overseas dissemination of information
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The New System for Promoting Soundness in Local Finances in Japan

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1 A new system aimed at achieving soundness in local government finances

Recently, a new system has come into being aimed at achieving soundness in local government finances. This paper aims to give an overview of what kind of system this is and how it came into being.

1-1 The formation of the new system

If we look at the state of local government finances in recent years, we can see steadily growing severity, as illustrated by such examples as the bankruptcy of Yubari City in Hokkaido in 2006, and efforts to get to grips with the restoration of sound finances on the basis of the Special Measures Law for the Promotion of the Rebuilding of Local Finances. The cause of the bankruptcy of Yubari City can be found in the expenses that Yubari City had to bear following the closure of the local coal mine and the failure to realize a planned tourism and resort development project. Specific instances that can be cited are the expiry in 2001 of the validity of the “Emergency Measures Law to Promote Coal-mining Districts”, which had as its objective local promotion following coal-mine closures, and the reduction in local allocation tax as a result of central government administrative financial reforms (Hobo, 2007).

On the basis of the continuing severity of local finances, the government enacted in June 2007 the “Law Relating to the Financial Soundness of Local Governments, etc.” (hereafter, Local Finance Soundness Law). The objectives of this law were set out as follows: “To establish a system of making public announcements concerning the ratios of local government finances, and to enable local governments to decide on a system for the speedy achievement of financial soundness and financial rebuilding as well as formulating plans aimed at promoting the sound management of publicly managed enterprises. At the same time, there is a need consider administrative and financial measures for the implementation of such plans, and in this way to contribute to the financial soundness of local governments as a whole.” (Local Finance Soundness Law, Article 1).

Systems aimed at putting local government finances on a sound footing have a long history. Through the enactment in 1955 of the Special Measures Law for the Promotion of the Regeneration of Local Finances, and the enactment in 1952 of the Law on Publicly Managed Local Enterprises, systems were established to restore a sound financial basis to local governments with deficits and publicly managed enterprises with deficits respectively¹.

Taking as a basis the issues raised by the hitherto prevailing systems of bringing soundness to local finances, the paper will now give an overview of the points of improvement in the new system created by the Local Finance Soundness Law². Looking first at the problem points in the prevailing system of achieving financial soundness, these can be listed as follows. ① the financial information

shows in an easily understandable manner is inadequate, ② the only criteria are those of reconstruction organizations, and there is no function for a speedy correction of errors, ③ only indicators for income and expenditure focused primarily on the general accounts are given consideration, and even if issues in the financial information about stock (liabilities) are cited, they are not taken up, and ④ there is no speedy correction function with reference to publicly managed enterprises. In short, under the hitherto prevailing system, local governments could not issue local reconstruction bonds without going through the procedure of formulating a financial reconstruction plan in the form of an application and obtaining the consent of the Minister of the Interior (now Minister of Internal Affairs and Communication (hereafter, MIC)), and thereafter carrying the process of financial reconstruction.

Against the background of this situation, the following improvements were made on the basis of the new system created on the basis of the Local Finance Soundness Law. ① Establishment of indexes and full information disclosure: establishment as flow indexes of the real deficit ratio, the consolidated real deficit ratio, and the real debt service ratio; establishment as stock indexes of the future burden ratio = indexes by real liabilities, including public enterprises, third sector enterprises, etc.; attachment of the audit inspection report and reporting to the assembly, together with a public announcement. ② Achievement of financial soundness through independent improvement efforts at the early financial soundness stage: formulation of a financial soundness plan (required to be approved by the assembly) and obligation to request an internal audit; requirement for a report to the assembly and a public announcement on the progress of implementation within every fiscal year; in the event that the early achievement of financial soundness is deemed to be outstandingly difficult, necessary recommendations are to be made by the Minister of MIC or the prefectural governor. ③ Definite rebuilding through involvement of the central government, etc., at the stage of financial rebuilding: formulation of a financial soundness plan (required to be approved by the assembly) and obligation to request an internal audit; there is a choice whether or not to seek consultation with and the agreement of the Minister of MIC concerning the financial rebuilding plan (in the event of non-agreement, there are restrictions on the issue of local bonds, excluding disaster rehabilitation projects, etc.; in the event of agreement, it is possible to issue local bonds (rebuilding transfer special bonds), the redemption deadline of which falls within the period of the plan in order to transfer the balance of the financial shortfall); in the event that financial management is deemed not to conform with the plan, central government will recommend budget changes, etc.

1-2 Progress of formation of the new system

The beginning of getting to grips with the enactment of a new law aimed at the achievement of financial soundness can be found in a report issued in July 2006 by the “Round Table Vision of Decentralization in the 21st Century”, organized by the then Minister of MIC (Hiraoka; Mori, 2008). This report identified the following 6 problem areas: ① excessive intervention by central government and the financial dependence of local governments; ② an increase in the accumulated debts of local governments; ③ a drop in sustainability in the context of a declining population; ④ the inadequacy of efforts to put together a package of factors that make a particular locality uniquely

attractive; ⑤ inadequacy of participation and governance by local residents; and ⑥ the actual lack of transparency of local finances. In addition, the report also showed an awareness that a national average that exceeded the national minimum would be virtually impossible to sustain in a context of declining support, and that economic vitality would be lost unless the continuing growth of a financial burden was brought to a halt. Specifically, the following 5 principles of decentralization were set out: ① Freedom and responsibility; ② Small government; ③ Individual competition; ④ Governance by residents; and ⑤ Thorough information disclosure³.

If we look at the connections between the suggestions made by the “Round Table Vision of Decentralization in the 21st Century” and the Local Finance Soundness Law, we find that reference is made to strong connections between the said law and a “legal system of financial rebuilding after collapse”; there are also “indications of need for disciplined restoration of local finances in the context of a feeling of crisis at having reached the point at which a local government will collapse as a result of management failure”. Against this background, the Vision suggested a time-scale of less than 3 years for a speedy start on preparations for an examination of a “legal system of financial rebuilding after collapse”. Moreover, the Cabinet resolution of July 7, 2006, entitled “Basic guidelines concerning economic and financial management and structural reform, 2006” specified an “appropriate re-evaluation of rebuilding laws and regulations”⁴. Subsequent to this, with a view to examining the desired state of a financial rebuilding system for local governments, the “Research Group on a New Local Financial Rebuilding System” was established in August 2006, and in December of the same year, brought together the results of its examination in a document entitled, “Report of the Research Group on a New Local Financial Rebuilding System”⁵. Issues that were pointed out in this Report included a lack of disclosure of easily understandable financial information and the lack of any mechanism to enable corrections to the system to be made. In response to this situation, the Report suggested that a mechanism should be established to set out and make public financial indexes, and at the same time establish a new system aimed at a speedy achievement of financial soundness.

This paper will aim to provide an overview of postwar developments up to the enactment of the Local Finance Soundness Law, and of the present financial state of local governments, and will also introduce the contents of the said law.

2 The history and the present state of attempts to achieve the financial soundness of local governments

Firstly, the paper will look at the growing severity of the situation of local finances since the 1970s in the light of the history of the promotion of the soundness of local finance. Against this background, the paper will then give an overview of the present situation.

2-1 The postwar history of the efforts to achieve sound local finances

The situation of local finances has become increasingly severe since the 1970s. In 2001, Iwaba wrote as follows: “At the present time (2001), the financial deficit and the accumulation of debt must be looked at as, so to speak, a transformation of the basis of the deficits that have afflicted Japanese finances since the 1970s. It is also fair to say that this deficit and accumulated debt on the part of

local finances constitutes the most distorted part of the structural characteristics of the financial system, and has contributed to the enlargement of the financial deficit that is dominated by the deficit situation of the country as a whole.” (Iwaba (2001), p 6. The bracketed part within the quotation has been added by the author).

Furthermore, when we look at the 1990s, we can see that the financial situation is moving toward crisis point. Namekata (2001) identified the structural characteristics of local finances in the 1990s in terms of the following 2 factors. ① The steep increase in accumulated local debts: the total of the balance of local bonds, the balance of local public enterprise bonds, and the balance of the special accounts for local allocation tax⁶, exceeded ¥180 trillion in fiscal 2000, thus approaching 37% as a percentage of GDP⁷. ② The increasing distortions shown by the local fiscal situation (the restructuring of financial relationships between local governments): the specific content is as follows. (a) the decline of the revenue guarantee function as a result of the rise in the bond flotation appropriation ratio and the increasing subsidization of local allocation tax in respect of enterprises specially designated as falling under government policy leadership; (b) strengthening of the Local Finance Equalization Grants System, whereby funds were transferred from urban local governments to financially weak local governments so as to achieve a guarantee of revenue; (c) a reduction in national treasury subsidies and an increase in the burden on local governments; (d) a deepening of the financial crisis centered on large cities. It should also be noted that as a cause of (d), it is possible to cite the decline in revenue derived primarily from 2 taxes (personal corporate tax and corporate business tax) caused by the instability resulting from the collapse of the bubble (pp 41-66), The financial crisis situation in Japan, affecting both the national and the local sectors, continued after entry into the 2000s.

In response to this kind of crisis situation, the Koizumi Cabinet implemented structural reforms, as part of which the Council on Economic and Fiscal Policy issued in June 2001, an “Outline of Basic Policies for Macroeconomic Management and Structural Reform of the Japanese Economy” (the so-called “Large-Bone Policy (2001)”), which showed the basic direction to be followed. As one of seven projects aimed at structural reform, the above document specified a “Program of Local Autonomy and Revitalization”, setting out the following directions of reform in terms of the relationship between central government and local governments: ① “Revitalization through individuality and competition” in a shift away from “Balanced development”; ② Strengthening of the foundation of local government administration so that it can become a receptacle for development, and at the same time, promotion of municipal mergers in support of this strengthening policy; ③ clarification of the relationship between benefits and burdens; and ④ a reduction in subsidies, local allocation tax, etc. Furthermore, in the following year, in June 2002, the government issued a document entitled “Basic Policies for Economic and Fiscal Management and Structural Reform 2002” (the so-called “Large-Bone Policy of 2002”). The policies aimed “to examine the ideal pattern of tax revenue distribution in terms of the “trinity reform”, including national treasury subsidies and obligatory shares, local allocation tax, and transfer of tax revenue, and to set a target of achieving tax reforms within one year”.

The result of this was the fundamental direction of the “trinity reform”, as set out in the policy

document of June 2003, entitled “Basic Policies for Economic and Fiscal Management and Structural Reform 2003” (the so-called “Large-Bone Policy of 2003”). The policies set the period from fiscal 2004 through fiscal 2006 as the period for reform, the content of which can be defined in terms of the following objectives. ① to abolish and reduce the national treasury subsidies and obligatory share to approximately 4 trillion yen; ② to maintain the financial adjustment function of local allocation tax, but to restrain the revenue guarantee function; and ③ to transfer about 80% of revenue sources from national treasury subsidies to local revenue, primarily focusing on reinforcing fundamental tax revenue, and to expand the autonomous rights of local governments to levy taxation (“Large-bone policies 2001-2003”, Shigemori, 2004). Reforms based on these policies were taken forward, but the local financial situation remained as before in a very precarious condition. The following section will give an overview of the present state of affairs.

2-2 The present financial state of local governments

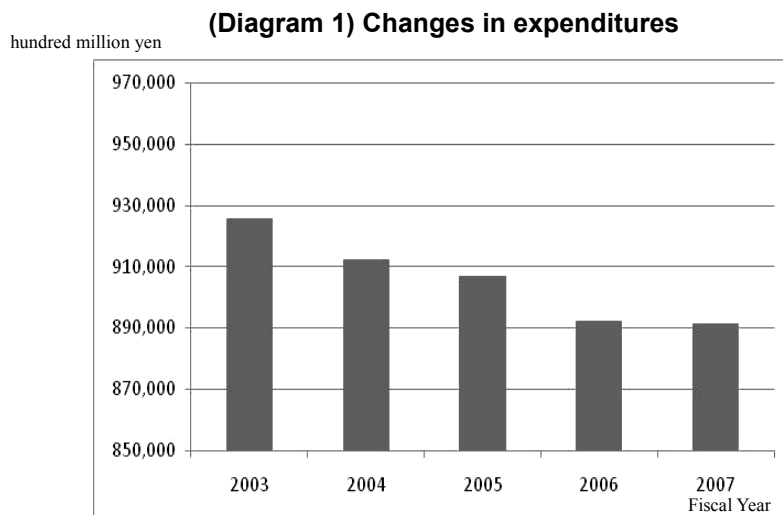
This section gives an overview, in terms of the current state of local government finances, of the final settlement of ordinary accounts⁸ and of enterprises.

2-2-1 The settled ordinary accounts of local governments⁹

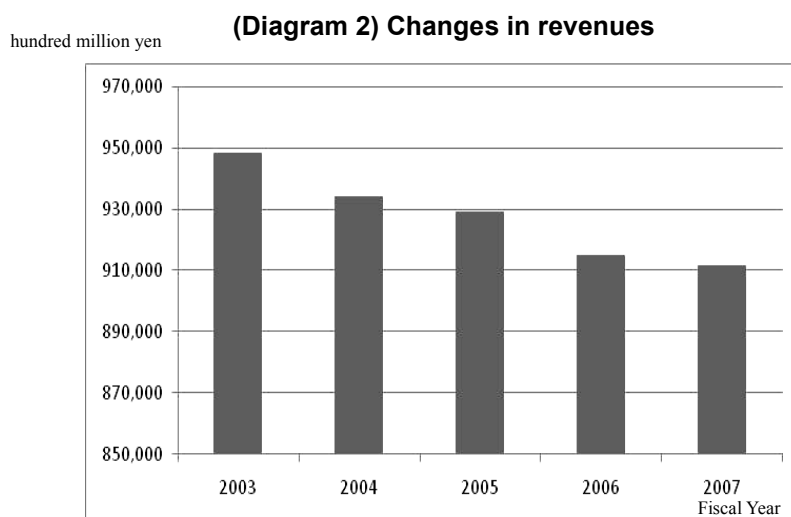
Itemized below are details of expenditures and revenues, of closing balances and of the flexibility of financial structures.

- (1) Expenditures: The figure for expenditures in fiscal 2007 was ¥89.1476 trillion, a fall, after 8 successive years of decline, of ¥63 billion (for details of the decline since fiscal 2003, see Diagram 1). In specific detail, the change from fiscal 2006 to fiscal 2007 is as follows. As a result of such circumstances as reform of the system and a natural increase, expenses concerned with social security increased (an increase of ¥717.6 billion), and retirement expenses increased sharply by ¥426.8 billion, due to the large number of baby-boomers who reached retirement age. On the other hand, staff salaries decreased by ¥280 billion, while investment expenditures decreased by ¥915.4 billion, showing that strenuous efforts to reduce expenditures were continuing.
- (2) Revenues: Total revenues for fiscal 2007 amounted to ¥91.1814 trillion, a decrease of ¥346.9 billion from fiscal 2006, marking the 8th successive year of a decline (for details of changes since fiscal 2003, see Diagram 2). As a result of such factors as the tax revenue transfer from income tax and the cessation of the fixed rate tax reduction, local tax revenue increased for 4 years in succession, and local allocation tax, including emergency financial countermeasure bond issues, also effectively decreased for the fourth successive year. Furthermore, as a result of such factors as restrictions on national expenditures concerned with local publicly operated enterprises, national treasury subsidies also decreased for the sixth year in succession.
- (3) Closing balances: From fiscal year 2006 into fiscal year 2007, the effective credit closing balance was ¥1.3597 trillion yen, an overall decrease of ¥164.8 billion yen resulting from the fact that the fall in revenues was greater than the fall in expenditures. It should also be noted that 25 public bodies had effective debit closing balances (1 prefecture, 24 municipalities).
- (4) The flexibility of financial structures: From fiscal 2006 into fiscal 2007, the operating balance

ratio rose by 2 points as a result of such factors as the decrease in local allocation tax, reaching 93.4%, and the financial structure became increasingly rigid. However, in the same period, the real debt service ratio (the figure resulting from the indices established later on the basis of the Local Finance Soundness Law) fell overall by 2.1 points to 12.8% as a result of such factors as the reflection in the general revenue figures to which appropriations for public bond expenses were allocated in line with the actual state of the city planning tax.



Source: Ministry of Internal Affairs and Communications, Overview of closing balances of ordinary accounts of local governments for fiscal 2007, (Nov. 2008)



Source: Ministry of Internal Affairs and Communications, Overview of closing balances of ordinary accounts of local governments for fiscal 2007, (Nov. 2008)

2-2-2 Local public enterprises¹⁰

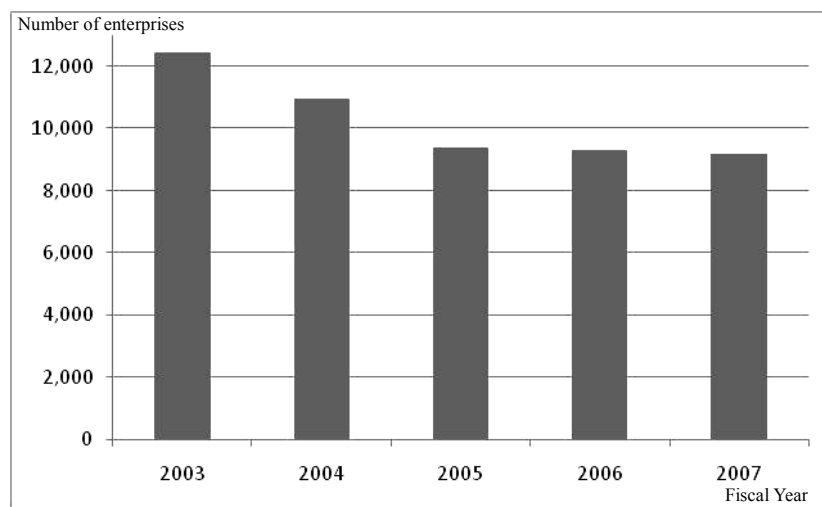
An overview of the state of local public enterprises in fiscal year 2007 is as follows.

(1) Number of enterprises and of employees

At the end of fiscal year 2007, the number of organizational bodies operating local publicly

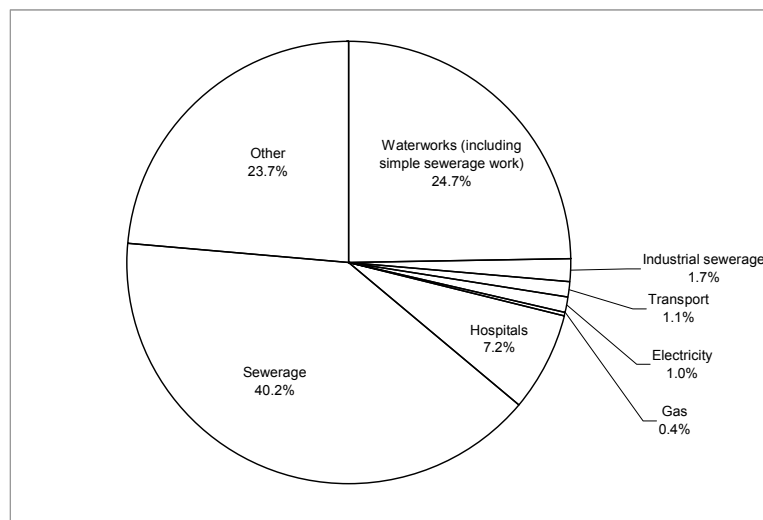
managed enterprises was 1,863 (including 5 bodies managing local public enterprises in the form exclusively of enterprise organizations and partial-affairs associations as well as the 23 special wards of metropolitan Tokyo). Of this total number, 47 were prefectures, 17 ordinance-designated cities, and 1,799 general cities, towns and villages. The number of enterprises thus managed was 9,210; in recent years, there has been a declining trend (for shifts since fiscal 2003, see Diagram 3), and the number of enterprises in fiscal 2007 was 107 fewer than in fiscal 2006. Furthermore, in terms of the categories of enterprises in 2007, sewerage enterprises accounted for the largest number with 40.2%, followed by sewage disposal (including simple sewerage work, *ibid* below) at 24.7%, and hospital enterprises at 7.2% (Diagram 4).

(Diagram 3) Changes in the number of local publicly managed enterprises



Source: Ministry of Internal Affairs and Communications media document, "Overview of the closing balances of local publicly managed enterprises in fiscal 2007" (Sept. 30, 2008)

(Diagram 4) Percentage categories of local publicly managed enterprises



Source: Ministry of Internal Affairs and Communications media document, "Overview of the closing balances of local publicly managed enterprises in fiscal 2007" (Sept. 30, 2008)

(2) Financial management situation

(a) Overall financial management situation

Looking at the overall financial management situation, including enterprises to which the Local Publicly Managed Enterprise Law applies and those to which it does not¹¹, the proportion of enterprises with credit balances is 86.4%, and those with debit balances, 13.6%, resulting in an overall credit balance of ¥468.6 billion (Table 1) (the credit balance in fiscal 2006 was ¥193.3 billion).

(Table 1) Overall management situation (income by enterprise category)

(Unit: hundred million yen)

Enterprise	Waterworks	Industrial sewerage	Transport	Electricity
Total income	2,692	198	102	44

Continued from the above

Gas	Hospitals	Sewerage	Other	Total
△43	△1,947	1,054	2,585	4,686

Note: "Simple sewerage work" is included in "waterworks".

Source: Ministry of Internal Affairs and Communications, "Overview of closing balances of local publicly managed enterprises in fiscal 2007" (Sept. 30, 2008)

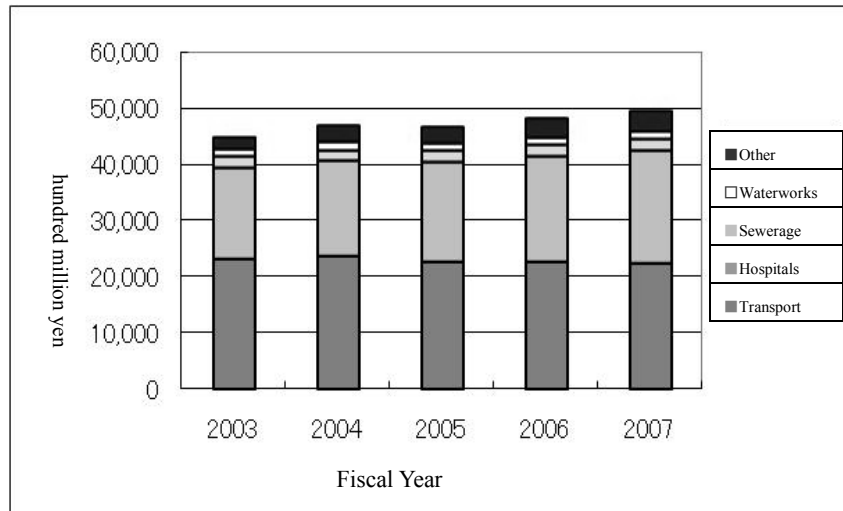
(b) Accumulated deficit

The accumulated deficit amounted to ¥4.9381 trillion in fiscal 2007, an increase of 2.7%, or ¥128.4 billion, compared with fiscal 2006. Categorizing the deficit by kinds of enterprises, transport enterprises were the most numerous, followed by hospital enterprises, sewerage enterprises, and waterworks enterprises (Diagram 5).

(3) Bad debts

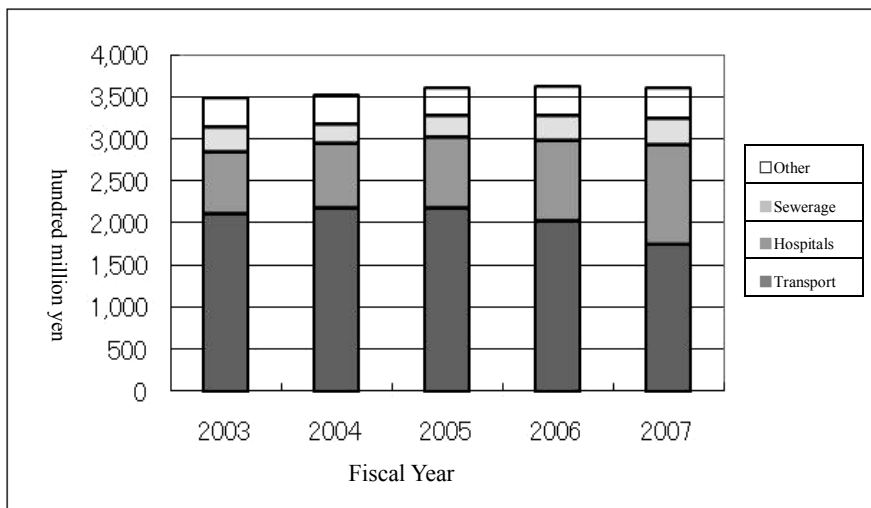
Bad debts in fiscal 2007 amounted to ¥360.1 billion, showing only a decrease of 0.8% (¥2.8 billion) compared to fiscal 2006. Categorizing the bad debts by kinds of enterprises, transport enterprises were the most numerous, followed by hospitals and sewerage enterprises (Diagram 6).

(Diagram 5) Changes in the amount of accumulated deficits



Source: Ministry of Internal Affairs and Communications, "Overview of closing balances of local publicly managed enterprises in fiscal 2007" (Sept. 30, 2008)

(Diagram 6) Changes in bad debts



Source: Ministry of Internal Affairs and Communications, "Overview of closing balances of local publicly managed enterprises in fiscal 2007" (Sept. 30, 2008)

2-2-3 The third sector, etc.

This section aims to provide an overview of the present state of third sector enterprises in which local governments invest. Third sector enterprises are not financed by local governments, but play an important role in achieving administrative objectives.

(1) The objects of investigation

The document needed to understand the situation of the third sector is an investigation report¹² issued by the central government on December 25, 2008 (the situation as of March 31, 2008). The objective of the investigation was to grasp the situation with regard to the financial management of and investment in third sector enterprises as corporate bodies (=juridical persons) in receipt of

investment by local government bodies. The parameters of the investigation are as follows.

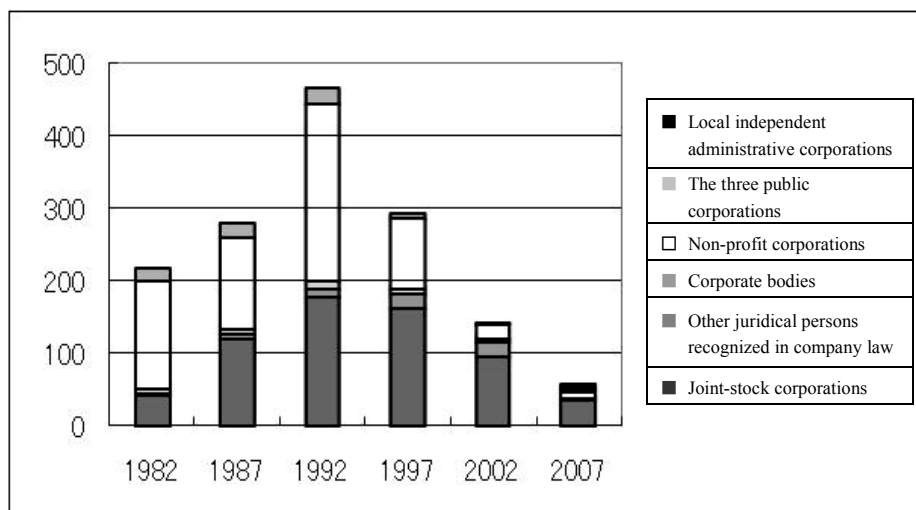
- (a) The “third sector”, comprising corporate bodies, as recognized in company law as well as in civil law, at the time of the investigation, in which such bodies “local governments” themselves as well as bodies in which local governments are majority investors.
- (b) The so-called “three public corporations”, namely the Local Housing Corporation, the Local Highway Corporation, and the Land Development Corporation.
- (c) Local independent administrative corporations.

Furthermore, with regard to the following sections, namely (4) the state of management and financial support, and (5) the adoption of the point-evaluation of information disclosure and financial management, the following corporate bodies will be the objects of investigation. (a) corporate bodies recognized as such in company law as well as civil law (including corporate bodies in which the total of investment by multiple local governments is more than 25%) in which the percentage of investment by local governments, as well as bodies in which local governments are majority investors, exceeds 25%; (b) corporate bodies recognized as such in company law as well as civil law, in which the percentage of investment is less than 25%, but which are in receipt of financial support (subsidies, loans, compensation for losses, guarantee against debts); (c) the “three public corporations”; and (d) local independent administrative corporations.

(2) Number and mode of establishment of corporate bodies

The number of corporate bodies is decreasing. The number of bodies in the third sector, etc., as of March 31, 2008, was 8,899, a decrease of 1.2% (108 corporate bodies) compared to the position at March 31, 2007. Furthermore, the number of newly established corporate bodies is also decreasing. The number of corporate bodies newly established in the calendar year 2007 was 14 fewer than in 2006, totaling 58 such bodies (Diagram 7).

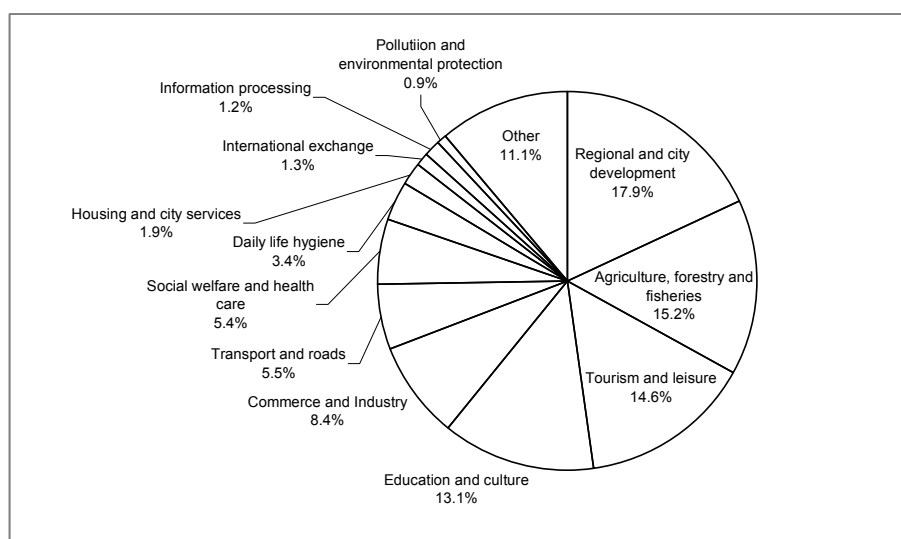
(Diagram 7) Types of established juridical persons



Source: Ministry of Internal Affairs and Communications, "Results of an investigation concerning the third sector, etc." (Dec., 2008)

Furthermore, the composition by category of third sector bodies is as shown in Diagram 8.

(Diagram 8) Composition by subject category of bodies in the third sector, etc.



Source: Ministry of Internal Affairs and Communications, "Results of an investigation concerning the third sector, etc." (Dec., 2008)

“Regional and city development” is the most numerous, accounting for 17.9%, followed by “agriculture, forestry and fisheries” at 15.2%, and “tourism and leisure” at 14.6%. It is also noteworthy that in the fields of “information processing”, “transport and roads”, and “tourism and leisure” there are a large number of joint-stock corporations (89.7%, 79.9% and 69.7% respectively), while in the fields of “international exchange”, “social welfare, health and medical care”, and “education and culture”, there are a large number of non-profit corporations (98.3%, 93.4% and 90.2% respectively)

(3) The investment situation

The total figure for investment by local public bodies, etc., in 7,686 third sector organizations (in company law as well as in civil law) amounted to 49.9% of the total figure (Table 2). However, since the investment percentage by local governments the “three large corporations” and by local independent administrative corporations is 100%, corporations are excluded from the above figures.

(Table 2) The state of investment in the third sector

(Monetary units: million yen)

Category classification	Total investment amount (A)	Investment amount by local public bodies (within A)	Private sector investment amount (within A)	Percentage of investment by local governments	Number of corporate bodies
Juridical person in company law	3,078,398	1,307,897	1,770,501	42.5%	3,713
Juridical person in civil law	1,320,085	887,377	432,708	67.2%	3,973
Third sector total	4,398,483	2,195,274	2,203,210	49.9%	7,686

Source: Ministry of Internal Affairs and Communications, "Results of an investigation concerning the third sector, etc." (Dec., 2008)

(4) The state of management and financial support

The current state of the 7,621 corporate bodies comprising third sector bodies, etc., is as follows (corporate bodies in respect of which financial statements were not made due to reasons that occurred shortly after they were established, are excluded).

(a) 65.8% of third sector organizations have credit balances, while 35.2% have debit balances.

(b) In the case of 5.6% of third sector organizations, their debts are greater than their assets.

Furthermore, the situation regarding financial support given by local governments to the 7,621 third sector organizations is as follows.

(a) Among third sector organizations, the number of corporate bodies which received subsidies is 3,020 (47.1% of the total), and the total amount of grants given is ¥258.5 billion¹³.

(b) Among third sector organizations, 631 corporate bodies (9.8% of the total) are in receipt of loans from local governments, and the total amount of loans is ¥267.8 billion.

(c) Among third sector organizations, the number which have debts in respect of which local governments have made a contract covering compensation for loss or a guarantee to cover the debts is 491 (7.7% of the total), and the total balance thus provided amounts to ¥1.9417 trillion.

(5) The adoption of point-evaluation for information disclosure and financial management

One essential precondition to achieving financial soundness in the third sector is full disclosure of the financial situation and of the actual condition of the third sector enterprises concerned; in this situation, there is a demand for procedures to be put in place to enable a check on the actual condition and circumstances to be made by society or an external organization. Specifically, an overview of how 7,612 corporate bodies implement information disclosure and point-evaluation of their management is as follows.

(a) Information disclosure by third sector organizations

Information disclosure is positively implemented by 85.3% of third sector organizations¹⁴, making it clear that it is something carried out by the vast majority of organizations. It is also worth noting that in 48.8% of third sector cases, local governments have determined the practice of information disclosure by means of bylaws or published guidelines.

(b) Management point-evaluation system

The percentage of corporate bodies that implement a management point-evaluation system on a regular basis by means of committees and the like is 21.6%. In the case of other corporate bodies too, there are cases where point-evaluation is regularly implemented without reliance on committees and the like.

2-3 Financial evaluation of local governments on the basis of basic numerical indicators

The following paragraphs provide once again an overview of evaluation on the basis of fundamental numerical indicators of the finances of local governments in fiscal 2007.

Looking first at the general account, the situation is very severe in that total expenditures are continuously decreasing as a result of efforts to make reductions, and total revenues are also

decreasing. A further point is that organizations with closing balances which show a surplus are decreasing, while there are also cases of closing balances that show a deficit. Furthermore, revenue and expenditure ratios are also rising, and financial structures are showing an increasing rigidity.

If we look also at the condition of publicly managed corporations, we see that the number of corporations showing a deficit stands at 13.6%, and that while there is a slight decrease in the number of bad debts, there is an increase in the amount of accumulated losses. Furthermore, turning to the condition of third sector organizations, approximately 30% show deficit balances, while 5.6% have liabilities in excess of assets. There are also a not inconsiderable number of organizations that have received subsidies or loans from local governments or which receive support in such forms as an agreement to provide compensation for losses. There are also third sector organizations in respect of which streamlining or legal restructuring procedures have been implemented.

Given the above, according to the oversight provided by numerical indicators before the move to establish indices, it is clear that although efforts to make improvements could be seen, there was a steadily deteriorating trend. The following section will examine the financial situation of local governments as revealed by indices based on the Local Finance Soundness Law.

3 The indicators in the Local Finance Soundness Law

If we examine the Local Finance Soundness Law, we can find as means of judging the soundness of local government finances, 4 indicators on the basis of which to judge the financial soundness ratio, as well as the financial shortfall ratio, comprising an indicator to enable us judge the managerial soundness of the accounting of public enterprises. Details of the content of these various indicators are as follows¹⁵:

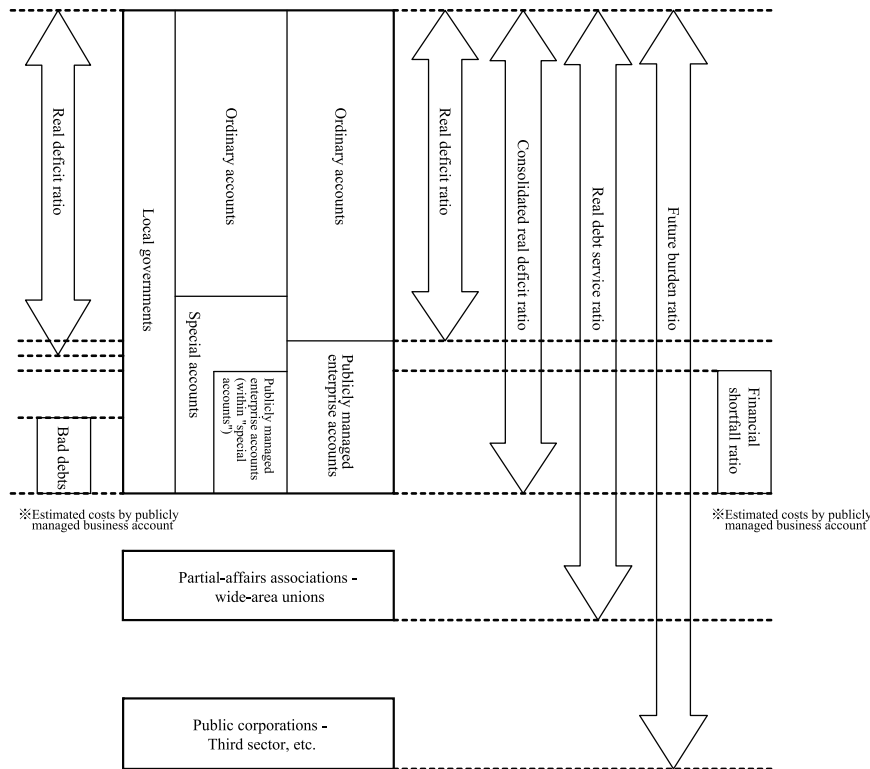
3-1 4 financial indicators for judging the degree of financial soundness

Within the framework of the Local Finance Soundness Law, the 4 financial indicators are designated in terms of their contribution to the achievement of financial soundness. They give an objective portrayal of the financial soundness of local governments (prefectures, municipalities and special wards) and provide the conditions necessary to make a judgment on the speedy achievement of financial soundness or on regeneration (Diagram 9).

(Diagram 9) Accounts to measure the financial soundness ratio

(former administrative system)

(Law Relating to the Financial Soundness of Local Governments)



Source: Ministry of Internal Affairs and Communications, Local Public Finance Bureau, Finance Investigation Division, "concerning the Law Relating to the Financial Soundness of Local Governments" (June 4, 2008) (http://www.soumu.go.jp/iken/zaisei/kenzenka/exm/pdf/080604_1_3.pdf) (accessed Aug. 23, 2009)

Local governments are obliged, in each fiscal year, to make a public report to the local assembly concerned, providing at the same time details of the audit inspection, with the calculation data on the degree of achievement of financial soundness based on the closing accounts of the previous fiscal year. The 4 financial indicators are as follows.

- (1) Real deficit ratio: Taking the general account¹⁶ of the local government concerned as the target, the actual amount of the deficit (※a) in relation to the standard financial scale.
- (2) Consolidated real deficit ratio: Taking the general account of the local government concerned as the target, the actual amount of the deficit, or the amount of the financial shortfall (※b) in relation to the standard financial scale.
- (3) Real debt service ratio; “The inserted amount for the standard revenue demand accruing to special revenue + the principal and interest of redemption money • quasi-principal and quasi-interest of redemption money” deducted from “the amount of the principal and interest of redemption money as well as the quasi-principal and quasi-interest of redemption money that represents a burden on the general account of the local government concerned (※c)” in relation to the amount (※d) that constitutes the basis of the standard financial scale.
- (4) Future burden ratio: The actual burden (※e) that the local government is expected to bear in future in respect of its general accounts, including debt incurred by local public corporations or

by investing corporate bodies engaged in implementing compensation for loss in relation to the amount (※d) constituting the basis of the standard financial scale.

It should be noted that the definitions of (※a) to (※e) as used in (1) to (4) above are as follows.

(※a) real deficit amount: amount advanced + (deferred payment amount + carried over enterprise costs.

(※b) consolidated real deficit: the extent to which the total of ① and ② below exceeds the total of ③ and ④ below.

① The total of the real deficit in the accounts generated by actual deficits, taken from special accounts other than the general account as well as publicly managed corporation accounts (corporations to which the Public Management Corporation Law applies and those to which it does not apply).

② The total of the financial shortfall as the accounting amount generated by the financial shortfall, as taken from the special accounts for public corporations.

③ The total of the real profit balance of the sum generated by actual profits, taken from special accounts other than the general account and the accounts of public corporations.

④ The total of excess funding as the accounting amount generated by the excess funding sum, as taken from the special accounts for public corporations.

(※c) The quasi-principal and quasi-interest of redemption money: The total of the following listed items, ① through ⑤.

① In the case of a local bond subject to lump-sum repayment on reaching maturity, the amount equal to one annual repayment installment of the principal of a bond, the repayment period of which is set at 30 years in annual installments.

② Money recognized as having been assigned to the revenue of publicly managed corporation bonds within the funds taken from the general account into special accounts other than the general account.

③ Money recognized as being assigned to repayment revenue of local bonds created by cooperatives, taken from charges imposed on, or financial support given to cooperatives and local development corporations (cooperatives, etc.)

④ Money equivalent to public bond expenses taken from income and expenditure based on bond-charging procedures.

⑤ Interest on short-term loans.

(※d) Amount constituting the basis of the standard financial scale: The quasi-principal and quasi-interest of redemption money deducted from the standard financial scale deducted from the amount inserted as the standard financial demand relating to the principal and interest of redemption money.

(※e) The actual debt: “the amount inserted as the standard financial demand related to the basic amount that can be assigned + the amount included in special revenue + the total of the local debt” deducted from “the future burden”, which is the total of the items listed below as ① through ⑧.

① The total of the local public debt at the end of the fiscal year preceding the current fiscal year

in the general accounts.

- ② The anticipated expenditure based on debt-incurring actions (expenses related to Article 5 of the Local Finance Law).
- ③ The amount expected to be inserted, as taken from the general accounts assigned to the principal of repayment of local bonds in accounts other than the general accounts.
- ④ The estimated debit representing a charge on the local public body concerned in terms of the money allocated for redemption of the principal of a local public bond issued by a cooperative to which the local body concerned belongs.
- ⑤ The estimated charge on general accounts, as taken from the amount estimated as needed for retirement allowances (the amount to be paid to all employees at the end of their term of service).
- ⑥ In the case of the debt of corporate bodies established by local governments after meeting set criteria, the estimated charge to general accounts of such debt after taking into consideration the financial and management circumstances of the said corporate bodies.
- ⑦ The real consolidated deficit.
- ⑧ The estimated amount to be charged to general accounts as taken from the amount corresponding to the real consolidated deficit of a cooperative or the like, or the “amount which has the potential to be so charged”, showing the basic sum which can be allocated to the repayment sums shown in ① through ⑥ above, under Article 241 of the Local Autonomy Law.

3-2 Speedy achievement of a sound condition for local finances, and rebuilding of local finances

In cases where the ratio for determining soundness on the part of a local government exceeds the standard early financial soundness criterion, the local government must determine the plan for the achievement of such financial soundness before the end of the fiscal year in which the probability of the said achievement of soundness is made public. Moreover, in a case in which the rebuilding judgment ratio (3 ratios excluding the future ratio from within the ratio for determining soundness) exceeds the standard financial soundness criterion, the local public body concerned must determine, before the end of the fiscal year in which the ratio for determining soundness is made public, a financial rebuilding plan (Table 3).

Regulations concerning the public announcement of the ratio for determining soundness as well as of the financial shortfall ratio were implemented from April 1, 2008, and the ratio applied was that of the ratio for determining soundness based on the final accounts of fiscal 2007. Moreover, the obligatory framing of a plan to achieve financial soundness as well as other regulations were implemented on April 1, 2009, and the ratio applied was that of the ratio for determining soundness based on the final accounts of fiscal 2008.

(Table 3) Criteria for attaining early financial soundness - criteria for financial rebuilding

	(reference) Criteria for shifts in the system of consulting on and getting permission to issue local bonds	Criteria for attaining early financial soundness	Criteria for financial rebuilding
Real deficit ratio - real deficit ratio in the general accounts	Prefectures: 2.5% Municipalities: in compliance with financial regulations 2.5%~10%	Prefectures: 3.75% Municipalities: in compliance with financial regulations 11.25%~15%	Prefectures: 5% Municipalities: 20%
Consolidated real deficit ratio - real deficit ratio in all accounts	—	Prefectures: 8.75% Municipalities: in compliance with financial regulations 16.25%~20%	Prefectures: 15% Municipalities: 30%(Ref. Note)
Real debt service ratio - ratio showing public bonds as well as the ratio of expenses equivalent to public bonds	18%	Prefectures – municipalities: 25%	Prefectures – municipalities: 35%
Future burden ratio - ratio showing the real burden expected to be assumed in the future in general accounts other than the public debt balance	—	Prefectures · Designated cities: 400% Municipalities: 350%	—
Financial shortfall ratio of public enterprises - ratio of the financial shortfall by category of publicly managed enterprise	10%	20%	—

Note: Changing criteria over 3 years from fiscal 2009 through fiscal 2011 are established as follows: Prefectures 25%→25%→20%; Municipalities 40%→40%→35%

Source: Ministry of Internal Affairs and Communications, Local Public Finance Bureau, Finance Investigation Division, "concerning the Law Relating to the Financial Soundness of Local Governments" (June 4, 2008) (http://www.soumu.go.jp/iken/zaisei/kenzenka/exm/pdf/080604_1_3.pdf) (accessed Aug. 23, 2009) and MAC media document, "Overview of criteria for determining financial soundness and of the financial shortfall ration in fiscal 2007" (confirmed document), issued on Nov. 28, 2008)

3.3 Public announcement of the financial shortfall ratio

Local public bodies (including cooperatives and local development projects) that manage publicly managed enterprises must make a report on the financial shortfall ratio (the ratio of the financial shortfall (※f) to the scale of the enterprise (※g)), by publicly managed enterprises, to the assembly of the public body concerned, attaching a copy of the audit investigation, and at the same time must make the contents of the report public. In the event that the financial shortfall ratio exceeds the criteria for financial soundness, the local public body must decide on a plan for the achievement of such soundness.

Furthermore, the definitions of the expressions (※f) and (※g) used above are as follows:

(※f) Financial shortfall ratio

Financial shortfall ratio (enterprises to which the Local Public Enterprise Law is applied) = dynamic debt + the amount on hand of local bonds raised for the purpose of allocation to revenue in terms of incidental expenses other than expenses for construction improvement – current assets (※1) – financial shortfall that can be deleted (※2)

Funding insufficiency ratio (enterprises to which the Local Public Enterprise Law is not applied) = (needed funds moved forward + the amount on hand of local bonds raised for the purpose of allocation to revenue in terms of incidental expenses other than expenses for construction improvement) – financial shortfall that can be deleted

Furthermore, in the definition of financial shortfall, the definitions used for the expressions (※1) and (※2) are as follows.

(※1) Current assets: in the case of a publicly managed enterprise that undertakes residential land development, there is a special case concerned with the calculation of current assets related to the evaluation of the land.

(※2) Financial shortfall that can be deleted: a set sum deducted from the financial shortfall in cases where an enterprise suffers from a lack of structural funding within a set period after the commencement of the enterprise.

(※g) The scale of an enterprise (※3):

Scale of an enterprise (enterprise to which the Local Public Enterprise Law is applied) = the amount of trading profits (※4) – the amount of profit from entrusted work.

Scale of an enterprise (enterprise to which the Local Public Enterprise Law is not applied) = the amount of income corresponding to trading profits – the amount corresponding to profit from entrusted work.

It should also be noted that the complementary explanations of expressions (※3) and (※4) used in the above definition of the scale of an enterprise (※g) are as follows.

(※3) The scale of an enterprise undertaken by a publicly managed enterprise in respect only of housing land development denotes the total of the capital and debt as shown by the “scale of the source of revenue for project management” (the scale of the funding raised)/

(※4) The business profits of a publicly managed enterprise that has introduced the designated administrator system (user charge system), are treated as special cases.

3-4 The characteristics of the new system based on the Local Finance Soundness Law

The major characteristics of the new system based on the Local Finance Soundness Law are that there are 4 financial indicators, not just the “general accounts” as has been the case in the past. These are: ① the real deficit ratio; ② the consolidated real deficit ratio; ③ the real debt service ratio; and ④ estimated future burden ratio. By means of the use of these indicators, it is possible to grasp the financial situation of local public bodies that have consolidated all their accounts including separate corporate bodies.

Specifically, the different sets of figures can be listed as follows. Firstly, there is the “real deficit ratio”, which takes the “general accounts” as the object to be evaluated and serves as the foundation.

In addition to this, three sets of consolidated financial indicators have been set up as a structure, namely the “consolidated real deficit ratio”, which takes the accounts of “publicly managed corporations”; the “real debt service ratio”, which takes the accounts of “partial-affairs associations and wide-area unions”; and the estimated “future burden ratio”, which takes the accounts of the “local public corporations and the third sector” as the object to be evaluated. From among these, the “real debt service ratio” and the “future burden ratio” show the level of the burden to borne by the “general account”.

Furthermore, the indicator termed the “financial shortfall ratio” has also been introduced. This is an independent indicator, calculated by the accounts of each publicly managed corporation, and it is based on the actual financial shortfall that results when the shortfall that can be wiped out (planned deficit) is deducted from the financial shortfall (current debts – current assets) that is at the base of the financial shortfall concept that has been used up to now (current debts – current assets / operating profits).

By means of the introduction of financial indicators, local governments have become able to grasp the state of their finances in an objective and multi-faceted manner. It has also become possible, by using judgments based on these indicators, to set up procedures which have mobilized a speedy achievement of financial soundness or rebuilding on the basis of intervention by central government. In ways such as these, systems aimed at comprehensively and systematically implementing the achievement of sound local finances have been established. Mention must also be made of important characteristics of the new system, in the form of a strengthening of the external administrative checking function of the process of achievement of financial soundness, including the imposition of an obligatory audit of the indicators, the preparation of a plan for the achievement of financial health or for financial rebuilding, and the incorporation into a system of assembly resolutions concerning the achievement of sound management by publicly managed enterprises.

3-5 Ratio for determining financial soundness – financial shortfall ratio¹⁷

I will now try and give an oversight of the situation regarding the ratio for determining financial soundness and the financial shortfall ratio in respect of local governments. Local governments in Japan comprise 47 prefectures, 17 designated cities, 789 cities and wards (“core cities”, “special case cities”, “cities”, and “special wards”), and 1,004 towns and villages, making a total of 1,857; the total number of publicly managed enterprise accounts amounts to 7,448. The position with regard to the number of bodies in the case of which the ratio for determining financial soundness exceeds the early financial soundness ratio, and on the other hand the number of publicly managed enterprise accounts in the case of which the financial shortfall ratio exceeds the management soundness criterion is shown in Tables 4 and 5 respectively.

(Table 4) Number of organizations for which the achievement of financial soundness is judged to have exceeded the criteria for the early achievement of such soundness

	Real deficit ratio	Consolidated real deficit ratio	Real debt service ratio	Future burden ratio	Total
Prefectures [47]	0	0	0	0	0
Designated cities [17]	0	0	0	0	0
Cities and wards [789]	2(1)	9(2)	8(1)	3	22(4)
Towns and villages [1,004]	0	2	25(1)	2	29(1)
Total [1,857]	2(1)	11(2)	33(2)	5	51(5)

Note 1: Figures within [] designate the number of individual organizations

Note 2: Figures within () designate the number, within the total in the box, of organizations that exceeded the financial rebuilding criteria (40% was applied as the consolidated real deficit ratio in fiscal 2009).

Note 3: The future burden ratio is not the financial rebuilding criterion.

Note 4: The figure in the "total" box is the total number of organizations, i.e. the net total of organizations that exceeded the criteria for the achievement of early financial soundness (financial rebuilding criteria), comprising 43 (3) organizations in all (15 (2) cities and wards, and 28 (1) towns and villages.

Source: MAC media document, "Overview of criteria for determining financial soundness and of the financial shortfall ratio in fiscal 2007" (confirmed document), issued on Nov. 28, 2008)

(Table 5) The number of accounts of publicly managed enterprises with financial shortfall ratios that exceed the criteria for management soundness

	Prefectures	Designated cities	Municipalities	Partial-affairs associations	Total
Waterworks enterprises	0(26)	0(17)	3(1,262)	0(101)	3(1,406)
Simple waterworks enterprises	0(3)	0(6)	6(925)	0(3)	6(937)
Industrial waterworks enterprises	0(39)	0(7)	0(96)	0(8)	0(150)
Transport enterprises	0(3)	4(20)	13(70)	0(4)	17(97)
Electricity enterprises	0(30)	0(4)	1(27)	0(3)	1(64)
Gas enterprises	0(0)	0(1)	0(33)	0(1)	0(35)
Port and harbor work enterprises	0(29)	0(4)	0(36)	0(4)	0(73)
Hospital enterprises	0(48)	1(17)	50(520)	2(83)	53(668)
Market enterprises	0(8)	1(17)	7(142)	1(11)	9(178)
Livestock raising and slaughtering enterprises	0(3)	0(6)	3(44)	0(12)	3(65)
Housing development enterprises	0(54)	0(25)	24(451)	3(9)	27(539)
Sewerage enterprises	0(44)	0(27)	13(2,648)	0(22)	13(2,741)
Enterprises related to tourism facilities	0(6)	0(6)	22(336)	0(2)	22(350)
Other enterprises	0(19)	0(1)	2(84)	0(41)	2(145)
Total	0(312)	6(158)	144(6,674)	6(304)	156(7,448)

Note: Figures within () are the number of accounts of publicly managed enterprises by kind of enterprise

Source: MAC media document, "Overview of criteria for determining financial soundness and of the financial shortfall ratio in fiscal 2007" (confirmed document), issued on Nov. 28, 2008)

On the basis of the above, the following points can be made with regard to the ratio for determining financial soundness on the part of local governments in fiscal 2007. Out of the total of 1,8578 local governments, a net total of 43 exceeded the criterion for achievement of early financial soundness, and of this total, 3 local governments displayed very severe financial circumstances in excess of the criteria for financial rebuilding. This figure is a very small percentage of the overall total, but when consideration is taken of the need to provide stable administrative services to the residents of the various local governments concerned, it cannot be overlooked. In the case also of publicly managed enterprise accounts, out of the total of 7,448 accounts, the number of such accounts in which the financial shortfall ratio exceeded the criterion for management soundness totals 156, and this number presents a serious problem. Even if the number of local governments which are experiencing severe conditions in terms of the ratio for determining financial soundness and/or the financial shortfall ratio, is small, it is expected that measures aimed at tackling the issues involved in achieving financial health will continue to be steadily implemented.

4 In conclusion

The central core of the new system aimed at enabling local public bodies to attain financial health through the Local Finance Soundness Law can be found in efforts to obtain a still firmer grasp of the real situation of local finances and to respond in a speedy and appropriate manner in cases where there are problems. Up until now, the soundness of local government finances has been judged as a separate issue, taking as a foundation the ordinary accounts and the actual state of local publicly managed enterprises. However, the field of local government covers a very wide area, including the third sector, and the various parts of local government finances are closely inter-connected and exert a great influence on each other.

The fields of activity of local governments have expanded so as to enable local governments to respond to the diversification of people's value judgments and the growing sophistication of their needs. As a result of this trend, it has become impossible for local government to get an accurate grasp of an overall picture of their situation only by referring to financial issues concerned with their previous fields of activity. From the point of view also of the complicated financial structure of local governments that has been shown in this paper, their activity is required to be evaluated from a variety of perspectives, including general accounts, publicly managed enterprise accounts, partial-affairs associations and wide-area unions, local government public corporation and third sector accounts, and so on. At the same time, local governments are also required to unify their various activities within one activity framework, and to carry out their decision-making and implement their activities in a rational manner. In order that local governments can identify appropriate objectives for their own actions, it is necessary for them to implement financial evaluation level by level and in a comprehensive way, and the new system for achieving financial soundness introduced by means of the Local Finance Soundness Law is precisely what will enable them to respond to this requirement.

Through the said law, local governments have acquired a multi-faceted, comprehensive indicator of their financial condition. What is important from now on is that in the financial areas too that have

been added as objects of financial evaluation under the new system, local governments get an adequate grasp of their financial condition and at the same time, of the actual state of their activities, and devise measures to respond to the issues that emerge.

[Notes]

- 1 Ministry of Internal Affairs and Communications, ed., [in Japanese] *Chihou zaisei hakusho* [*White Paper on Local Public Finance*], 2009 edition, p 130 (closing balances are for the 2007 fiscal year).
- 2 Ministry of Internal Affairs and Communications
(http://www.soumu.go.jp/iken/zaisei/kenzenka/pdf/kenzenka_data_1.pdf) Accessed Nov. 11, 2009.
- 3 According to a “Report on the Round Table Vision of Decentralization in the 21st Century”, issued on July 3, 2006, by the Round Table Vision of Decentralization in the 21st Century.
- 4 According to the “Report of the Research Group on a New Local Financial Rebuilding System”, issued on December 8, 2006, by the Research Group on a New Local Financial Rebuilding System.
- 5 According to the report referred to in f.n. 4
- 6 The formal name of “special tax allocation account” is “special account for tax allocation and transfer tax distribution”. “Tax allocation” refers to “local tax allocation”; without infringing on the autonomy of local public bodies, this device aims at achieving balanced fiscal revenue throughout the country, and at guaranteeing the planned management of local administration. Set percentages of different kinds of national taxation, namely income tax, corporate tax, liquor tax and tobacco tax, are calculated in respect of each tax and transferred by central government to local governments. Local allocation is classified into ordinary local allocation tax and special local allocation tax, which is allocated in response to special circumstances such as natural disasters. Ordinary local allocation tax is allocated to local public bodies whose basic financial needs exceed their basic financial revenues, and the amount of the allocation is the difference between the two sets of figures (deficit in financial resources). Source: Ministry of Internal Affairs and Communications, ed., [in Japanese] *Chihou zaisei hakusho* [*White Paper on Local Public Finance*], 2009 edition (closing balances are for the 2007 fiscal year) , p(10)
- 7 At the end of fiscal 2008, the balance provisionally entered was ¥197 trillion, an increase to 37.4% of GDP. Source: Ministry of Internal Affairs and Communications, *Chihou zaisei no genjou* [The present state of local finances], http://www.soumu.go.jp/iken/zaisei/pdf/genjyo_070518_2.pdf (accessed Sep. 19, 2009).
- 8 The “ordinary account” is the net account figure for accounts other than that for local public enterprises in local public bodies. In addition to the general account, it also covers matters other than those related to local public enterprises within special accounts. The range of each account differs by each individual public body, making integrated control and comparison of financial circumstances very difficult to achieve. It is therefore for reasons of statistical convenience that the accounts classification system is used in local finances. Source: Ministry of Internal Affairs and Communications, ed., [in Japanese] *Chihou zaisei hakusho* [*White Paper on Local Public Finance*], 2009 edition (closing balances are for the 2007 fiscal year).
- 9 Ministry of Internal Affairs and Communications, Media document, [in Japanese] *Heisei 19 nendo chihou koukyou dantai futsuu kaikei kessan no gaiyou* [*Overview of the closing balances of ordinary accounts in local public bodies in fiscal 2007*], issued November 28, 2008. The document summarizes the net closing balances for ordinary accounts in prefectures (47) as well as in 3,297 municipalities (1,793 cities, towns and villages; 23 special wards; 1,374 partial-affairs associations; and 107 wide-area unions).
- 10 According to: Ministry of Internal Affairs and Communications, ed., [in Japanese] *Chihou zaisei hakusho* [*White Paper on Local Public Finance*], 2009 edition, (closing balances are for the 2007 fiscal year); and Ministry of Internal Affairs and Communications, Media document, [in Japanese] *Heisei 19 nendo chihou kouei kigyuu kessan no gaiyou* [*Overview of the closing balances of publicly managed enterprises for fiscal 2007*], issued on September 20, 2008.

- 11 “Enterprises with legal applicability” are enterprises to which the Local Publicly Managed Enterprise Law (Law No. 292, 1951) is applied in its entirety or in terms of financial regulations contained in the said law, while in contrast, “Enterprises without legal applicability” are enterprises to which the Local Publicly Managed Enterprise Law does not apply, and which carry out accounting procedures according to the national government accounting formula. Source: as in f.n. 10.
- 12 According to a report issued by the Ministry of Internal Affairs and Communications on December 25, 2008, [in Japanese] *Dai-3 sekutaa nado no joukyou ni kansuru chousa kekka* [*Results of an investigation concerning the third sector, etc.*].
- 13 Corporate bodies in receipt of subsidies from local public bodies have been investigated since fiscal 2008 not only in respect of subsidies earmarked for management profits, but also in respect of other subsidies. Source: as cited in f.n. 12.
- 14 With regard to the parts of the third sector, etc., in which information disclosure is thoroughly implemented, the disclosure of financial statements (including overviews) is made in any event and does not depend on a demand for this information being made. Source: as cited in f.n. 12
- 15 According to the media document, *Heisei 19-nendo kessan ni motodzuku kenzenka handan hiritsu – shikin fusoku hiritsu no gaiyou (kakuhou)* [*An overview (confirmed report) on the ratio for determining soundness and the financial shortfall ratio on the basis of the closing balances for fiscal 2007*], issued on November 28, 2008.
- 16 Within the accounts operated by local public bodies, the “general account” deals with matters other than the accounts of local publicly managed enterprises. It has almost the same scope as the ordinary account used in local public body financial statistics, and no distinction is made between this and set accounts such as “assumed business accounts”. It should also be noted that local publicly managed enterprise accounts are the generic name covering the accounts of public business managed by local public bodies, national health care enterprises, enterprises concerned with the health and medical care of elderly persons, nursing care enterprises, for-profit enterprises, agricultural mutual aid enterprises, communications disaster mutual aid enterprises, and medical enterprises attached to public universities. Sources: as in f.n. 15; and *Chihou zaisei hakusho* [*White Paper on Local Public Finance*], 2009 edition (closing balances are for the 2007 fiscal year), issued by the Ministry of Internal Affairs and Communications.
- 17 According to the source cited in f.n. 15.

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