

Globalization of Local Finance

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- * Paper for the Workshop *Local Governance in a Global Era –In Search of Concrete Visions for a Multi-Level Governance*, 7-8 December 2001
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1 . Introduction

The relationship between financial reform and administrative reformation of Japan is arranged, and the problem of globalization of local finance is examined there. Local finance is experiencing a systematic crisis in Japan. As for the cause, first, the deterioration of single fiscal year revenue and expenditure is given. The reasons are due to the financial capital turning on to non-efficiency section, according to measures to boost the economy in the latter half of 1990's and the restriction sections.

Secondly, it is due to the aggravation of the deflation economy. The aggravation of the deflation economy influences a financial constitution and the policy formation to which the growth to the upward right is required. The biggest cause is due to the revolution of the relation between local finance and a financial market, according to the reform of a financial market where globalization is advanced. Moreover, bad private loans that have moved to the public section such as local governments, in the process of a financial reform, cause a systematic crisis of local finance. The bad-loan problem of Japan has a different characteristics than the United States, which not only the stocks and the real estate, but also the public section and private sectors are defective in union. Public section has turned to public money, due to the bad loan processing of the private sector. The public section has a large amount of bad loans by which the tax turning on in the future is assumed to be inevitable internally. Therefore, both private sectors and public sections' blockage on financial management by the bad loans are strong, and a present low interest rate policy supports the financing of the public section. It is necessary to execute inventory of property and debt of public section immediately, to overcome this kind of situation. The possibility of making finance healthy may not only be prevented, but also the reform discussion when the realities of financial affairs of the public section is not understood deepens the bad-loan problem further. As for a temporary model, the expansion of fiscal expenditure becomes indispensable in the bad loan processing of the public section.

It is a necessary to set the frame with respect to rule control, by setting of the government bond issue frame of 30,000,000,000,000 yen to the fiscal reconstruction. The frame functions to narrow the financial capital supply to non-efficiency and the restriction field through measures of boosting the economy, which will depend on the approach. However, the following aspect is insufficient in present Japan. The reasons

for this are first, lack of the mechanism of annual expenditure review to non-efficiency and the restriction field. The second is the lack of determination of necessary cost for the purpose of structural reform of the public section. It is difficult to keep issuing past government bond and provinces bond, with the progress of financial reform. The limit will be seen as a factor to support fiscal deficit like the savings excess and the trade surplus of Japanese economy.

The maintenance of the administrative and financial structure requires a more upward right growth, has this has become more difficult than in the past, because of the increase of the deflation pressure from Asia, in addition to financial reform. Moreover, it is raised to the basis of the flow of financial finance to face the wave of globalization, with respect to the big Japanese economy. Globalization lowers the wall of a country as much as possible, and enable the movement of things such as capital, people, and information freely. Corresponding to globalization in the field of economy and finance is a problem even in international economy. However, the stability of Japanese economy and regional economy, and the independence of local finance cannot be expected to follow to the global standard. When a regional policy progresses, power by which the policy formation not only matches to the global standard but also the voluntary formation of global standard is necessary.

At the same time, power in which local standard is formed is obtained. Especially, the strategy to make local government unite correspondence to the global standard, in terms of the contradiction of two axes of the local standard is needed. To the main axis as the strategy of the local government the efficiency improvement of financial affairs and it an improvement of customer satisfaction measurement. The efficiency improvements of financial affairs of these main axes are strongly influenced by the wave of globalization in financial reform. On the other hand, the formation of local standard, based on the outlook on value in the region, as well as the region itself is required for the improvement of customer satisfaction measurement through regional policy.

In the following, I want to grasp an idea of what local finance should be, how local standard is formed. At the same, I would like to clarify the realities of local finance, to which corresponds to globalization.

2. Essence of local financial crisis

As for local finance, the whole system has been facing systematic crisis in Japan. This crisis is different from the crisis when the province bond balance increases rapidly, and when the principal and interest repayment pressed local finance temporarily until

80's. The present systematic crisis means the maintenance of the entire local fiscal system becoming difficult. It means the inability to overcome the annual expenditure control by expecting the economic recovery in the future and the funds moving from the country unlike financial crisis in the past. The crisis of local finance will become aggravated further in ten years. New local fiscal system, which includes the introduction of the provinces bond issued prior to consultation system is needed, and globalization of finance will become full-scale.

The first problem which should be overcome in ten years is the change period with big structure of property and debt that has been piled up by past policy as it comes into stock cycle. Secondly, the limit of the circulation composition of a regional financial market and local finance must be dealt with.

(1) Coming into stock cycle

Coming into the stock cycle, which is the first problem, is an important problem which the local government encounters in a full scale for the first time, after the war. Financial activity changes the structure of property and the debt greatly, which local finance at the present time faces, after 50 years. The cycle is composed by three waves.

Wave of repayment of province bond

The first is a wave of repayment of the province bond. The amount of the repayment of the debt will peak within ten years in the local government. If the province bond issued for a past policy and the business received expiration, the capital could be procured by converting. However, ever since globalization of the financial market advanced, and the marketability of the province bond became old, when evaluated from the investment side. What the country and the local government should think about is the revolution of the confidence composition, especially the value of flow risk.

Up to now, the discussion has been centered on the risk of public section, which has been developed in Japan, in terms of credit risk. Credit risk means the irrecoverable debt risk. In financing and investment in the public section, up until now, there was no necessity for recognizing confiding risk. The debt of the local government is a system, which the country substantially guarantees, and not a big change takes place today. The problem is in actualizing the flow risk that had not been recognized to date. The flow risk means the risk by which the necessary investment capital cannot be collected when the investor needs the capital. As for current financing to local government, converting is always done even if there is a repayment time limit.

Therefore, the capital near the perpetual bond has been substantially fixed through

necessity by the investor. The limitation of capital operation by such fixation becomes difficult inside with the advancing of globalization of the financial market. The important thing is that the rise of liquidity of the capital influences the policy formation. The funding tendency to changing condition becomes strong from a fixed condition, and the introduction of narrowing the object area of the policy and various policy means to be based on a short-term view becomes indispensable.

Retiree problem

The second wave is that the number of staff of local governments, which retire, is facing its peak. The number of cases of financing difficulty due to payment of the retirement salary in a large amount of staff retirement, will increase in the local government where savings for retirement salary may hardly exist in the future. The change in the financial environment will overlap with the expansion of such capital demand.

Moreover, this problem causes a similar problem also in the capital operation of the mutual aid system, in time. Additionally, a big distortion is caused in the personnel composition in the local government, after large amount of staff retires, and after the reviews of promotion and the civil servant system.

Maintenance of infrastructure

The third wave is that the maintenance of the infrastructure. The expansion of demand for the update of superannuation of the infrastructure, which has been maintained up to now, in addition to the business being newly maintained and management, will become full-scale in the future. Therefore, securing the maintenance update cost of existing facilities is needed.

In budgetary process, it is necessary to understand the cost of not only construction, but also maintenance, management, and update. The introduction of mechanism of life cycle cost is reflected in the policy formation. In a long-term plan of the local government, it is necessary to recognize the cost of the life cycle of the policy, and clarify the restriction factor, as the whole, to the policy development. Besides this, the change in the population composition such as declining population of children and increase in elderly influences the revenue of the local government like the residence tax.

The annual revenue structure changes around the local government in the city part and the financial position deteriorates rapidly. As for the generation into the stock cycle and overcoming it, the review of the vested rights structure that form the resource

allocation is included, too. The formation of financial information not recognized from this in the policy formation of the past, and reflection in the policy discussion become inevitable. It is necessary to clarify that there is a limit in the administration, and the need to restructure the role allotment etc. of the administration and the resident.

(2) Circulation composition of the administrative and financial market

The second problem is a limit of the circulation composition of administration and finance in the region. A local fund has assumed to be a cash deposit up to now and has been deposited mainly to local financial institution. A local financial institution has accomplished the function to support the flow of funds of the region, like the undertaking of the private placement of local government bond, which the local government issues. However, the composition of the flow of funds of the region reaches the limit by decreasing a local fund sharply. It is an age where the local government also makes an effort towards confidence securing of the market.

Moreover, a financial reform invents a situation when the risk of making for a long-term province bond to fixation and possession should be considered. Additionally, the introduction of the market-value accounting, which becomes full-scale in the fiscal year 2001 becomes not only the stock market, but also an urge towards big review on the entire province bond system. The change in finance and an economic environment will challenge the confidence power of the local government through local finance and will demand the quality of explanation power. Uniform confidence is formed under the rule and guidance of the country, and the relation with the local government that has functioned and the financial institution is limited, due to the substantial guarantee of country. The effort for local government to voluntarily form confidence in the organization and each business is needed.

(3) Treasury investment and loan system reform

Local finance has greatly depended on the treasury investment and loan system. The treasury investment and loan dependency of the financing of local finance reaches 65% or more on the average. This treasury investment and loan system has shifted to a new system since April 2001, where the relation between the administration and finance changes, too. This shift becomes the one which influences financial management of the local government in a mid/long term. The nucleus of this reform is to abolish the obligatory capital put into Trust Fund Bureau which lies postal savings and pension reserve fund. As a result, a new debenture issue of the treasury investments and loan bond has been institutionalized as a new funding means.

The treasury investments and loan bond is a mechanism where the public debt can be issued with the budget, in the load of the financial capital's special accounting process within the range of the amount of money when the resolution of the Diet is passed. The process where obligatory capital putting in such as postal savings is abolished is the largest point in new treasury investment and loan. Therefore, in the market, postal savings will operate the collected capitals by its own responsibility. Postal savings which are the maximum original capitals of old treasury investment and loan become voluntary management, and new treasury investment and loan becomes a system for which the capital is procured by the debenture issue.

The new treasury investment and loan system is a mechanism where only a necessary amount of debenture and the capital are actively issued. This new system does not collect capitals automatically or passively, but the administration of necessary amount of capital is procured from the market. The treasury investment and loan system reform is a part of financial reform, administrative reformation, and one problem, because there is a big influence is on the financing of the local government, with a high ratio which depends on the treasury investment and loan capital. In addition, privatization of three postal administration businesses including postal savings has the possibility to reach an essential change in the capital operation of postal savings. It is a limit of contribution to debt management policy by the postal savings capital and contribution to local finance.

(4) Problem of confidence formation

Movement to revalue the confidence of the local government through the change in relations in the administration and finance, and the reforms of the treasury investment and loan system becomes full-scale. The problem of this confidence is arranged through a general rule

Value and debt implementation power of organization

Ranking judges not only the value, regardless of the organization or the business, but also the confidence power. The stocks aggregate market value and total assets of an enterprise are concerned when evaluating the value of such enterprises. However, the confidence power of the enterprise does not relate to the aggregate market value of the stocks directly, and will be judged by the debt implementation ability. Concretely, the debt implementation power is evaluated on how much solvency exists alone through the cash flow generated by a single organization and the business. The judgment of the debt implementation power becomes a judgment element that is important, whether

the period of about five years is foreseen, and to which extent the cash flow for the period becomes.

The tendency of setting the periods of the confidence of the province bond and the government bond is substantially made short-term from such a background, from 10 years of the situation to date to about 5 years. Ranking evaluates the debt implementation power, and cash itself becomes the subject of debt implementation. For instance, the investment expansion to capital investment and the research and development, expands total assets of the organization and increases the scale. Therefore, the property total which the organization increases, and the value of the entire organization rises.

However, the ranking evaluation does not necessarily become a plus factor. The reason for this depends on the possibility that the cash flow to the debt implementation decreases human, material consumption, when it expands and if the investment expands. On the contrary, it is another question that the debt implementation power of creditor becomes high, and the value of the organization will increase the cash flow abundance. The reason why the cash flow is abundant is because the investment is not appropriately done, and the room capital is held too much.

Another question can be posed from such a viewpoint, in terms of the necessity of the cash flow grasp, and with respect to the ranking of the organization body that aims to earn. How the capital is turned into the organization and how the business distributes its investment and the debt repayment, becomes an important problem in the public section, including the local government.

Management resource turning on to borrowed capital procurement

The balance sheet of the enterprise is formed with the debt and the capital, which it is an operation barrel property of the procurement capital and is a content of the funding. The debt and the capital are both capitals procured from the outside, and it is expressed as a borrowed capital and an equity capital. In the management of a current Japanese enterprise, when borrowed capitals are compared with the equity capital, more management resources have been turned on for securing equity capital. The shareholders' meeting measures can be called as the model.

On the other hand, we can see the same structure from the borrowed capital that has been made clear from the management resources of enterprise in current states.

The enterprise comes into non-market through the main bank through procurement or the government-affiliated financial institution, when the capital was procured from

outside the enterprise. Therefore, the fact that it has been disregarded is a reality in information disclosure to the entire market, and the defense cost to the market. Moreover, a similar structure can be seen from the content of the funding, assumed to be clear in the country and the local government by the consistent balance sheet of the public accounting reform. A lot of resource turning has been turned to the acquisition of the subsidy from the country.

However, a lot of resource turning has not been accompanied now, and the information sharing with the market had not been achieved, with respect to the issue of the province bond, which had market funding characteristics. It has been disregarded in Enterprise Management, which puts the base on the parent company and the main bank system in the resource investment to accomplish the information sharing and the explanation responsibility with the market. To offer information on the debt implementation power to the borrowed capital procured through the market, ranking is executed. Making of the province bond issue to which non-market funding has been done, up to now, centered on the local government to the market is recommended. Ranking should recognize the judgment of putting economical value of the organization body but also the debt implementation power and the one to accomplish the information sharing of the borrowed capital and the explanation responsibility enough for such a big flow.

The aspect mentioned above is closely related to the approach of the public accounting reform through the balance sheet making in the local government. For instance, there is little stock information which shows the resource allocation in the current public accounting, but the stock cycle is assumed to be a start and there is a lot of valuable financial information that has not been understood. The meaning of the balance sheet making is significant from the viewpoint of restructuring, the risk grasp, and confidence. However, enough consideration is needed then for the shown property.

The local government should keep having the property to maintain the continuance of administrative service, and keep substantial clearance possibility low. In that case, it is essential to grasp the property, assuming that the update and the maintenance cost in the future are shown. The argument has not been discussed from a financial side of the local government, and has been discussed only on the basis of the plus evaluation, however there are a lot of other properties. The local government should advance the conversion from making ALM and the asset management to the property use as aspect of local finance. In addition, the local government does not have the property and diversification, such as providing administrative service when needed from private organization by the service purchase.

The reform of public accounting including the balance sheet making has a big meaning in the place where the accumulation of the cooperation of the administration and the resident and know-hows is promoted on the side how to analyze and to use new information at the same time as making new financial information.

3. Administrative reformation since the second temporary and administration investigation association

(1) Administrative reformation since DOKO interim investigative committee

An increase and the issue balance of the government bond even in 30,000,000,000,000 yen level in the fiscal year 2001, swelled up from 14,000,000,000,000 yen level of fiscal year 1980, from 70,000,000,000,000 to 400,000,000,000,000 yen or less of Japanese finance. Of course, the quality of finance cannot be judged from a scale of deficit alone. Whether any resource allocation is formed in Japanese economy and the entire society becomes an important point in finance. The problem in Japanese finance is that the resource allocation stiffens with the system.

Why has stiffening of a financial system progressed as a whole? It is in the risk imputation structure by the annual expenditure reduction. The fiscal reconstruction in the 80's started from "fiscal reconstruction of which did not increase taxes" route of the 2nd temporary and administration investigation association. It was an approach, which tried to revolutionize the annual expenditure scale and the structure of finance by clarifying "do not increase taxes".

Moreover, "Review of the relation between the administration and the private sector" is presented at the same time, and the new idea assumed that it is an approach, which set the problem not in relation to the administration and finance reform, but the administration and the private sector. However, the approach of the annual expenditure reduction was not related to the area of the administration and the review of the function, and thus the structure of the risk move was brought in. It is necessary to note the existence of the risk move and the advance of the annual expenditure reduction in finance.

The annual expenditure reduction is accompanied by the risk move. As for the annual expenditure reduction in the general account, the risk is moved easily to the treasury investment and loan and local finance. The reason is that the risk moved though the deficit is expanded in the specially designated public corporation and the local government that does not have the system of bankruptcy, unlike private

companies, even if the risk that can be moved may be held.

Holding the risk results in the determination of government confidence, which finally supports the entire financial system, for the long term. It is a structure that a past risk move flows backward to a financial main body, in the background of the rapid increase of the ranking decrease in today's Japanese government bond and fiscal deficit. The risk move was accelerated further by the privatization policy of Nakasone Cabinet. Administration such as quasi-public corporations, and the cooperation of the private sector have changed in quality, to the administration and the mechanism of the risk move of the private sector.

(2) Correspondence of local finance to globalization

The age when big expansion of trade surplus and national savings which had supported fiscal deficit, while an economic globalization advanced was not expected, but nonetheless happening. It is clear that there is a limit in the annual expenditure reduction type of fiscal reconstruction, where the risk moves to another in the meantime. The relation between the administration and the private sector is reviewed, and the formation of a financial system mainly composed of the region is needed. The idea of the relativity of an administrative activity and the corporate governance becomes important, when taking into consideration the advance the constitution reform to enter, even a past administrative area and the technique as assumption of the strategy of the fiscal reconstruction.

The first "relativity of an administrative activity" means the performance of an administrative activity, which is evaluated and verified objectively through comparison with the activity of the private organization. Therefore, the meaning of "publicity/polity" will not only be roles for bureaucrats, but also the private sector must undertake what was thought to be the domain for publicity and polity.

Secondly, the idea of "corporate governance" meant stockholders, customers, consumers, and the local populace that observed corporate activity. However, it will become necessary to re-examine the people's dependence on administration, and financial mistake, by constructing a new system of evaluation through the national assembly, the market, and the people, and co-sharing the information of local administration.

A financial reform and the progress of information sharing in the market, and globalization bring an environmental change in the economy for the local government, and it will strengthen the depth of it as well. To correspond to this environmental change, the decentralization of function and the risk are recommended. The conversion

to "management type from the risk evasion type" is raised as a common problem which the administration and finance of Japan has as a whole, regardless of the country or the provinces where finance is reformed. The essence of the policy development in a current market risk evasion type is "imputation of the load and the responsibility and profit inducements" to which the safety net by the income of the re-distribution outside the market is required. It also has the essence of the market risk management type in "achievement of a clarification of the evaluation and the responsibility and even selections" to which restructuring the safety net to be included in the market is required as well. The paraphrase of the final purpose of fiscal reconstruction, "the current state of the risk distribution of the entire society is clarified, and the restructuring is achieved" becomes possible. It is a review of the resource allocation.

The existence of a government means "failure of the market". A society and an economic activity are always accompanied by "failure of the market". An original role of administration and finance is to distribute the income again because supplements to the market mechanism bring distortion. Market control such as monopoly and the oligopoly of non-symmetry and the dealings cost of information exists, which leads to the failure of the market by various factors, like the existence of a limit and an external character of the exchange. However, the failure of the market does not mean the necessity of what by no one it, nor does it mean that government should mortgage the validity of all policies through voluntarily positive act, either.

(3) Valuing of "Citizens"

It is necessary to form local standard that will correspond to the failure of the market, while the action on the market by the globalization is advanced and forms a multiple structure of the market and the society.

The first should value overcoming it by private mechanism as a reaction to the failure of the market. Especially, overcoming it by private mechanism of the local government becomes important while globalization is advanced on the financial side. Overcoming through private mechanism is a method of overcoming the failure of the market, by using a principle of non-market, which exists in private sector, and by the supply of public goods, such as partnerships and volunteers. In Japan, the discussion made for simplified administration, the private sector, or two poles become subjects.

It is necessary to straighten the cooperation of the administration and the private sector, and to enhance the value of the strengthening region, by means of the following requirements:

Sharing of profit and the risk between the administration and private organization;
Relationship in terms of flexibility and long term supported by contract;
Buyer and donor of public service are divided;
Decision-making in public sector decentralization of power;
Thoroughness in transparency and explanation responsibility;
Policy decision according to clear evidence;
Watch by citizens and enhancements of responsibility.

I can do nothing but strengthen the correspondence to globalization, while the dependence of financial market to local finance rises. However, the policy development by the formation of local standard for which the citizens participate is needed.