Framework of Governance for Metropolitan Areas and Economic Agglomerations

The case of Tokyo Metropolitan Government

Tokyo Development Learning Center

Japan Project Brief

Background and Objectives

Tokyo Metropolitan Government (TMG) is an administrative body that covers an area of 2,191 km^2, accommodating about 13.49 million residents[1]. Tokyo consists of 23 special wards, 26 cities, 5 towns and 8 villages over the mainland and on small islands. Territorially, the 23 special wards are regarded as Tokyo's core area with a number of Grade-A office buildings, major transportation facilities, regional public services, and 9.24 million residents. Despite the fact that Japan's entire population is gradually shrinking, the residential inflow into Tokyo and the surrounding jurisdictions, including Kanagawa, Saitama, and Chiba prefectures, continues to grow, due mainly to its strong economy (Figure 1). In fact, Tokyo as Japan's political, economic, and cultural center contains about 620,000 offices and 8.17 million employees[2] and produces around 20% of the national GDP.

Possessing the nation's largest economic engine, best assets, and living services, TMG can exercise its huge monetary power to allocate public resources, redistribute economic benefits, and stabilize dynamic markets in a distinctive manner. The fiscal structure may not be comparable to any other local governments in Japan but includes many important implications for the governance of emerging megacities and for financial challenges in other countries.

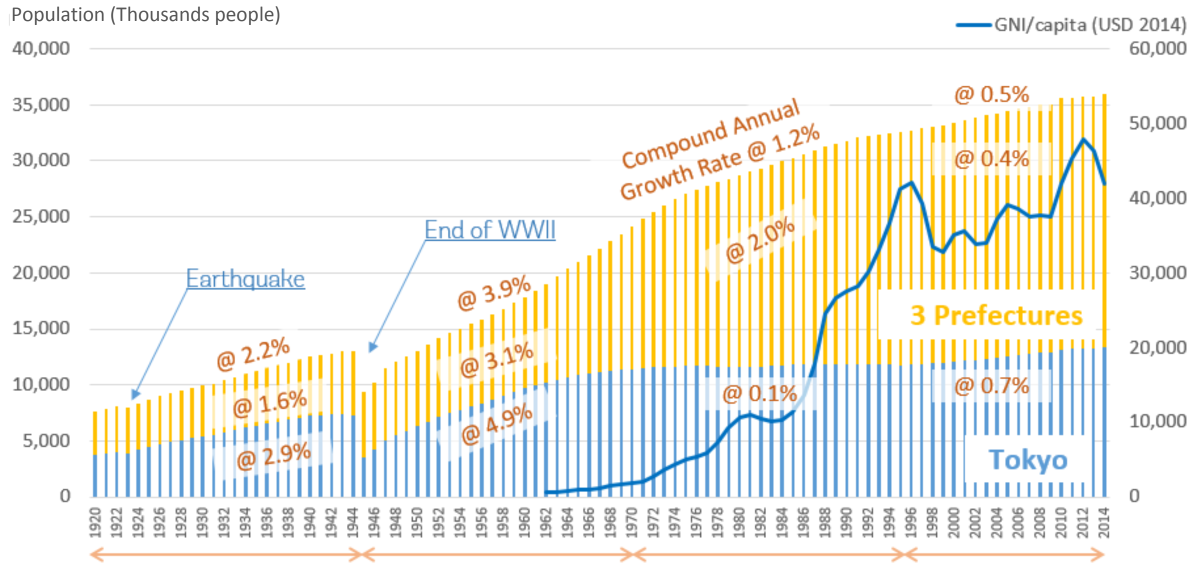

Figure 1: Population growth of Tokyo and surrounding prefectures (Chiba, Kanagawa, and Saitama)

Source: National Census, 2015

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Project Overview

The budget of TMG is composed of general, special, and public enterprise accounts. The sum of these three accounts for Fiscal Year 2016 reached JPY 13.658 trillion, which was almost as large as Sweden's national budget. Of the three, the general account budget was the largest one, estimated at up to JPY 7.011 trillion. The characteristics of both revenue and expenditure for TMG's general account budget are introduced below.

TMG's Revenue

High degree of fiscal self-reliance: TMG's large general account budget is relatively self-reliant without many subsidies from the national government. This is due to affluent revenue gained through local taxes (or "Metropolitan Tax") (Figure 2). The Metropolitan Tax accounted for 74.3% of the total revenue of TMG in FY2016. This proportion is considerably higher than that of all other local governments (45.1%). In contrast, the percentages of national treasury disbursements and local bonds are much lower than those in other local governments. Additionally, TMG is the only prefectural government that does not receive intergovernmental grants (i.e., local allocation tax) through the national tax redistribution system[3].

High vulnerability to dynamic market conditions: TMG's revenue stream is sensitive to market conditions due to its high dependency on corporate-related taxes (i.e., Metropolitan Inhabitant Tax on Corporations and Business Tax on Corporations), accounting for 34.7 % of the Metropolitan Tax revenue (Figure 3). In fact, the revenue sharply dropped – more than JPY 1 trillion - after the global financial crisis in 2008 (Figure 4).

Earmarked Taxes for urban improvement: Under unstable economic circumstances, earmarked taxes enable the TMG to keep stable and multiple-year resources for large-scale capital projects. Among more than 13 kinds of local taxes, two are earmarked for urban capital improvements (Figure 3). City planning tax, which accounts for 4.7% of the total revenue, is levied on land parcels and properties in the urban development promotion areas and collected together with Fixed Assets Tax (property tax). The revenue is specified to use for urban development and land readjustment programs. Another earmarked tax for urban capital improvements is Establishment Tax, which accounts for 2.1% of the total revenue. This tax is levied on offices with large floor areas and/or with a large number of employees in the 23 special wards and four cities of Tokyo. The revenue is to be used specifically for improving urban business environments.

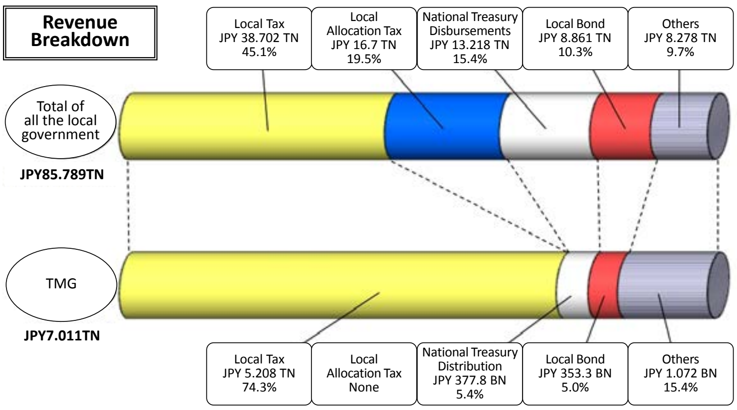

Figure 2: Revenue breakdowns of TMG and all the other local governments in Japan

Source: Bureau of Finance, Tokyo Metropolitan Government. April 2016. TMG's finance. http://www.zaimu.metro.tokyo.jp/syukei1/zaisei/2804tozaisei.pdf

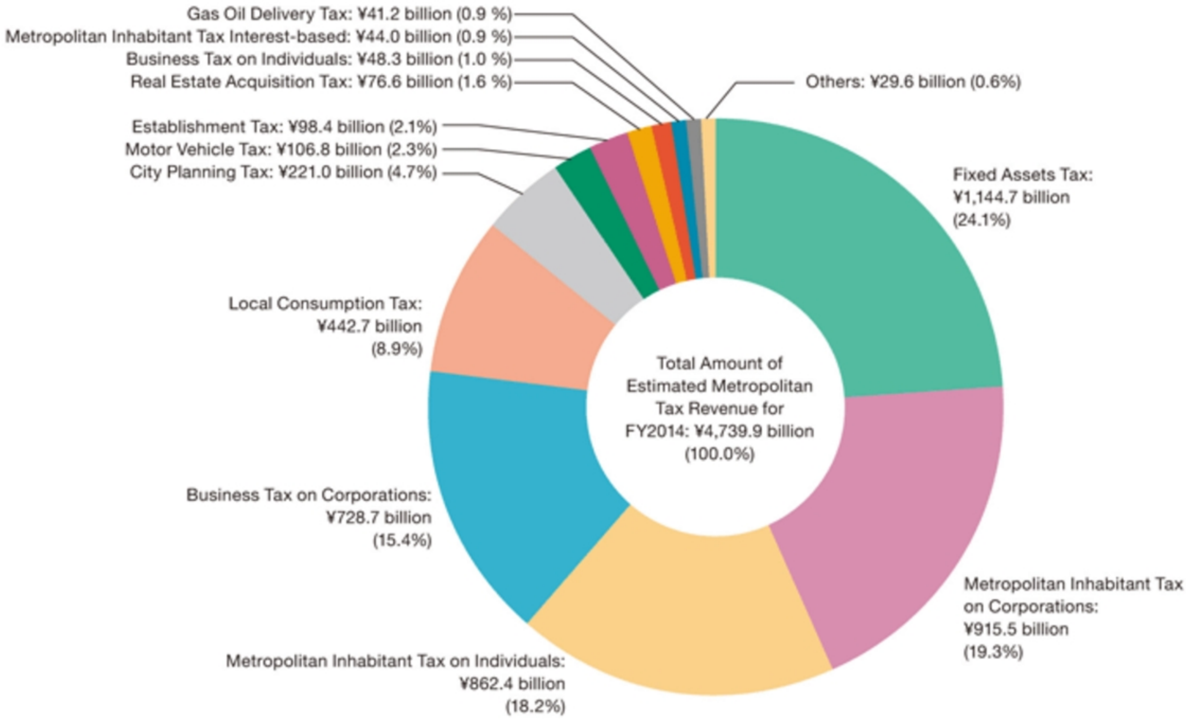

Figure 3: Breakdowns of estimated Metropolitan Tax revenue in FY2014

Source: Tokyo Metropolitan Government Homepage. Tokyo's Financial System.
http://www.metro.tokyo.jp/ENGLISH/ABOUT/FINANCIAL/financial02.htm

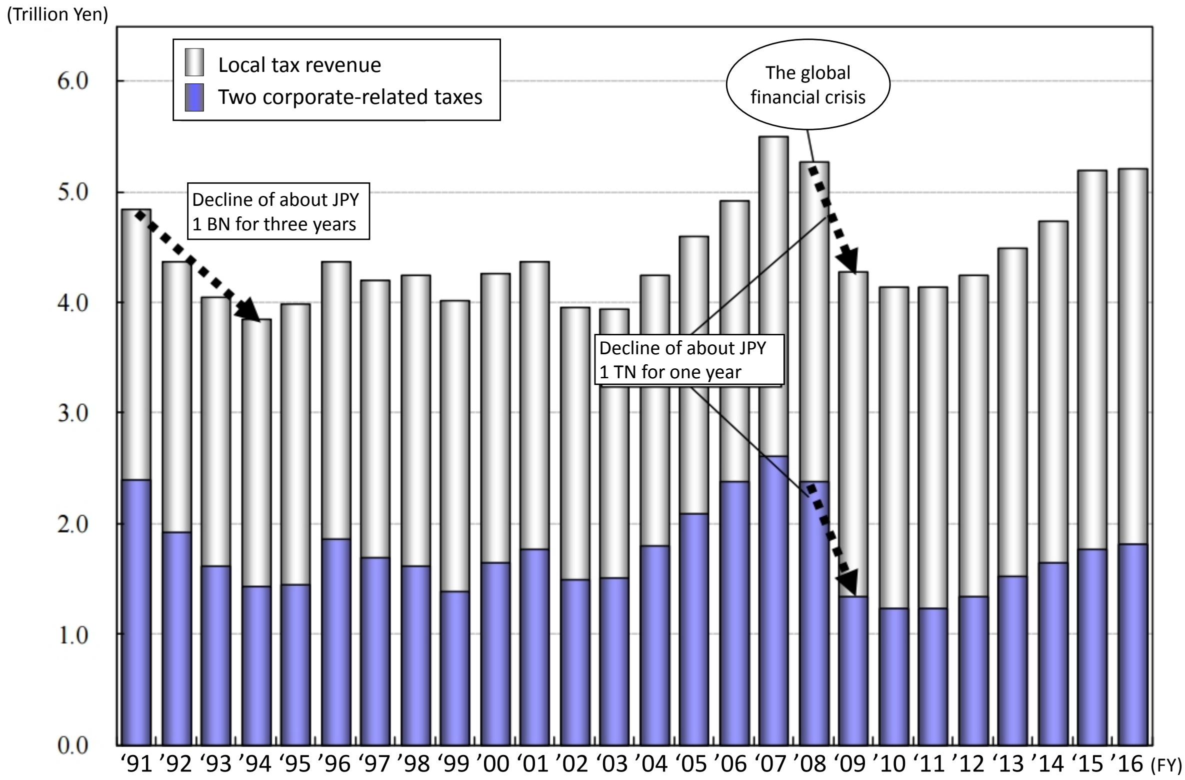

Figure 4: Transition of Metropolitan Tax revenue in TMG

Source: Bureau of Finance, Tokyo Metropolitan Government. April 2016. TMG's finance.
http://www.zaimu.metro.tokyo.jp/syukei1/zaisei/2804tozaisei.pdf

TMG's Expenditure

Larger expenditure on urban capital investments: The unique features of TMG's expenditure profile compared to all other local governments are found to be more capital investment and the existence of an adjustment cost[4] that contributes to fiscal balance among the 23 special wards (Figure 5). Capital investments are spent on urban infrastructure such as roads and bridges, schools, and social welfare facilities. Since the revenue is highly affected by macroeconomic cycles and political swings, this type of construction-related expenditure is also affected by those factors. The government continued to invest in large-scale public facilities as part of the economic stimulus, despite the sharp drop in tax revenues after the crash of Japan's bubble economy during the 1990s. Consequently, TMG faced a serious financial crisis. The government made concerted effort to reduce expenditure under a fiscal reform scheme for about a decade. Once the fiscal balance was recovered, construction-related expenditure has continued to increase over the last 12 years.

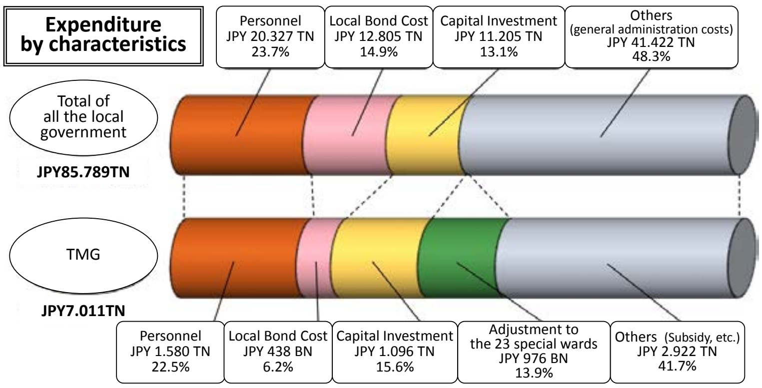

Figure 5: Expenditure of TMG and all other local governments in Japan by characteristics

Source: Bureau of Finance, Tokyo Metropolitan Government. April 2016. TMG's finance. http://www.zaimu.metro.tokyo.jp/syukei1/zaisei/2804tozaisei.pdf

Expenditure for policy implementation: The general expenditure, which is equivalent to the costs for policy implementation, amounts to JPY 5.093 trillion. By purpose, the social welfare cost is JPY 1.167 trillion (22.9%) – the largest portion of the total expenditure. In response to the increasing public needs, this cost has been increasing over the last 12 years, while the proportion of other expenditure items, including urban development and management, are on a downward trend.

Lessons Learned

Over the next few decades, a number of megacities are predicted to emerge in the Asia Pacific region. However, the development and management of those emerging megacities now call for the expansion of institutional capacity ahead of growth for urban improvement and fiscal sustainability. Key lessons and challenges from TMG's fiscal structure are summarized below:

Well-Mixed Revenues:

Large cities tend to rely heavily on corporate-related tax revenues, although they are basically market-sensitive sources. To secure stable fund resources for urban development programs over a certain period regardless of economic circumstances, the application of earmarked taxes for urban capital improvements could be a useful approach. However, an item-fixed budgeting approach is likely to discourage flexible resource allocation across projects and programs, and could result in by "organizational sectionalism". Therefore, it is essential to find a variety of revenue sources and establish a well-balanced fiscal structure, according to the socioeconomic nature of a city.

Future Challenges

Although TMG's fiscal structure is relatively self-reliant at this point, more public spending is expected to overcome social difficulties and create economic opportunities. An aging society will require huge government expenditures on social welfare programs in the coming decades. Policymakers must also consider the urgent issue of disaster prevention, which requires huge capital reinvestment. More recently, many construction projects, such as stadiums, hotels, transportation, and other related public facilities, are in progress for the upcoming Tokyo Olympic and Paralympic Games in 2020. However, these event-driven capital projects are likely to cause cost overruns and/or demand shortfalls in the post-event period. Moreover, there is growing fiscal pressure for massive renovation of old infrastructure over the coming decades. Hence, it is vital to incorporate the idea of "life-cycle asset management" into TMG and other related local government fiscal management practices.

[1] Tokyo Metropolitan Government Home Page. Tokyo's history, geography, and population. http://www.metro.tokyo.jp/ENGLISH/ABOUT/HISTORY/history02.htm

[2] Bureau of Industrial and Labor Affairs, Tokyo Metropolitan Government. Industry and Employment in Tokyo 2015 (in Japanese). http://www.sangyo-rodo.metro.tokyo.jp/toukei/pdf/pdf/ch01/1_02.pdf

[3] The local allocation tax from the national government to local governments comes from the revenue of five national taxes: 33.1% of income tax, 50% of liquor tax, 33.1% of corporation tax, 22.3% of consumption tax, and 100% of local corporation tax. Note that this local allocation tax does not have any constraints on how it is used, whereas the national treasury disbursements are given only to specified purposes. Only 77 (incl. TMG) out of 1,765 local governments in Japan did not receive local allocation tax in 2016.
Source: Ministry of Internal Affairs and Communications. FY2016 Status of Non-delivery Groups (in Japanese) http://www.soumu.go.jp/main_content/000430841.pdf

[4] The fiscal allocation from TMG to the 23 special-wards comes from the revenue of 55% of three metropolitan taxes: Municipal Inhabitant Tax on Corporations, the Fixed Assets Tax, and the Special Land Ownership Tax.

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