

Proposal for Establishment of  
Reconstruction Fund and Reconstruction  
Solidarity Tax to Finance Rehabilitation after  
Great Earthquake of Unprecedented Scale

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## **1. Preliminary Work to Support Earthquake Relief, Reconstruction**

On March 11, Japan was struck by an unprecedented 9.0-magnitude earthquake (Tohoku Pacific Offshore Earthquake), which unleashed a tsunami that engulfed the Tohoku and Kanto coastline. Fatalities are estimated at over 10,000 people. Aftershocks continue to shake the region, and our highest priority is saving lives, providing aid to evacuees, and preventing secondary damage. We must overcome this hardship with government leadership and the utmost level of cooperation from citizens.

Our first emergency measure must be to immediately enact a supplementary budget. This will involve reducing and reallocating expenditures, as well as possibly issuing government bonds. However, it is imperative that we secure the financial resources needed to finance a comprehensive plan to stabilize victims' lives and reconstruct the damaged region. Public finances are in dire straits, and Japanese citizens will need to bear some of the burden to prevent rating cuts for JGBs and financial ruin. New legislation and the budget for post-earthquake reconstruction must not lead to sustained expansion of our fiscal deficit.

Assuming nationwide support, local governments will take the helm in implementing well-planned strategic initiatives to rebuild the affected regions. This will require rebuilding both life-support infrastructure such as lifelines, public facilities, and houses, as well as industrial infrastructure, including thoroughfares, railways, crippled farmland, seaports, airports, and bridges. The disaster brought societal collapse to some regions, as if the entire society had been lost. Implementing measures to facilitate social welfare and create jobs could entail significant spending as a result.

We also foresee expenditure to shore up the financial system, since malfunctions and instability among the region's financial institutions could trigger new problems. Damages related to the nuclear power plant accident could also increase the fiscal burden considerably.

We cannot easily estimate the public funds required for rehabilitation, but damage from the Great Hanshin Awaji Earthquake in Kobe came to around 2% of GDP, which is nearly commensurate with production in Hyogo Prefecture and the three Tohoku prefectures that suffered heavy damage from the recent quake (Iwate, Miyagi, and Fukushima). National wealth in those prefectures totaled roughly Y57 trillion, as well. Both factors suggest that direct damage from the quake could exceed Y10 trillion. This time around, the disaster impacted a larger area and resulted in a greater number of fatalities. Furthermore, we should note incidents peculiar to the Tohoku Pacific Offshore Earthquake: the massive damage from the tsunami and the nuclear power plant accident. Taking these factors into consideration, we think the total damage may reach Y20 trillion or more.

## **2. Establishment of Eastern Japan Great Earthquake Reconstruction Fund**

Strong state support is indispensable for rehabilitating the afflicted area. The central government must implement extraordinary measures to assure that local governments in the region can raise the funds needed to support reconstruction without difficulty. Local governments are strapped for cash, so rehabilitation is likely to require considerable investments for awhile. Also, regional financial systems probably sustained damage, which could have nationwide repercussions.

Thus, we propose establishing the Eastern Japan Great Earthquake Reconstruction Fund (provisional name; see separate chart) under state control. The fund would provide investment and loans to local governments, corporations, and victims in the afflicted region for the sole purpose of rebuilding after the massive quake. A certain amount of the fund will likely come from issuance of ordinary JGBs. However, the government's serious financial situation makes this a limited resource, and the fund must be kept separate from the general fiscal deficit. We must implement conventional measures that rely on

public financing (Japan Finance Corporation, Japan Finance Organization for Municipalities), as well, but the extent of the damage indicates that these resources may not be enough.

### **1) Accountability for Usage**

The Eastern Japan Great Earthquake Reconstruction Fund is only for investment and loans to local governments and other entities to support disaster recovery work. The money would be used to restore housing, water and sewage systems, electricity, gas, and other types of life-support infrastructure, as well as to rehabilitate damaged thoroughfares and railways, crippled farmland, seaports, airports, bridges, and other types of industrial infrastructure. From a different angle, development of purely public infrastructure as part of the reconstruction efforts would be designated as coming from general government accounts, and the money basically would be used to create sources of future cash flow such as urban development and redevelopment; restoration of residential land, water and sewage systems, public transportation, and port operations; and re-establishment of cultural facilities and lending to the private sector.

In other words, usage of the Eastern Japan Great Earthquake Reconstruction Fund would be limited to post-earthquake reconstruction, thus ensuring high transparency and accountability to Japanese citizens and the market. Additionally, explicitly stating that the investments would work to raise the future standard of living and increase industrial activity should provide a level of certainty regarding the probability of repayment.

### **2) Vehicles for Funding**

Creation of the fund would involve issuing government-backed reconstruction fund bonds (provisional name) in the market. These financial products would be priced slightly differently than JGBs, and if the Bank of Japan included the bonds as part of collateral for its open market operations, they would likely attract demand from financial institutions and institutional investors.

Funds could also be raised by issuing reconstruction fund bonds for individuals, allowing the entire society to support the reconstruction efforts. For example, we can envision discount bonds that would pay no interest for the first three years or so and then pay higher interest rates the closer the bonds get to maturity. This way, the bonds would mirror prospective progress in the reconstruction work itself. Currently, household financial assets total around Y1,400 trillion, and even if 0.5-1.0% of these were used to purchase bonds, it would raise between Y7 trillion and Y14 trillion. Purchasing bonds could give citizens a sense of participating in the rehabilitation.

### **3) Investment and Loans to Local Governments**

The Ministry of Finance would manage the fund, and the local ministry offices that have jurisdiction over each region would assess the credit worthiness of borrower entities such as local governments. The recent disaster inflicted damage across a wide swath of eastern Japan, so local governments must work in concert with each other and carry out the reconstruction work in an efficient and systematic manner. Local governments also must maintain fiscal discipline, performing the reconstruction work without accruing more debt than necessary, including in the form of local government bonds.

Local governments would form the core of the rehabilitation plan, and residents of each region would be encouraged to participate in its design. Granted, the local plans must not obstruct the development of lateral ties between the local governments affected by the disaster.

### **4) Sources of Repayment**

Over the long term, borrower entities must repay principal and interest on loans received from the fund. We see critical need to maintain fiscal discipline while implementing measures such as the ones outlined below to ensure the repayment.

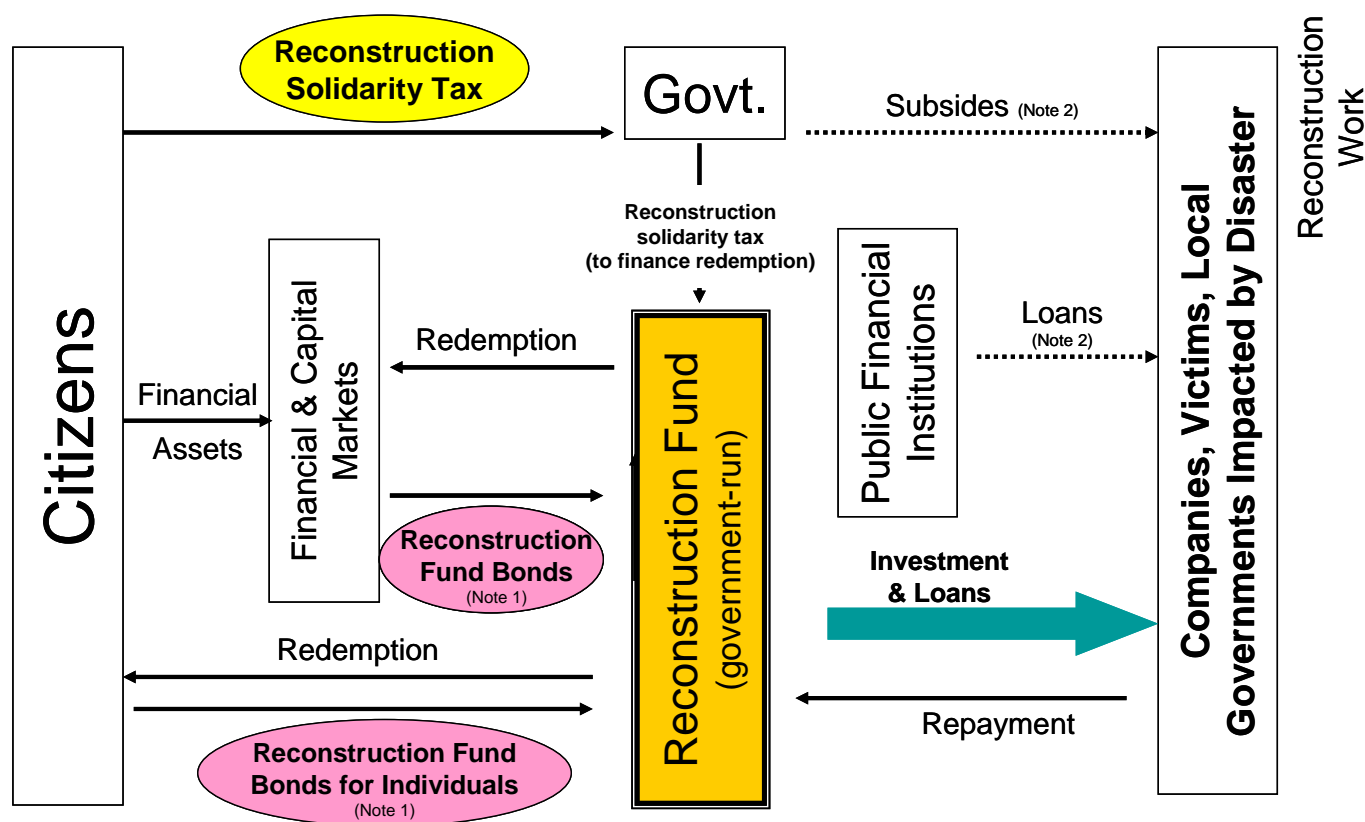
We should state in advance that, if the reconstruction is successful, fee revenue and local tax revenue will be the preferential source of funds to repay the loans. Financial need will be factored in when calculating the amount of national tax revenue distributed to local governments. However, the entire country will support the earthquake relief efforts, so the central government should consider establishing a framework to allocate part of the grants originally for unaffected regions to affected ones assuming a constant amount for the aggregate of such grants to municipalities.

To cite an historical example, an additional solidarity tax was levied to generate funds to pay expenses involved with integrating West and East Germany. Similarly, we propose establishing a temporary reconstruction solidarity tax (provisional name) so all citizens can share the burden of rehabilitating the disaster-stricken area. For example, we could hike the consumption tax by 1% for the three to five years required for reconstruction. This could generate revenue of roughly Y7 trillion over three years and Y12 trillion over five. Under this scenario, tax on company purchases would be deductible, eliminating negative impact on corporate activity. Also, certified disaster victims would receive tax refunds after the fact, as they should not have to shoulder any burden from the rehabilitation work. We think revenue from the reconstruction solidarity tax will be used both to fund the reconstruction work and to redeem the emergency bonds issued by the central government to support disaster relief.

After the Gulf Crisis in FY90-91, Japan contributed over \$10 billion dollars (approximately Y1.4 trillion) to help restore peace. The government temporarily increased the corporate income tax rate to raise some of the funds. Based on precedence, then, we view higher corporate and personal income tax rates as a viable option.

Another possibility would be to raise electricity and gasoline taxes. The crisis at the Fukushima Daiichi nuclear reactor may lead to a serious energy supply shortage over the long term, so hiking taxes on electricity and gasoline seems like a rational measure.

## Outline of Eastern Japan Great Earthquake Reconstruction Fund



- Notes: (1) Reconstruction fund bonds are government-backed, and purpose of funding is limited to rehabilitation work. BOJ likely to buy/sell the bonds in the secondary market.  
 (2) This framework has historical precedents.

### <Points>

1. Eastern Japan Great Earthquake Reconstruction Fund (provisional name) would be managed by government, with the purpose limited to financing disaster relief work.
2. Money for fund to come from reconstruction fund bonds (government-backed) targeting institutional investors and individuals.
3. Local governments impacted by disaster must use investment and loans to efficiently and systematically carry out reconstruction work.
4. Expect sources of repayment to come from post-reconstruction revenue and temporary reconstruction solidarity tax (provisional name). Local governments must maintain fiscal discipline throughout the process.