Daiwa Securities

Daiwa's Economic View

Fiscal spending for a backup capital scheme

- Firstly, it is necessary to determine what a backup capital would be
- If objective of backup capital scheme were to be to foster regional economic hubs, authorities would likely consider balancing this with regional revitalization grants
- It could take several years before a secondary capital was selected; no applicable prefecture may emerge for the time being, particularly if the metropolitan ward system were to become a prerequisite

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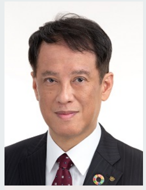

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The Japan Innovation Party (JIP) has listed achieving its scheme for establishing a backup capital as a condition for forming a coalition with the Liberal Democratic Party (LDP). Firstly, it is necessary to determine what discussions surrounding a backup capital are about.

If one of the major objectives of the backup capital scheme were to be to foster regional economic hubs, the focus of government spending would be for fiscal support. In that case, authorities would likely consider balancing that with the Y200bn in regional revitalization grants in the initial FY25 budget.

Even if a bill for the backup capital scheme were passed in the 2026 ordinary Diet session, the selection process could take several years. Notably, if the metropolitan ward system were to become a prerequisite for the backup capital, no applicable prefecture would emerge until a referendum on the Osaka Metropolis Plan was approved.

First of all, what would a backup capital be?

Japan's capital is Tokyo, which constitutes both a metropolis and a prefecture. However, if another prefecture were to be designated as a backup capital, what would the conditions for that be? Specifics in this regard are not necessarily defined in detail in the JIP's backup capital scheme.

The LDP-JIP coalition government agreement stipulates the following:

> The two parties shall establish a joint consultative body during the 2025 extraordinary Diet session with the aim of building a backup system for the capital's crisis management functions, decentralizing capital functions, and forming decentralized, multipolar economic zones. Once the responsibilities and functions of the capital and backup capital have been determined, the plan shall undergo prompt study, and a bill for it shall be passed in the 2026 ordinary Diet session.

In short, the LDP and JIP will discuss what a backup capital would mean going forward.

The backup capital would basically function as a backup for the primary capital when the primary capital faced a crisis. We would need to determine what kind of facilities and operational structures would be necessary for this backup function, how these facilities would be used during normal times, and whether there would be a relocation of central government ministries and agencies, something that is said would reduce administrative efficiency.

Would the main objective be to foster regional economic hubs?

The formation of decentralized, multipolar economic zones would be another objective of the backup capital. Looking at the JIP's various policy documents, a major objective appears to be to diversify the economy, away from its extreme concentration in Tokyo, and towards multipolar economic zones.

According to the backup capital vision promoted by Osaka Prefecture and Osaka City, it would act as a backup for the capital's functions in emergencies. During normal times, it would aim for economic growth and the enhancement of urban functions as a growth engine for Japan.

In this case, the majority of government spending might be used to provide fiscal support for the backup capital's economic growth. The problem would be balancing this with regional revitalization, which is a key policy of the LDP. The amount allocated for regional revitalization grants up until the FY24 initial budget was Y100bn/year, and several tens of billions of yen have been added in supplementary budgets. For FY25, the amount in the initial budget was doubled to Y200bn.

Even if the Takaichi administration were to increase the budget for regional revitalization grants tenfold, it would amount to Y2-3tn. If this were the total budget for all regions, several hundred billion yen in fiscal support for the economic development of a backup capital would seem like an appropriate balance.

When would the backup capital project begin?

The LDP-JIP coalition agreement states that a bill shall be passed in the 2026 ordinary Diet session. However, it is unlikely that the backup capital would be decided or a budget for it allocated through this bill.

Other prefectures besides Osaka may also express interest, particularly if one of the objectives of the backup capital were to be to provide fiscal support for developing a regional economic hub.

Multiple cities considered entering discussions for the development of IR sites (integrated resorts that develop complexes incorporating multiple facilities, such as international conference centers, hotels, shopping malls, and entertainment venues), and it took several years before Osaka City was chosen as the first location. It would be reasonable for the backup capital to be selected after conditions had been examined from various perspectives. It would not be surprising if it took several years until the government's budget for the plan were allocated.

Furthermore, the metropolitan ward system was reportedly included as a prerequisite for the backup capital when the JIP was considering a coalition with the LDP. Currently, the only place with special wards under the metropolitan ward system is Tokyo, with its 23 wards. The only other entities aiming for this system are Osaka Prefecture and Osaka City. They held two referendums on their metropolis plan, but both were rejected.

If the metropolitan ward system were to become a prerequisite for the backup capital, Osaka Prefecture and Osaka City would need to hold a third referendum, and have it pass. This is said to be something that would be very difficult to achieve. In other words, even if a system for establishing a backup capital scheme were created, no applicable prefecture for implementing the scheme may emerge for the time being.

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