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Revenue, Expenditure,
and Intergovernmental Transfer in Japan

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abstract

The defining characteristic of Japan's system of intergovernmental fiscal relation has been the strong collective preference for equal access to public goods. Equal access to public goods and fair sharing of the burden to finance these goods were viewed as essential for economic and social development. Inter regional redistribution is, therefore, the central issue for Japan's system of intergovernmental fiscal relations. However, now Japan has been faced second transitional phase after the Second World War. This means a shift away from a society which emphasizes equal access to public services and equitable sharing of the burden of paying for them, toward a society which gives priority to individual citizen's expressed preference.

key words

intergovernmental fiscal relation, decentralization, fiscal equalization

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1. Introduction

Japan is an unitary state having a two-tier system of local government which consists of prefectures and municipalities. The total number of local governments is 3,281 -- 47 prefectures, 663 cities, 1,994 towns, and 577 villages. By the end of the Second World War, national government strictly controlled local governments by appointing the governor of prefecture. However the principle of local autonomy is guaranteed by the post-war Constitution. (Article 92) The chief executive officer and the member of assemblies of all local authorities are elected by direct popular vote today. Each local government has own budgeting accounts which compile the revenue and expenditure necessary for its activities.

According to OECD statistics, Japanese local public finance amounts to 14.0 per cent of GDP in FY 1993. This means that it occupies an important position, accounting for 70 per cent of general public expenditure, excluding social welfare funds, which is comparable to federal system such as Canada and Germany. Moreover, 80 per cent of public capital formation, amounting to 6.7 per cent of GDP, is implemented by local governments. Local governments are playing an extremely large role in the provision of social capital. Japan's relatively large local public finance suggests the great importance of fiscal coordination between central and local governments. The purpose of this paper is to examine Japan's intergovernmental relations from the viewpoint of fiscal side and draw some relevancy to the policy formation of many developing and transitional economies today.

The second section of this paper makes a brief survey of main feature of Japan's system: vertical fiscal imbalance, large-scale redistribution of sources of revenue, MOHA as a vital counter power in the central bureaucracy. It points out that the Japan's system is administered in the local rather than centrally, and central government's role is to guide the local towards a common fiscal situation by means of subsidies, tax allocations and local bonds. The third section describes expenditure responsibility and division of tax power in detail. It is argued that Japan's intergovernmental system is well designed to enforce macroscopic fiscal responsibility. However it is difficult to see how each local government can be accountable to their tax payers at the margin, as both efficiency and local autonomy require.

The fourth section reviews the role of unconditional tax-sharing grant in reduce regional fiscal disparities: computation formula of local allocation tax, calculation of the amount of LAT, and practical effect of fiscal equalization. It may be assumed that Japanese equalization system operates well, in general, to reduce territorial fiscal inequalities. Discussions in the final section try to clarify both advantage and disadvantage of the Japan`s intergovernmental system. Local allocation tax should be evaluated by several criteria -- revenue adequacy, local tax effort, equity and transparency. This section also points out briefly the shift away from a society which emphasizes equal access to public services and equitable sharing of the burden of paying for them , toward a society which gives priority to individual citizen's expressed preference.

2. Feature of Intergovernmental Fiscal Relation

a. Vertical fiscal imbalance

The main features of Japanese system are centralized tax administration, decentralized provision of public services and dependence of local government on intergovernmental transfers. In other words, Intergovernmental fiscal relations are marked by a vertical fiscal imbalance in Japan. Vertical fiscal imbalance is the disparity between revenue means and expenditure needs at various levels of government. This results from the division of expenditure responsibilities and revenue raising powers between the central and local governments. This imbalance can be seen by examining table 1 which estimates vertical fiscal imbalance in ten major countries based on National Accounts. Data is for 1992, while in the parentheses for 1974. In this table, "absolute vertical imbalance" is defined that local expenditure share minus local tax share, on the other hand "relative vertical imbalance" is the former divided by the latter.

table 1

As suggested by the table 1, following facts should be stressed. First the imbalance has been corrected somewhat for the past two decades. In every countries except for England and Spain, the imbalance in 1992 has been reduced in comparison with 1974. This is mainly due to increase in local tax share rather than decrease in local expenditure share. Second, however, there still remain large mismatch between

expenditure responsibility and tax assignment in these countries. The absolute imbalance of these countries is positive, maximum is 32.7 of England and average is 18.1 percent. The relative imbalance also more than one, maximum is 455 of England and average is 1.612. Third, the degree of the imbalance varies with countries considerably. Paying attention to the rank of the imbalance, it should be noted that the major surprise can be found in Japan (32.7 percent) , England (31.8 percent) and Australia (25.6 percent) where the vertical fiscal imbalance is overwhelmingly high. In Denmark and Spain this imbalance is more moderate, while in federal states except for Australia this imbalance is relatively low.

The question is why the degree of vertical fiscal imbalance in Japan is highest among ten countries. The direct cause of the high degree of vertical imbalance is a centralized tax administration, as mentioned quite frequently. However from the view point of international comparison, the true cause of imbalance can be found in division of expenditure responsibilities. In fact, local tax share as of total tax revenue in Japan is 36.5 percent, which is next to Sweden (50.9 percent), United States (45.9 percent) Canada (40.4 percent) in rank. Even in federal countries, Australia (23.0 percent) and Germany (35.3 percent) are next to Japan. This implies that decentralized provision of public services is the cause of the vertical imbalance rather than centralized tax administration.

Table 1 also illustrates local government expenditure as a percentage of general government expenditure in ten countries. Local government spending in Japan accounts for largest share among these countries. In two Scandinavian countries, local government spends around 50 percent of total public spending, while Southern European countries spends around 30-40 percent. In contrast to this Japanese local government spends 69.2 per cent of total public spending. This means that Japan's local public finance system is milder and more refined than the truly centralized systems of France, Spain and Italy. The system is administered in the local rather than centrally, and central government's role is to guide the local towards a common fiscal situation by means of subsidies, local allocation tax and local bonds^{註1} .

^{註1} Fiscal federalism (for example Musgrave, Oates, King) suggests that local government may become heavily involved in the allocation branch whereas the distribution and stabilization branches are mainly reserved to national government. It is difficult to apply this theory to Japanese experience.

b. Large-scale redistribution of sources of revenue¹²

Above mentioned imbalance is addressed by intergovernmental transfer. There is large-scale reallocation of revenue through earmarked and general subsidies in Japan. Table 2 shows the situation of tax share and fiscal transfer between central and local government from the historical perspective. In 1993 total tax revenues are 90,705 billion, which are divided into national and local taxes. Before fiscal transfers, local taxes account for only 35.0 per cent of total revenue. However a substantial portion of national taxes is transferred to the local governments. Major fiscal transfers are of two broad types: Unconditional transfers are tax-sharing grants on a lump-sum basis financed by the local allocation tax. Conditional grants are matching-type categorical grants which are called specific-purpose grant. After reallocating the tax sources among different levels of the government, the final share of total tax revenue accruing to local governments increases to 52.2 per cent. This means that one-third of national tax revenue is used at the local level. Although there was some increase in fiscal transfer during Meiji Era, by the end of 1930s main component of local government revenue had been local tax revenue. Starting from 1940 as a wartime mobilization, redistribution of tax revenue has been increased steadily for a nearly four decades as indicated by table 2.

table 2

Intergovernmental transfer is needed not only to balance the budget at the subnational level but also to offset the regional inequality created by the lack of population mobility. Given regional gaps in the tax revenues and financial needs, some means of fiscal equalization is necessary to provide local public services in poor areas. The most important means devised to handle this problem is the unconditional tax-sharing grant. In Japan, the local allocation tax system plays a key role as the Equalization Transfer Scheme. Although specific-purpose grant, local transfer tax and even some local tax also has the effect of equalization to some extent in Japan, discussion concerns the local allocation tax because of its key role in the Equalization Transfer Scheme.

table 3

Making a comparison between per capita local tax revenue and per capita revenue

¹² As to historical development of Equalization Scheme in Japan, see Mochida, N [1993]ch.4,5.

from general fiscal sources (i.e. local taxes, local allocation tax) of prefecture in 1993; it may be ascertained that the disparity in the financial resources among rich and poor districts is considerably reduced. In Table 3, all prefectures are grouped into 5 categories according to the index of fiscal capacity which is defined basic fiscal capacity divided by basic fiscal need of each local government. A marked difference is observed in per capita prefectural tax revenues among localities in FY 1993, the largest being Tokyo 196 thousand of Yen, the smallest Okinawa with 60 thousand of Yen, corresponding closely to the difference in their economic resources and per capita income of inhabitants. More local allocation tax is provided disproportionately to those areas with lower resource bases to achieve some degree of equalization. The correlation between per capita prefectural tax revenue and per capita local allocation tax, in fact, is - 0.71.

As a result, per capita revenues from general sources in the area with low tax bases increases considerably. A surprise can be found that coefficient of variation in prefectural tax revenue accounting for 0.2408 differs little with that in general revenue which accounts for 0.2293. However this phenomenon resulted in a reversal of the rank ordering of disparities among prefectures rather than deterioration of equalization effect. The degree to which fiscal transfer reversed the relative wealth of prefectures can be measured by the rank ordering correlation. The rank order correlation between per capita prefectural tax and per capita general revenue is - 0.5195. After fiscal transfer the prefectures with lower tax capacity, as measured by prefectural tax revenue, had the higher total resources, as measured by general revenue. General resource of Aichi, Osaka and Kanagawa is only a half of that of Tottori, Shimane and Kochi. It may be assumed that Japanese equalization system reduces territorial fiscal inequalities quite extensively, though many questions relating its mechanism remain unsettled^{註3}.

c. MOHA as a vital counter power in the central bureaucracy^{註4}

A legal definition of the central-local fiscal relations is not sufficient to guarantee its strict implementation. Institution representing the interests of the local governments in the national political arena must be established to counteract central agency to appropriate

^{註3} It is to be noted that these figures refer merely to the per capita amount of the prefecture. Financial needs for local function are not necessarily proportional to the number of inhabitants. In a sparsely populated district, for example, per capita revenue gives a large figure, notwithstanding the low level of accomplishment of services. On the other hand, a densely settled district requires fiscal means beyond the average.

^{註4} This section is based on Fujiwara, T[1996].

fiscal powers from the localities. In Japan, the conflict between the Ministry of Finance (MOF) and the Ministry of Home Affairs (MOHA) reflects one of the main points of Japan's central-local fiscal relations, the latter institution espousing greater fiscal and political power for the local authorities. The MOHA represents a vital counter power in the central bureaucracy against MOF incursions into local matter, and is thus an indispensable institutional component in achieving and sustaining decentralization.

The MOHA has a secretariat, three bureau, two departments, and a college. The Fire Agency is attached to the Ministry. With regard to fiscal side, we should pay attention to Local Finance Bureau and the Local Tax Bureau. The former deals with planning and implementation of the local finance system. The Local Allocation Tax is the most important fiscal transfer this bureau has devised. The Local Finance Bureau is also charged with planning and the implementation of the Local Public Enterprise System. The latter is charged with planning and implementation of the local tax system. Since the taxpayers are the same as national and local taxes, this bureau establishes the organization for national, prefectural, and municipal levels. Based on the frame work provided by the Local Tax Law, each local government prepares its own tax by-laws for its tax administration.

MOHA's key role is to express its opinion on behalf of local government as a whole. Since local regulations are subservient to ministerial regulation, local authorities need to find other measures to counterbalance the center's pressures. In addition, it is difficult for over 3,500 local governments to lobby consistently and successfully at the central level. Against this background, MOHA seeks to coordinate other ministries' policies from the viewpoint of the localities, and more specifically, the way these policies are implemented and the way they affect local authorities.

MOHA began as the Ministry of Interior (MOI) and was founded in 1873, in the early period of the Meiji Era. As a MOI charged with domestic affairs in establishing a stable new unified country, Ministry of Interior covered a wide range of administrative responsibilities such as local government system including local finance, police, civil engineering, geographical surveys, and public health. After the Second World War, the General Headquarters of the occupation dismantled the MOI. The occupation forces mainly came from a federal country and did not understand the role of MOI. Thus MOI as a key player in internal administration was reduced to a division in the Prime Minister's

Office. When the Ministry of Interior was dismantled, local governments found themselves thrown out into a jungle of central powers and up against interventions. Soon after this occurred, there was an impoverishment of local finance and an unconcerned intervention from each ministry again. It was thirteen years after the crush of the MOI that the MOHA was founded as a new, comprehensive ministry charged with local government systems and intergovernmental relations. The local allocation tax system was devised by the MOHA in the process of alleviating the impoverishment of local government.

3. Expenditure Responsibility and Division of Tax Power

a. Division of expenditure responsibility

It is local government which shoulders the responsibility of Japan's domestic administration. Almost all administrative function closely connected to the daily life of the nation are carried out by local government. As a result, local public finance accounts for approximately two thirds of the public expenditure burden, on final disbursement base. Figure 1 demonstrates role-sharing between national and local governments in FY 1994. In Japan, the central government directly perform relatively few public functions such as national defense, pension-related public welfare expenditure, and expenditure to repay a debt. About 80 per cent of disbursement of national government's general account are simply transferred to other accounts of which local government comprises largest share. In contrast, local governments are responsible for a major share of public spending, including on national land conservation and development expenditure, school education expenditure, social education, police and fire-defense, social welfare, sanitation and general administration. Although the ratio of national to local public expenditure in Japan is 34.5 to 65.5, on a final disbursement base, the ratio of the distribution of tax revenue is just reverse, namely, 62.4 to 37.6 in favor of the national government. There exists a very large discrepancy as between final expenditure and the distribution of tax revenue.

Figure 1

Although considerably more public spending takes place at the local level than at the national level, the national government remains heavily involved in almost every aspect of local public spending. Unlike American and Canadian system, no clear division

of function exists in Japan. Although Local Public Finance Law established rules for fiscal responsibility and cost sharing^{註5}, there is no clear separation of central and local function. The function of central government is carried out not through the field agencies of the central government itself but by delegation of function. Major program(education, health, public works) are formulated by national ministries and financed by many specific grants. National ministries also retain numerous authorities with respect to local governments.

In this respect, the most important instruments are an agency-delegated function, the national government disbursements for specific purposes and the local allocation tax. Among them, the agency delegated function (ADF) is representative of Japanese central-local relations. Before Second World War, local leaders were appointed by the central government. The Occupational Reform dismantled the Ministry of Interior and introduced direct election for governor, mayor and member of local assembly. The central government was able to reestablish local influence through the ADF, which required local leaders to act as agents of the central government in implementing assigned functions. There are 561 kinds of ADF prescribed in Local Autonomy Law. Kume suggests that the ADF has two institutional implications: it tends to restrict the scope of local participation by not providing for any explicit role for local assemblies, and it tends to increase the vertical scope of participation by allowing local chief executive some influence over the formation of national policy.

The national government also tries to control functions other than agency-delegated functions. Among them, the national government disbursements for specific purposes are the most general instrument for the national government. These disbursements are distributed on condition that the recipient follow the directives issued by the national government. If a local government fail to observe national directives, it is requested to refund the disbursement in whole or in part. A basic principle which underlies national government control seems to be uniformity throughout the country. The national government seeks to standardize local taxation as well as the distribution of public services. As a policy, the national government tries to treat all local governments equally. When a department of the national government distributes a specific-purpose disbursement, it takes great care not to discriminate against any local government. The local allocation tax also play a key role in standardizing the level of public services among

^{註5} On this subject, see Local Public Finance Law article 9,10,12.

local jurisdictions. The local allocation tax is annually paid to local governments whose basic financial need exceed basic financial capacity, it varies directly with local fiscal needs and inversely with local fiscal capacity. Then the LAT enables local governments to provide public services at the level prescribed by the national government.

b. Tax assignment^{註6}

In Japan the ratio of total tax burden to GDP which reached 27-28 per cent today does not seem as high as those of other OECD major countries. Total tax revenue in FY 1994 amounts 86.5 trillion yen, of which 62.4 per cent is national taxes and 37.6 per cent is local taxes.^{註7} The ratio of local tax as of local government total revenue is 35.2 per cent which is not always low from the viewpoint of international comparison.^{註8} Every local government is authorized, by the Local Tax Law, to levy and collect several kind of local taxes.^{註9} Final authority to levy local tax, however, is guaranteed by local ordinance/bylaw enacted by each local assembly.^{註10} If a local assembly does not establish local ordinance/bylaw, taxpayer has no obligation to pay taxes to his/her local government.

The present classification of local taxes under the Local Tax Law are shown in Table 4. There are 14 kinds of prefectural taxes and 9 kind of municipal taxes. The total amount of local tax revenues in FY 1996 is estimated 33.7 trillion yen, of which 13.7 trillion yen is prefectural tax revenue and 20.0 trillion yen is municipal tax revenue. Among prefectural tax, enterprise tax comprises the largest share, 35.2 per cent, prefectural inhabitants tax accounts for 28.9 per cent, automobile tax accounts for 11.8 per cent, light oil delivery tax accounts for 10.0 per cent. Among municipal taxes, fixed assets tax comprises largest share, 44.1 per cent, municipal inhabitants tax accounts for

^{註6} This section is based on Ishi, H[1993] and Ministry of Home Affairs[1996a], [1996b], [1996c]

^{註7} The major component of total tax revenue is income tax, consumption tax and property tax. The amount of Income tax is 50.2 trillion in FY 1994, of which 65.3 per cent is national tax, 8.9 per cent is prefectural tax, and 8.5 per cent is municipal tax. The amount of consumption tax is 20.7 trillion, of which 76.8 per cent is national tax, 19.3 per cent is prefectural tax, and 3.9 per cent is municipal tax. The amount of property tax is 15.6 trillion, of which 34.0 per cent is national tax, 4.5 per cent is prefectural tax, and 61.5 per cent is municipal tax. See, Ministry of Home Affairs[1996b].

^{註8} Major sources of local government total annual revenues in FY 1993 are local taxes (35.2 per cent), local allocation tax (16.2 per cent), central government disbursements (14.3 per cent), loans (14.0 per cent), charge & fees (2.3 per cent), and local transfer tax (2.1 per cent).

^{註9} Local Tax Law, article 2.

^{註10} Local Tax Law, article 3.1.

43.2 per cent, city-planning tax occupy 6.8 per cent.

table 4

A good local tax system, in general, should satisfy several criteria.^{註11} The first criteria is revenue response to economic growth.^{註12} In the long run it is desirable that local revenue increase/decrease in line with local expenditure needs. Although a buoyant tax base allow windfall revenue gains to local government, this problem can be overcome provided that the long run local elasticity of the tax base to economic growth is equal to one.^{註13} It should be noted that unlike United States and United Kingdom where local governments rely/ relied predominantly on property tax, Japan`s local tax system makes a good score for revenue response to economic growth. This is mainly due to the fact that major source of local own revenue is a kind of tax base sharing which are similar to surtax on national income tax base. Approximately 60 per cent of prefectural taxes revenue and 40 per cent of municipal taxes revenue are imposed on income of individual and corporation. According to these elasticity, the share of local tax in total tax revenue is relatively high in comparison with other unitary states.

Typical case can be found in the inhabitants tax. The individual inhabitant tax is a "burden-sharing" tax in which all residents are required to share the cost of maintaining the local community functions according to their ability to pay. It can be likened to a membership fee for being a part of the local community.^{註14} This tax is levied on income in a manner similar to the collection of the national individual income tax. However, the inhabitants` income tax is assessed on the income of a year previous to the income assessed in the national income tax. Generally speaking, the inhabitants` taxes is the best candidate for raising a large amount of local tax revenues, because it place the responsibility on as many inhabitants as possible to finance local public services.

The second criteria is small revenue fluctuation over time. Strong fluctuations in

^{註11} As to local tax criteria, see Bennett R.J. and G.Krebs[1987].Chapter 7.

^{註12} In the British literature this is referred to as buoyancy of revenue.

^{註13} Bennett R.J. and G.Krebs[1987]p.251.

^{註14} The inhabitants` tax is collected by both prefectures and municipalities. In levying this tax, mutual co-operation is established among the municipal, prefectural and national government. When the municipal governments levy their inhabitants` tax on individuals, they collect the prefectural inhabitants` tax too, using the same tax base. Information on taxable income necessary for computing the local inhabitants` tax is given by the national government.

revenue during business cycle can be regarded positively for a national tax, but this is not true for local taxes. First, local expenditure needed is fairly continuous and revenue fluctuation make planning difficult. Second, local expenditure should not run contrary to national economic policy, although the scope for local authority to pursue a counter-cyclical budget policy is rather limited. In Japan, instability of enterprise tax revenue is most serious problem. The important tax at the prefectural level is the enterprise tax, which accounted for nearly 35 per cent of the total prefectural tax revenues.^{註15} Since the enterprise tax on corporation is generally imposed on net income, not on sales or turnover, the tax revenue fluctuates strongly during bussines cycle. Introduction of new tax base such as sales, capital ,value added has been suggested in various proposal in order to make tax revenue less sensitive to business condition. The introduction of a local consumption tax in FY 1997 also may be a first step towards revenue stability^{註16}.

The third criteria is distribution between local authorities. Local tax system should produce a relatively balanced distribution of revenue among local government in relation to their expenditure needs. Large difference in tax base between localities may cause many undesirable effects which require intergovernmental fiscal equalization. Over the time regional disparity measured by per capita local tax revenue has been reduced, however , area with lowest fiscal capacity has only one third of richest area`s tax capacity. The property tax satisfies the requirement of a local tax, partly because the tax base is evenly distributed over the country and partly because it produces fairly stable revenues every year. The property tax, which is called the *fixed asset tax* by the Ministry of Home Affairs, is reserved for the municipal governments and raise 37 per cent of all municipal revenues. However substantial under assessment is more the general rule than the exception.

The fourth criteria is local fiscal autonomy and `fiscal equivalence`. The power of determining tax rate and base allows sensitive local variations in fiscal burdens to local preferences which should encourage fiscal accountability. Despite strict uniformity,^{註17}

^{註15} In calculating the tax base of the corporate tax at the national level, the prefectural enterprise tax is allowed as a deduction. If a taxpayer has an office within the jurisdiction of two or more prefectures, the tax base is allocated to all prefectures concerned. The allocation is made on the bases of number of employees.

^{註16} As to local consumption tax, see Ministry of Home Affairs[1996a].

^{註17} All revenue sources are subject to control by the national government under the Local Tax Law. The tax base and rates of major items are legislated by the Diet and can be altered by the proposal of both the MOHA and MOF.

there are two options available to local government for setting tax rate and base in Japan. One is that central government sets fixed tax rate for a number of local taxes,^{註18} but provides range for some other local taxes as demonstrated by Table 5. Each local authority can use standard tax rate with/without upper-limit set by MOHA and MOF.^{註19} Excess amount of tax revenue which local governments levy over standard tax rate, however, is only 1,878 hundred million Yen at prefectural level and 4,751 hundred million Yen at municipal level. Former accounts for only 1.3 per cent of total prefectural tax revenue and latter for 2.3 per cent of total municipal tax revenue. Moreover, in FY 1996, 2944 out of 3233 municipalities apply same standard tax rate on property tax base. These facts suggest that there is strong preference to equal access to public services and equitable sharing of the burden in Japan.

The other option is concerned with the imposition of new taxes not listed in the law. Local government is given the authority to propose new taxes and must seek the approval of the MOHA and MOF. In FY 1996, only 14 prefectures and 21 municipalities are given permission to use a non-listed tax such as nuclear fuel tax on nuclear power plants.^{註20} Local governments in Japan have relatively large receipts from local taxes, but since the flexibility in determining tax base and rate is strictly limited, it is difficult to see how they can be accountable to their constituents at the margin, as both efficiency and local autonomy require.^{註21}

c. Local Public Finance Program

Japan's intergovernmental system is well designed to enforce fiscal responsibility. The probability of a local government going bankrupt or getting itself in severe financial difficulties is less than in North American or Western Europe. As Reed points out very clearly, Japan is like France in the sense that the central government takes

^{註18} Type of local tax to which central fixed rate is applied is indicated by [FR] in table 4. Standard tax rate without limit and standard tax rate with upper limit is indicated by [ST],[SL] respectively.

^{註19} Local governments which collect local tax below standard tax rate cannot apply for permission to debt-finance. See, Local Public Finance Law article 5.1.

^{註20} The amount of non-listed local tax is only 239 hundred million Yen at prefecture and 245 hundred million Yen at municipalities.

^{註21} It should be noted that in the prewar period, the local surtax method, in which a piggyback surtax was applied to the national tax played a key role, but this was abolished in the postwar era to support local autonomy. Today each level of local government levies its own taxes including local income tax, separate from the collection of national taxes.

responsibility for enforcing proper financial practices on local government, while in other countries this responsibility lies more with the local electorate and the banking system .

In this regard, attention should be paid on the role of Local Public Finance Program. The local public finance program serves as a tool to estimate annual aggregate local revenue sources to cover standardized total local spending. The MOHA assumes the role of formulating the local public finance program every year. The MOHA has primary responsibility to ensure local governments have enough revenue to balance the program. On the expenditure side, the local public finance program covers the whole of local governments` standard activities except for local public enterprise special accounts which are basically run on an independent profit system and a few other special accounts. On the revenue side of the program, it covers all the standard local revenue sources such as local taxes, local allocation tax, national disbursement , local loans, fees and tuition. The most important function of the Local Public Finance Program is to ensure macroscopic fiscal responsibility, because if the estimated program does not balance for the year, the MOHA has to propose some measure such as local tax amendments, increase of Local Allocation Tax, increase of local loans.

The MOHA is so responsible for local public finance program, that it negotiates very hard with the Ministry of Finance in order to secure the sources of revenue of local governments. In principle, the tax sharing ratio of Local Allocation Tax must remain unchanged, even if total amount of financial shortage exceeds the legal amount of local allocation tax. National government is required to raise the tax sharing ratio if the legal amount of local allocation tax differs from financial shortage "continuously" and "remarkably". But this fundamental principle could not be applied in the strict sense of the word into the era of post-rapid growth . In practice ,the short-term borrowing from the Fund Management Board of the MOF and issue of deficit-covering local bond played a key role in local public finance other than raising tax sharing ratio.

This can be found in table 4 which summarize the "Special Measure concerning Local Public Finance" after oil crises. The discussion was focused on whether the tax sharing ratio would be altered based on the provision of Local Allocation Tax Law (clause2, article6-3). By FY 1984, both short-term borrowing from the Fund Management Board of the MOF and issue of deficit-covering local bond played a key role in the local public finance. In FY 1977, while MOHA and the representatives of local

authorities claimed raise in the tax sharing ratio by 5 percent, MOF has rejected this request because of huge financial deficit in the national budget. As a result, following "memorandum" has been confirmed between both Minister of Finance and of Home Affairs in 1977. (1) to make up for the amount of financial shortage by increase in both local allocation tax and deficit-covering local bond. (2) to increase the amount of local allocation tax by transferring provisional local grant from the general account and by borrowing from the Fund Management Board of the MOF.^{註22} As for the latter, to redeem a half amount of the principal and the total amount of interest by the burden of the general account of national budget^{註23}.

table 5

However, revenue of three national taxes increased steadily under "bubble economy" in the late 1980s. The amount of financial shortage, therefore, has been reduced quite extensively as Table indicates. In FY 1984 following new "memorandum" was confirmed between the two Ministers. (a) to suspend borrowing from Fund Management Board of the MOF as a rule after FY 1984. (b) to redeem the half amount of the both principal and interest by the burden of each national and local government. (c) to transfer special addition of local allocation tax from the general account of national budget, in place of borrowing from the Fund Management Board of the MOF. As these episode indicates, a kind of special measure, such as borrowing from the Fund Management Board of the MOF and deficit-covering bond issue, is not determined automatically as a matter of course, but based on arbitrary political negotiation between MOHA and MOF.

4. Intergovernmental Fiscal Transfer and Regional Disparity^{註24}

a. Evolution of fiscal equalization

The first regular scheme for equalizing local finance was the Local Distribution

^{註22} The financial sources of Fund Management Board of the MOF are mostly from Post Saving Accounts and Welfare Annuity Insurance System

^{註23} The third point is to carry over special addition of local allocation tax in order to make up for the difference in interest between local bond placed on the market and that absorbed by the Fund Management Board of the MOF.

^{註24} This section is based on mainly Mochida, N [1996]. There already exists valuable literature written in English concerning with the local allocation tax. However these efforts are just a general overview. See, for example, Ito, H. [1967]; Yonehara, J. [1987]; Ishi, H. [1993].

Tax in 1940 which was carried out in connection with tax reform of central and local governments corresponding to the quasi-war situation.^{註25} The local distribution tax was a kind of national tax the proceeds of which were shared with local units.^{註26} They were distributed among localities without restriction not by the tax source principle but by a formula designed to provide equalization. However, the local distribution tax had some defects from the viewpoint of local autonomy. First, the tax sharing ratio varied in practice from year to year according in part to the fluctuation in receipts caused by the sensitivity of income taxation, and part to the fiscal deficit in national finance. Second, in the distribution tax, the total amount to be given to individual local units was divided into two parts, which were apportioned separately: one according to the need for services, the other according to fiscal capacity, bearing no relation to each other.

A big change in the basic structure of fiscal equalization system was brought about by the US occupation after the Second World War. Great stress was placed on the importance of local autonomy in a democratic nation, and the prewar system was completely restructured in order to encourage decentralization. In accordance with the Shoup Recommendation^{註27}, distribution tax was converted in 1950 to "the local finance equalization grant" (*chihozaisei heiko-kofukin*).

It is true that the equalization grant was more reasonable than the distribution tax so far as the idea of the scheme was concerned. Equalization grant was computed respectively by means of the formula which contained two parts, the first relating to the measure of the local need for basic services, and second relating to the measure of local financial ability.^{註28} Then the total the total financial capacity was subtracted from total

^{註25} But we had already as forerunners grants in 1930s. A marked territorial inequalities in per capita prefectural tax revenue was occurred in the era of Great Depression. As device to counter depression, "provisional grant" (*rinji-chihozaisei hokyukin*) was introduced. They were for salaries of primary school teachers and for natural disaster rehabilitation which were apportioned among rural districts.

^{註26} Under the law of 1940 the aggregate amount to be distributed among local units was the sum of (1) 17.38 percent of the yield from income tax and corporation tax, (2) 50 percent of that from admission tax and amusement, eating and drinking tax.

^{註27} The 1949 Shoup Mission played a significant role in shaping the style of the tax system in postwar Japan. On this subject, see Ishi H. [1993], Chapter 2.

^{註28} The local need for each item was computed as the number of units of the service, multiplied by the standard cost per units of the service at an acceptable but minimal quantity and quality. The total need for each locality was the sum of the amounts needed for all basic services combined. The financial capacity of each locality was computed as 70 percent of revenues that all regular local taxes would yield assuming that they were levied at a standard rate with standard levels of assessment and collection.

financial need, the difference being the basis for computing the grant of each particular locality. In the case of the equalization grant, the total amount was determined more closely in accordance with the difference between fiscal needs and resources of localities, irrespective of national tax revenue.

However four years' experience revealed that it had not worked as well as was hoped. For the aggregate sum of the grant was not paid out of the general funds of national government as computed by the formula but was determined every year, taking into consideration among other things the degree of stringency in national finance. So, every year it gave rise to frictions between local and national officials in the determination of the total amount. In view of above considerations, the equalization grant was abolished in 1953 and in its place Local Allocation Tax (LAT) was introduced in 1954.

b. Computation Formula of Local Allocation Tax

LAT has continued to the present with some minor alterations. The framework of the local allocation tax is founded in the main on that of the former distribution tax enforced between 1940 and 1949, retaining on the other hand the formula used in the equalization grant for the distribution of funds to localities. In the LAT system, the total amount to be distributed to local authorities is a fraction of yields from major national taxes. Present system is no other than the shared tax in which a share in the proceeds of national taxes is granted to poor localities without limitation as to use. Figure 2 illustrates the calculation process of the amount of LAT. First, the total amount of the local allocation tax is calculated as follows.

$$TT = 0.32 * (NT_y + NT_c + NT_a) + 0.24 * NT_v + 0.25 * NT_t \quad (1)$$

Where TT denotes total financial pool of transfer, NT_y is the total yield of personal income tax, NT_c is that of corporate income tax, NT_a is that of alcoholic tax, NT_v is 80 per cent of consumption tax revenue²⁹, NT_t is total yield of tobacco tax. These prescribed percentage of five major taxes of national government, is apportioned among local bodies in proportion to the amount of the difference of need and revenue. This is expressed by following equation.

²⁹ 20 per cent of consumption tax revenue is distributed to local governments through consumption transfer tax. Consumption transfer tax will be abolished on FY 1997.

$$LAT_i = N_i - C_i \quad (2)$$

Where LAT_i denotes local allocation tax to i th region, N_i is basic financial needs of i th region, C_i is basic financial capacity of i th region. It is annually paid to local governments whose basic financial needs exceed basic financial revenues. Those rich localities whose revenue exceeds need are neither eligible for the grants nor liable to contribute money for fiscal adjustment, as is the case in some countries.

Before calculating basic financial needs, public services for each prefecture and municipality are divided into some service items (*gyosei-komoku*). Regarding prefecture there are 24 service items such as police, road-bridge, primary school and as for municipality there are 24 service items such as city planning, park, garbage collection and so on. Basic financial needs of i th local authority is calculated according to following formula.

$$N_i = \sum_k (I_{ik} * U_{ik} * M_{ik}) \quad (3)$$

Where I_{ik} is measurement unit for service K of i th region, U_{ik} is unit cost for service K of i th region, M_{ik} is modification coefficient for service K of i th region. For each local body, according to the formula mentioned above basic financial needs for each service item is calculated as the number of measurement units by multiplying the unit cost, adjusted by modification coefficients. The total basic need in each locality is the sum of the amounts needed for all service items combined. First step is to select measurement units. A measurement unit reflects the size of the beneficiaries of a particular expenditure. For example, a measurement unit of education is number of teachers, that of police is number of policemen and that of road is length of roads.

Second step is to determine an unit cost. unit cost is a kind of net standard cost per measurement unit for each service item. Assuming a certain local body with standard condition and scale, the unit cost for each service item is calculated based on following formula. In case of prefecture only one fictitious local body whose population is 1.7 million and land area is 6500 square kilometers is assumed as "standard local body"; in case of municipality population 0.1 million and land area 160 square kilometers.

$$U = (C_g - R_s) / S \quad (4)$$

Where U is unit cost, C_g is gross standard cost, R_s is special revenue and S is a figure of measurement unit. Third step is to determine modification coefficients. The unit cost, however, is uniform throughout the whole country, and due regard is paid neither to the peculiar type of services nor to the special circumstances of localities. So an exceedingly complex adjustment is made as to the unit cost applicable to such types of service and localities by means of detailed modifiers decided in accordance with their differences. Currently modification coefficients are classified according to eight categories^{註30}.

On the other side, the basic financial revenue of each locality, on the other side, is expressed as a combined total of two types of revenue: (1) 80% in the case of prefectures, 75% in the case of municipalities of the sum of the yields of all regular local taxes, assuming that each is levied at the uniform rate or standard rate prescribed in the Local Tax Law, (2) the sum of revenues from local transfer taxes^{註31}. This is expressed following equation.

$$C_i = G (\sum_j B_{ij} * t_j) + LTT_i \quad (5)$$

Where G is 0.75 (case of municipality) and 0.80(case of prefecture), B_{ij} is i th region's j th tax base, t_j is standard tax rate on the j th tax base, LTT_i is revenue from local transfer tax. There are two reason for adopting such prescribed percentages. First, it is impossible to measure completely the basic financial needs of all local governments by a uniform formula. Second, it is necessary to retain incentives for local governments to collect their own taxes. On the other hand, all revenue allotted from the local transfer tax are included, mainly because it is collected by the national government and has no relation to the tax collection effort at the local level.

The available fund of transfer calculated in advance, however, does not necessarily cover the sum of the entitlement, i.e., aggregate amount of the deficiencies of local governments whose basic financial needs exceed their basic revenues. A currently

^{註30} As to modification coefficient, see Mochida, N [1996].

^{註31} As for the revenue items which are included in the calculation of basic financial revenues, see Mochida, N [1996].

used methods is either to increase the size of fund or to adjust the size of the entitlement proportionally according to the size of the fund. First, some special measure has been taken every year without change of tax-sharing ratio to increase the size of pool. These special measures which will be explained later from the historical perspective can be divided into following five types^{註32}.

- (1). borrowing from special account of Fund Management Board of the MOF.
- (2). carrying forward of local allocation tax.
- (3). cancellation of local allocation tax cut.
- (4). transfer of provisional local grant.
- (5). special addition/reduction of local allocation tax.

Beside above mentioned special measure, final adjustment is necessary to adjust the size of the entitlement proportionally according to the size of the fund by using an adjustment coefficient α . The actual amount of ordinary allocation tax granted to a local government is calculated according to following formula^{註33}.

$$LAT_i = (N_i - C_i) - \alpha \times N_i \quad (6)$$

Where LAT_i denotes local allocation tax to i th region, N_i is basic financial needs of i th region, C_i is basic financial capacity of i th region and α is adjustment coefficient.

c. Who calculates the amount of the LAT?^{註34}

In Japan, there is a national ministry named "the Ministry of Home Affairs". The Ministry of Home Affairs acts responsibility to coordinate and advocate local governments' interest in the central government. The MOHA is so responsible for local public finance, that it negotiates very hard with the Ministry of Finance in order to secure the sources of revenue of local governments. Therefore, MOHA is often to be said to be "an opposition party within the national government". As for the LAT, there is a law named "Local Allocation Tax Law", a cabinet order named "Local Allocation Tax Order", and are two regulations, which are "Regulation about the Ordinary Allocation Tax" and

^{註32} For detail of these special measure, see Mochida, N [1996].

^{註33} The adjustment coefficient α is calculated as follows.

$$\alpha = (\text{the sum of the entitlement} - \text{available pool of transfer}) \div (\sum \text{basic financial needs})$$

^{註34} This section is based on mainly Yamauchi, K [1996].

"Regulation about the Special Allocation Tax".

According to the LATL, the MOHA has power and responsibility to fix the amounts of the LAT that should be delivered to each local government (LATL § 4 II). But as to the LAT that should be delivered to the municipal government, each governor of a prefectural government has to manage the affairs on calculating and delivering LAT to the municipal governments within its own area (LATL § 17). In addition, the MOHA has also power and responsibility to collect data, which are used for calculation LAT and to put them in order (LATL § 4 II). And each governor is duty-bound to present these data to the MOHA and otherwise each mayor is also duty-bound to present these data to governor (LATL § 5(1)(2)). Furthermore, each agency of national government is also duty-bound to present the data, when it requested by the MOHA (LATL § 5(5)).

The MOHA has 4 bureaus, and one of them is the Local Finance Bureau. Within the bureau, there are 8 divisions. The Local Finance Division and the Local Allocation Tax Division, which belong to the Local Finance Bureau, are in charge of LAT. The former manages the affairs mainly of the Special Local Allocation Tax, and the latter, the Ordinary Allocation Tax. As to the Local Allocation Tax Division, it consists of 18 persons. That is to say, 1 Director, 2 Assistant-Directors and the other 15 staffs are working there. They are, of course, all specialists about the LAT. The 2 assistant-Directors play the most important part in calculating and fixing the LAT.

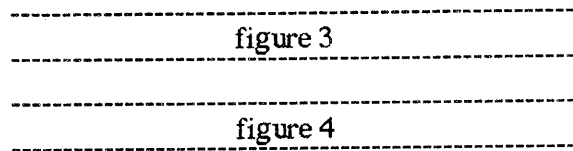
What kind of role do local Governments have on calculating the LAT? As to the LAT for prefectural government, only the MOHA has power to calculate, and so the staffs in the prefectural governments are duty-bound only to collect data and to present them. On the other side, as to the LAT for municipal governments, each governor is in charge of managing the affairs of calculating it, according to the LATL. But in reality, a foundation called "Local Autonomy Information Center" is left in charge of the task. That is to say, all prefectural governments deposit this task to the foundation. Therefore, the staffs are bound only to collect data and present them to the MOHA and the foundation. Paradoxically speaking, only the MOHA is in charge of calculating the LAT in fact. Local governments have no power to fix or calculating it in fact. But, the MOHA makes its own opportunity to hear longings of local governments, holds conference at least 4 times a year, in order to make the various information to them formally and informally, or sometimes discusses the matter together during the process of calculation.

d. Practical Effects of Fiscal Equalization^{註35}

Now we proceed to analyze practical effects of Japanese system on the general revenue of local body. To determine the actual degree of equalization achieved I added the per capita local allocation tax to the per capita local tax in order to obtain a notional total reflecting the area's resources after the addition of local allocation tax; this is termed General Financial Resources (GFR). I then determined the disparity, as measured by the Gini coefficient, in the GFR and compared it with the initial disparity in local tax per capita. The extent of the improvement (or deterioration) could then be measured as the difference between the Gini coefficient of local tax and that of GFR divided by the former. This measure can be expressed as the following equation.

$$\phi = (G_2 - G_1) / G_2 \quad (7)$$

Where G_1 stands for the Gini coefficient of GFR, G_2 for the Gini coefficient in local tax. ϕ denotes the extent of the improvement; this I have termed the Equalization Coefficient in this paper. Figure 3 indicates the change in the extent of improvement measured by the Equalization Coefficient. As this figure demonstrates, the extent of improvement has changed drastically every ten years.



The first half of rapid growth era (1954 to 1964). Increase in pre-grant disparity is a peculiarity of this period. As figure 4 demonstrates, the disparity in financial resources among rich and poor local authorities became to be bigger and was maintained at high level. A large number of young people moved from rural area to the metropolitan area such as Tokyo, Osaka, Nagoya. To deal with this social problem, the political slogan of "Improvement of Regional Disparity" became to be one of main national policy goal and was embodied in the National Comprehensive Development Plan established in October 1962. In line with this national policy guideline, local allocation tax was distributed mainly to the backward districts in inverse proportion to their financial capacities. As a result, local allocation tax served to reduce resources disparities quite extensively by 70 percent in each year.

^{註35} For detailed arguments for this section, see Mochida, N. [1996], [1993] and [1990].

The latter half of the rapid growth era (1965 to 1974). The reduction of pre-grant disparities and reversal of the rank ordering is a distinctive characteristic of this period. There was sharp decrease in the disparities among rich and poor districts. As figure 3 indicates, the Gini coefficient of per capita regional income decreased from 0.1248 in FY 1965 to 0.0753 in FY 1975. This improvement of regional disparities was not caused by success of the National Comprehensive Development Plan but by the dispersion of factories around the country and increase in the number of people employed in the local public works. Nevertheless, the distribution of local allocation tax followed the principle of equalization all the more. As a result, resources disparities actually increased after the equalizing effect of local allocation tax is taken into account (figure 4). However, this increase actually resulted in a reversal of the rank ordering of disparities among prefectures. We should notice that the sharp "decline" in the Equalization Coefficients means enforcement of improvement rather than deterioration of equalizing effect.

Oil crises and thereafter (since the mid-1970 up to mid-1980). Gradual increase in pre-grant disparity is a characteristic of this period. During this period, the disparities in per capita local tax has began to increase again as a result of population concentration on the Tokyo metropolitan area caused by the internationalization of financial market. As the figure 4 demonstrates, the Gini coefficient of per capita local tax has increased gradually after oil crises. On the other hand, the negative correlation between per capita tax revenue and per capita local allocation tax became to be weaker than before, because of the shortage of total amount of local allocation tax. As a result of these trends, reversal of the rank ordering of disparities among prefectures was corrected somewhat.

"bubble economy" and thereafter (since 1985 up to the present). A sharp reduction of pre-grant disparities and reversal of the rank ordering is a characteristic of this period. There was marked decrease in the regional disparities as figure 4 indicates. GINI coefficient of local tax declined from 0.19 in FY 1988 to 0.15 in FY 1993. As a result, the Equalization Coefficient has been dropped drastically from 0.4120 in FY 1988 to 0.085 in FY 1993. It is noteworthy that there is little difference between pre-grant disparities and area's resource disparities after the addition of local allocation tax. However, these trend does not mean deterioration of equalization effect, as mentioned above, but a reversal of the rank ordering of disparities among prefectures. These trends

can be explained by both fundamental tax reform and collapse of "bubble economy"^{註36}.

5. Implications of Japanese Experience

a. economic development and regional disparity

The main features of Japanese system are centralized tax administration, decentralized provision of public services and dependence of local government on intergovernmental transfers, as mentioned above. This means that Japan's local public finance system is milder and more refined than the truly centralized systems of France, Spain and Italy. The system is administered in the local rather than centrally, and central government's role is to guide the local towards a common fiscal situation by means of subsidies, tax allocations and local bonds. As a concluding remarks, I try to clarify both advantage and disadvantage of the system. Japan experienced large regional disparity in the early stage of post-war economic development. But Japanese government simultaneously responded to the issue of regional disparity. As for this regard, an attention should be paid on the significant role of local allocation tax. This actually had stabilizing effect on Japanese society as a whole. However present system is not complete one, but still evolving. It is noteworthy to evaluate local allocation tax and to refer to future reforms.

An effective intergovernmental transfer system, in general, should satisfy several criteria^{註37}. The first criteria is revenue adequacy. Local allocation tax is not a kind of general grant, but a kind of shared tax system. An automatic increase in major national taxes was the cause of continuous increase in the financial pool of local allocation tax during rapid growth era. On the other hand, total fund of transfer is sensitive to business condition because major component of the fund consists of income-elastic national taxes. During the period of 1970-95, the rate of increase in financial pool for transfer has changed within the extent between -14.1 per cent and 43.5 per cent every year. An average rate of increase and standard deviation is 9 per cent and 11.8 per cent respectively. Indeed both short term borrowing from the Fund Management Board of the MOF and deficit-covering local bond issue play a key role in filling the gap between total entitlement of local allocation tax and financial pool of the transfer in the post rapid growth era. Future reform necessary for revenue adequacy is to make the financial pool

^{註36} For detailed arguments for this point, see Mochida, N.[1996]

^{註37} As for criteria of the transfer, see Ma, J[1995].

less sensitive to business condition and more stable^{註38} .

The second criteria is local tax effort. Basic financial revenue is measured using figures of major tax base and standard tax rate. To retain incentive for local government to collect their own tax, basic financial revenue is calculated based on the prescribed percentage of the sum of local tax revenues. Regions with high tax effort are not penalized and regions with low tax effort are not encouraged. As for tax effort, however, local tax system is a question. Concerning local taxes, the base and rates of general tax cannot be determined by the independent initiatives of local government under the Local Tax Law. The tax base and the tax rates can be altered by the proposal of both the MOHA and MOF. This implies that a uniform rate is levied on the same tax base in all prefecture and municipalities. In FY 1996, 2944 out of 3233 municipalities apply same standard tax rate on property tax base. Present local tax system should be changed into more flexible system in which tax rate is determined at the discretion of local governments.

The third criteria is equity. Because local allocation tax is annually paid to local governments whose basic financial need exceed basic financial capacity, it varies directly with local fiscal needs and inversely with local fiscal capacity. Such approach actually corrected horizontal fiscal imbalance in Japan. Before 1970s, the transfer system contributed significantly to equality. But after that as regional fiscal disparities have fallen over time, there has been less "inequality" to fix through local allocation tax and the intensity of the equalization effect has fallen. Future reform, therefore, should be carried out based on not only equity criteria but also efficiency ground in order to improve poor condition of social infrastructure in the large cities.

The fourth criteria is transparency and stability. Local allocation tax is distributed according to a uniform formula based on basic financial need and basic financial capacity. The application of the formula contributed to remove intense negotiation and lobbying during the post war development. However calculation of the transfer became to be too complicated for local governments to forecast their own revenue(including the transfer) in order to prepare their budgets. A kind of special measure, such as borrowing from the Fund Management Board of the MOF and deficit-covering bond issue, is not determined automatically as a matter of course, but based on arbitrary political negotiation between

^{註38} For stabilizing financial pool of LAT, Fujita examined some methods such as making new special account, calculating tax base by 5years' moving-mean, returning to Equalization grant introduced by Shoup recommendation. See Fujita[1972],pp.143-147.

MOHA and MOF. Future reform is necessary to strengthen the transparency of present system.

b. Step towards Decentralization^{注39}

The defining characteristic of Japan's system of intergovernmental fiscal relation has been the strong collective preference for equal access to public goods.^{注40} The Japanese people and government were willing to commit themselves after World War to the evolution of autonomy for their newly defined structure of local government. However, equal access to public goods and fair sharing of the burden to finance these goods were viewed as essential for economic and social development. Hence, local governments were willing to maintain regional equity. To implement these principles, local autonomy would have to function within a framework of uniform structure and ground rules defined by the central government. Interregional redistribution is, therefore, the central issue for Japan's system of intergovernmental fiscal relations, as mentioned above. Japan's system of equitable tax allocations to the regions, which has no equivalent in the West, drastically reduces residents' Tieboutian voting with their feet between regions.^{注41}

In 1990's, Japan has been faced second transitional phase after the Second World War. This means a shift away from a society which emphasizes equal access to public services and equitable sharing of the burden of paying for them, toward a society which gives priority to individual citizen's expressed preference. Where local governments are unable to set their own tax rates of taxation, the Layfield Committee's concept of local accountability does not function effectively. In fact, recently decentralization has never been far from the top of Japan's political agenda. In 1993 the Upper and Lower Houses of the Diet passed a resolution calling for decentralization, and 1995 the Murayama coalition government has enacted the Decentralization Promotion Law (chiho bunken suisin ho), which will be effective for five years. These developments are all the more welcome nearly half a century after Shoup Mission delivered his recommendations, a long period during which little significant progress has been made toward decentralization.

^{注39} This section is mainly based on Mochida, N.[1995].

^{注40} On this point, see Dubravko M[1996].

^{注41} However, these shared idea of fairness have changed since post rapid growth era.

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Table 1 Vertical Fiscal Imbalance in ten countries (FY 1992) (%)

Country		(a) local expenditure as % of general government expenditure	(b) local tax as % of Total tax revenue	(c) vertical fiscal imbalance			
				absolute		relative	
				(a) - (b)	rank	(a) ÷ (b)	rank
Federal Countries	United States	51.4 (53.3)	45.9 (41.7)	5.5 (11.6)	9 (9)	1.120 (1.278)	9 (9)
	Canada	55.3 (53.0)	40.8 (32.6)	14.5 (20.4)	6 (6)	1.355 (1.626)	8 (6)
	Australia	48.6 (49.3)	23.0 (17.8)	25.6 (31.5)	3 (3)	2.133 (2.770)	2 (3)
	Germany	48.1 (54.7)	35.3 (36.4)	12.8 (18.3)	8 (7)	1.363 (1.503)	7 (8)
Northern Europe	Denmark	57.3 (63.8)	32.3 (29.8)	25.0 (34.0)	4 (2)	1.774 (2.141)	5 (4)
	Sweden	47.6 (51.8)	50.9 (34.2)	-3.3 (17.6)	10 (8)	0.935 (1.515)	10 (7)
United Kingdom		31.9 (39.0)	0.07 (12.5)	31.8 (26.5)	2 (4)	455.7 (3.120)	1 (2)
Southern Europe	France	31.1 (27.7)	18.0 (6.9)	13.1 (20.8)	7 (5)	1.728 (4.014)	6 (1)
	Spain	43.6 (17.2)	19.7 (17.3)	23.9 (-0.1)	5 (10)	2.213 (0.994)	3 (10)
Japan		69.2 (72.0)	36.5 (36.5)	32.7 (35.5)	1 (1)	1.896 (1.973)	4 (5)
average		48.4 (48.1)	30.2 (26.5)	18.1 (21.6)	-	1.613 (1.979)	-

(source) OECD, *National Accounts*, 1988, 1994., IMF, *Government Finance Statistics*, 1992.

note1 : data in parentheses are for FY 1974.

note2 : (a) = subnational expenditure ÷ (subnational expenditure + national expenditure - fiscal transfer) × 100

(b) = subnational tax ÷ (subnational tax + national tax) × 100

all based on SNA accounting, excluding social security fund.

Table2 Redistribution of Tax Revenue between National and Local Government (%)

	1890	1900	1910	1920	1930	1940	1950	1960	1970	1980	1985	1993
(1) Government Expenditure												
Net Total/GNP	11.5	17.2	21.5	14.2	21.5	22.1	23.6	18.8	20.3	29.4	27.6	30.0
Net National/GNP	7.5	7.5	14.2	8.2	9.5	13.7	10.4	5.9	5.9	9.9	10.2	10.3
Net Local/GNP	4.0	4.0	7.3	6.0	12.1	8.4	13.2	12.8	14.4	19.5	17.4	19.6
(2) Tax Allocation before Fiscal Transfer												
National Tax/Total Tax	69.4	63.2	70.5	62.1	64.3	78.5	75.2	70.8	67.5	64.1	62.6	63.0
Local Tax/Total Tax	30.6	36.8	29.5	37.9	35.7	21.5	24.8	29.2	32.5	35.9	37.4	37.0
Income Tax/Total Tax	0	0	5.9	5.9	10.0	26.9	38.6	21.7	31.2	38.1	39.4	36.9
(3) Fiscal Transfers												
Transfer as % of general account	3.7	2.7	1.8	4.0	10.6	13.8	35.1	47.2	48.7	44.0	38.5	36.0
Local allocation tax as % of general account	-	-	-	-	-	6.1	17.1	17.8	22.0	18.7	17.8	20.4
Transfer as % of local revenues	6.7	5.4	2.8	4.7	8.2	21.2	40.8	39.3	37.7	40.8	34.7	31.8
Local allocation tax as % of local revenues	-	-	-	-	-	9.2	19.9	14.8	17.0	17.3	15.5	18.0
(4) Final Share of tax after Fiscal Transfer												
of National government	68.4	62.2	70.1	61.3	60.8	74.9	65.2	57.0	51.1	46.0	45.3	47.5
of Local government	31.6	37.8	29.9	38.7	39.2	25.1	34.8	43.0	48.9	54.0	54.7	52.5

(Source) Mochida,N.[1993],p.57.

Note: transfer includes both local allocation tax and specific-purpose grant.

classification		tax revenue (hundred million))	allocation tax (hundred million)	revenue (hundred million)	prefectural tax	local allocation tax	general revenue
A	aichi	9,552	69	10,017	143	1	150
	osaka	11,369	272	12,232	130	3	140
	kanagawa	9,210	124	9,765	115	2	122
B	shizuoka	4,495	927	5,853	122	25	159
	saitama	6,286	1,563	8,145	98	24	127
	chiba	5,652	1,448	7,408	102	26	133
	hyogo	5,738	2,286	8,400	106	42	155
	kyoto	2,800	1,213	4,221	108	47	162
	tochigi	2,188	1,240	3,621	113	64	187
	ibaragi	3,122	1,742	5,049	110	61	177
	fukuoka	4,363	2,394	7,039	91	50	146
	gunma	2,121	1,203	3,513	108	61	179
	hiroshima	2,930	1,837	4,971	103	64	174
	gifu	2,201	1,546	3,927	107	75	190
	shiga	1,398	1,079	2,574	114	88	211
	mie	1,949	1,469	3,586	109	82	200
	miyagi	2,342	1,661	4,183	104	74	186
C	okayama	1,925	1,752	3,830	100	91	199
	ishikawa	1,290	1,217	2,688	111	105	231
	nagano	2,266	2,116	4,606	105	98	214
	kagawa	1,064	1,072	2,220	104	105	217
	toyama	1,261	1,388	2,750	113	124	246
	fukushima	2,120	2,222	4,549	101	106	216
	nara	1,150	1,348	2,580	84	98	288
	fukui	1,082	1,152	2,317	131	140	281
	yamaguchi	1,505	1,757	3,394	96	112	216
	niigata	2,539	2,828	5,607	103	114	227
	yamanashi	879	1,228	2,202	103	144	258
D	hokkaido	5,205	7,114	12,837	92	126	227
	ehime	1,253	1,854	3,224	83	122	213
	wakayama	941	1,560	2,600	88	145	242
	kumamoto	1,364	2,306	3,816	74	125	207
	oita	1,003	1,865	2,984	81	151	241
E	yamagata	1,007	1,938	3,068	80	154	244
	saga	740	1,476	2,288	84	168	261
	nagasaki	1,095	2,320	3,528	70	148	226
	iwate	1,093	2,489	2,714	77	176	262
	kagoshima	1,200	2,743	4,085	67	153	227
	tokushima	688	1,565	2,319	83	188	279
	miyazaki	815	1,958	2,862	70	167	245
	okinawa	735	1,800	2,605	60	147	213
	akita	919	2,198	3,218	75	179	262
	aomori	1,041	2,471	2,626	70	167	245
	tottori	486	1,356	1,914	79	220	311
	shimane	615	1,848	2,546	79	237	326
	kochi	590	1,863	2,531	71	226	307
F	tokyo	23,191	---	24,447	196	---	206
average		138,779	80,878	229,456	112	65	186

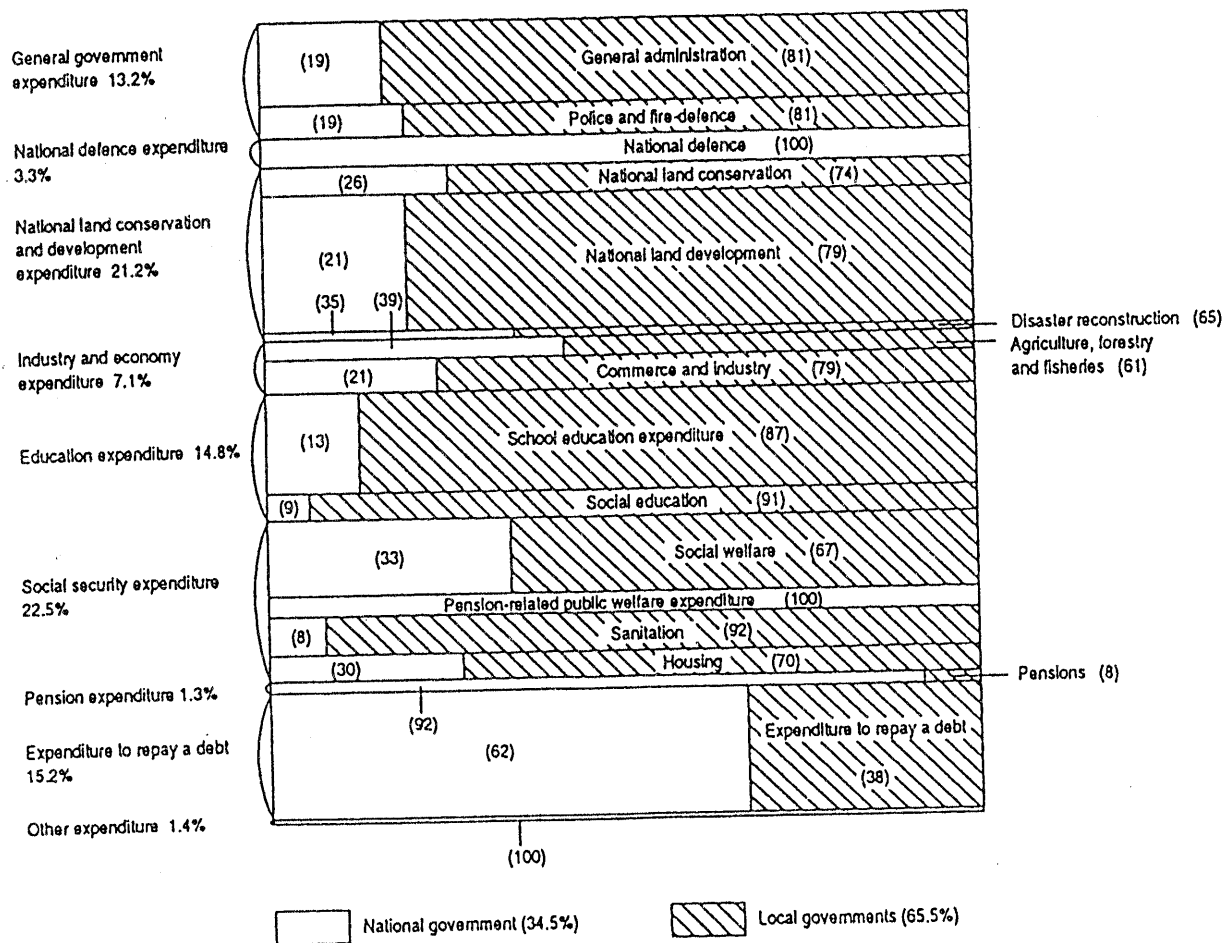
(source) MOHA`'s data.

Note 1: general revenue means the sum of prefectural tax, local allocation tax, and local transfer tax.

Note 2: 47 prefectures are grouped into 5 categories based on the index of fiscal capacity.

A 1.0~, B 0.5~1.0, C 0.4~0.5, D 0.3~0.4, E ~0.3

Figure 1 Role-sharing between national and local governments (fiscal 1994)
(Expenditure settlement/final disbursement base)



(National government expenditure: General accounts + specific special accounts; Local government expenditure: Ordinary accounts) (source) Ministry of Home Affairs, Local Public Finance System, 1996.

Note: Figures in brackets show percentage of national and local government expenditure to total expenditure for each item.

Table 4 Classification of Local Taxes under the Local Tax Law

1) Prefectural taxes

Tax	Taxpayer	Taxable object	Tax base	Tax rate	Revenue estimates
Prefectural inhabitants tax (direct)	Individuals residing in the prefecture, and corporations with a business establishment in the prefecture	Same as the left	Per capita rate (Individual, corporation) — taxation on the basis of fixed sum of money	Individuals: ¥1,000 Corporations: ¥20,000-800,000 [ST]	Units: hundred million yen, (%) 38,849 (28.9)
			Income rate (individual) — income of preceding year	2% 4% [ST]	
			Corporation rate (corporation) — corporation tax amount	5% [SL]	
			Interest rate (individual, corporation) — amount of interest etc. income expected	5% [FR]	
Enterprise tax (direct)	Individuals and corporations engaged in business	Business carried out by individuals and corporations	Individuals — income of preceding year	3-5% [SL]	48,552 (35.2)
			Corporations — income or gross receipts	For income [SL] 6-12%; For gross receipts: 1.5%	
Local Consumption Tax (indirect)	Transfer rate: Those businesses which performed transfer of levied property Cargo rate: Those taking over levied cargo from bonded area	Transfer rate: Transfer of levied property performed by business Cargo rate: Levied cargo	Transfer rate: Consumption tax value deductive of consumption tax concerning such matters as buying-in from consumption tax concerning such matters as transfer of levied property Cargo rate: Consumption tax concerning levied cargo	25% [FR]	
Real property acquisition tax (indirect)	Persons acquiring real property	Acquisition of real property (land or building)	Value of real property acquired	4%, however 3% for dwellings [ST]	7,201 (5.2)
Prefectural tobacco tax (indirect)	Wholesalers	Tobacco manufactured for sale	Number of cigarettes etc.	¥1,129 per thousand cigarettes etc. [FR]	3,764 (2.7)
Golf course utilization tax (indirect)	Persons playing golf on a golf course	Use of golf course		¥800 per player per day (Average (standard) tax rate) [SL]	961 (0.7)
Special local consumption tax (indirect)	Persons who use restaurants, inns etc.	Drinking, eating and accommodation	Charges paid for food, drink, accommodation etc.	3% [ST]	1,327 (1.0)
Automobile tax (direct)	Automobile owners	Automobiles		Example: Private-use passenger car (1,000-1,500 cc): ¥34,500. [SL]	16,243 (11.8)
Mine-lot tax (direct)	Persons holding mining rights	Mine-lots	Area of mine lot	Example: Working mine lots other than placer mine lots: ¥400/year for each hectare [FR]	6 (0.0)
Hunter's registration tax (direct)	Registered hunters	Hunter's registration		¥3,300-10,000 [FR]	20 (0.0)
Fixed assets tax (special case) (direct)	Persons with large-scale depreciable assets	Large-scale depreciable assets	The amount by which the value that becomes the tax base for the fixed assets tax levied by municipalities is exceeded	1.4% [ST]	119 (0.1)
Automobile acquisition tax (indirect)	Persons acquiring an automobile	Acquisition of automobile	Purchase price of the automobile	Private-use vehicles: 5% Commercial-use and light vehicles: [FR] 3%	6,017 (4.4)

Tax	Taxpayer	Taxable object	Tax base	Tax rate	Revenue estimates
Light-oil delivery tax (indirect)	Persons receiving light oil involving actual delivery	Receipt of light oil involving actual delivery	Quantity of light oil	¥32,100 per kilolitre [FR]	13,753 (10.0)
Hunting tax	Registered hunters	Hunter's registration		¥2,200, ¥6,500 [FR]	14 (0.0)
Prefectural taxes total					137,786 (100.0)

2) Municipal taxes

Tax	Taxpayer	Taxable object	Tax base	Tax rate	Revenue estimates	
Municipal inhabitants tax (direct)	Individuals residing in the municipality, and corporations with a business establishment in the municipality	Same as the left	Per capita rate (Individual, corporation) — taxation on the basis of fixed sum of money	Individuals: [SL] ¥2,000-3,000 Corporations: ¥50,000-3,000,000	Units: hundred million yen, (%) 86,321 (43.2)	
			Income rate (Individual) — income of preceding year	3%-11% [SL]		
			Corporation rate (corporation) — corporation tax amount	12.3% [SL]		
Fixed assets tax (direct)	Owners of fixed assets	Fixed assets (land, buildings, depreciable assets)	Value	1.4% [SL]	88,220 (44.1)	
Light vehicle tax (direct)	Owners of a light vehicle or other small vehicle	Light vehicles and other small vehicles		Example: Private-use four-wheeled light passenger cars: [SL] ¥7,200/year	1,077 (0.5)	
Municipal tobacco tax (indirect)	Wholesalers	Tobacco manufactured for sale	Number of cigarettes etc.	¥1,997 per thousand cigarettes etc. (For former nine brands, ¥948 per 1,000 cigarettes) [FR]	6,640 (3.3)	
Mineral product tax (direct)	Persons engaged in mining	Mining of mineral products	Value of mineral products mined	1% [SL]	20 (0.0)	
Special land acquisition and holding tax (direct)	Landowners or persons who acquire land	Land or acquisition of land	Purchase price of the land	Taxation on estate [FR] 1.4% Taxation on land acquisition 3%	1,230 (0.6)	
Bathing tax (indirect)	Customers taking a bath	Taking a bath at a hot-spring hotel etc.	No. of days bathed	¥150 per person per day [ST]	207 (0.1)	
Business facility tax (direct)	Persons conducting business in a business office or persons constructing a building for business use	Business activity, or construction or extension of a building for business use	Business activity	Asset rate — floor area of business office	¥600/m ² [FR]	3,041 (1.5)
				Employment payment — total amount of employee salaries	0.25% [FR]	
			Construction/extension — floor area of business office after construction or extension	¥6,000/m ² [FR]		
City planning tax (direct)	Owners of land and buildings located within urbanization promotion areas	Land, buildings	Value	0.3% (Limited tax rate) [SL]	13,271 (6.8)	
Municipal taxes total					200,029 (100.0)	

(source) Ministry of Home Affairs[1996a], *Local Tax Administration in Japan*.

Note: column of tax rate. [ST]:standard tax rate without limit, [SL]:standard tax rate with limit, [FR]:fixed tax rate, [OR]:optional tax rate.

Table 5 Special Measure concerning Local Public Finance (hundred million yen)

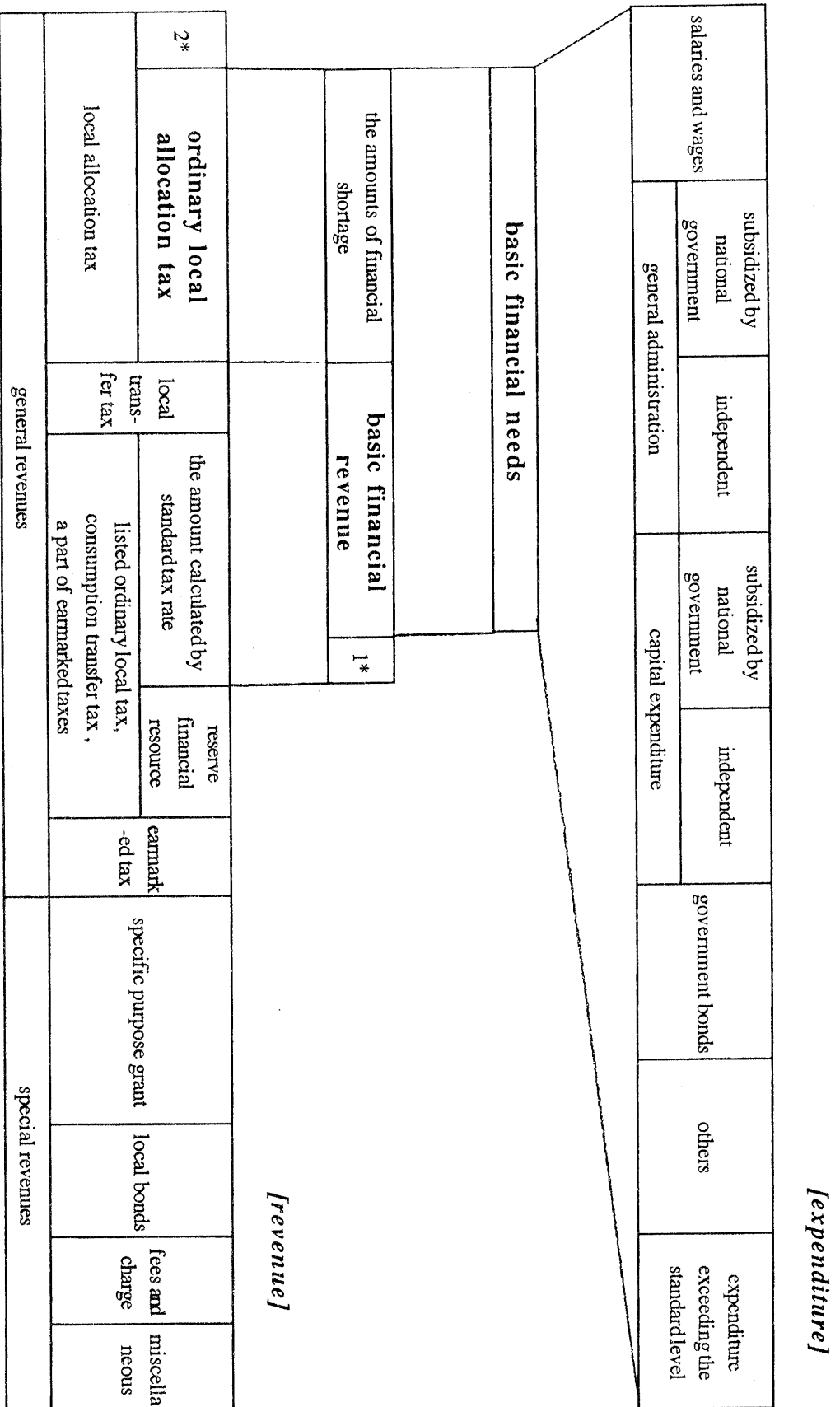
Fiscal Year	1975~79	1980~84	1985~89
1. the amount of financial shortage	28,046 (100)	20,593 (100)	16,514 (100)
ordinary balance	28,046 (100)	20,593 (100)	1,757 (10.6)
reduction in the matching rate of grant	0 (0)	0 (0)	14,757 (89.3)
2. increase in local allocation tax	15,413 (54.9)	9,757 (47.4)	2,709 (16.4)
borrowing from Trust Fund Bureau	14,408 (51.3)	8,932 (43.3)	900 (5.4)
special addition	1,005 (3.5)	825 (4.0)	1,809 (10.9)
3. increase in local bond	12,676 (100)	10,836 (52.6)	11,872 (71.9)
4. increase in local tax	0 (0)	0 (0)	1,933 (11.7)

Note: Figures in parentheses are percentage of the amount of financial shortage.

all figures are average per year.

sources: MOHA, *Chihokoufuzaiseido Enkakusi* (The History of Local Allocation Tax) etc.

figure 2 Basic formula of local allocation tax



Note; 1* surplus of financial resources
 2* special local allocation tax

Figure 3 Extent of fiscal equalization by LAT

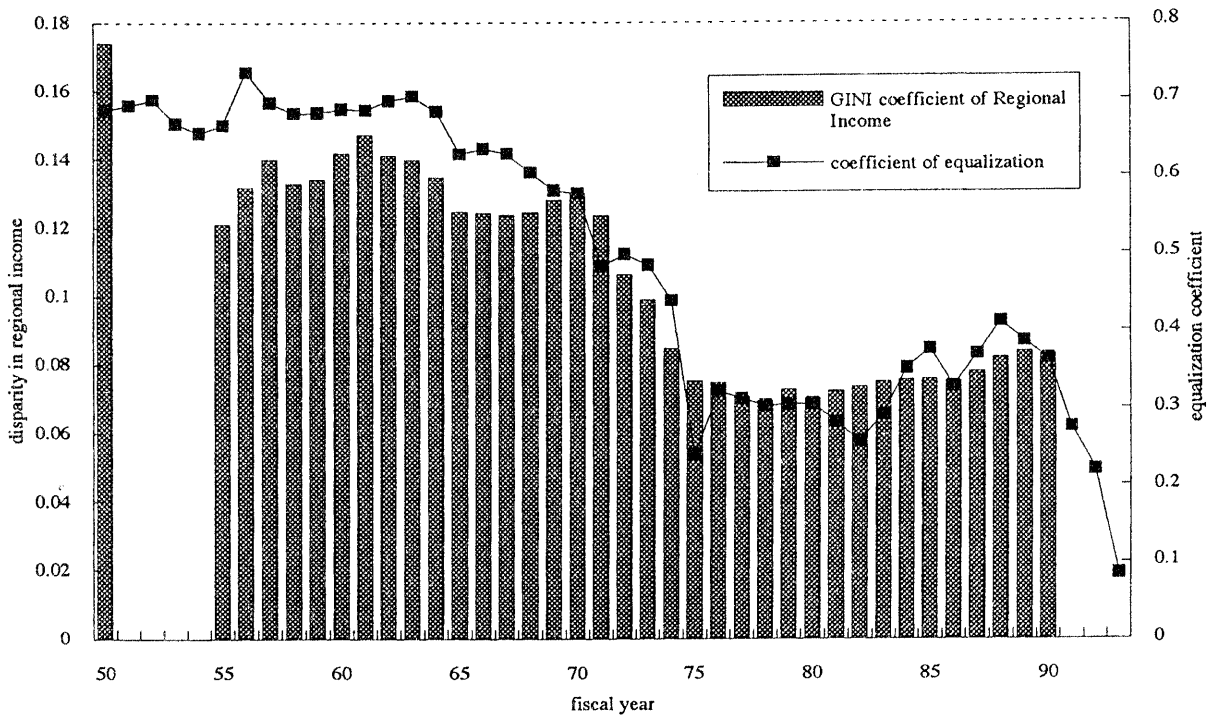


Figure 4 Distribution of per capita resources

