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*Hidehiro Ichikawa*THE LOCAL PUBLIC FINANCE AND ECONOMIC GROWTH
IN JAPAN

In Japan, the constitutional law (Chap. 8, On the Local Autonomy) provides the principles of local autonomy. That is based on the idea that the local autonomy is the foundation of democracy. Under the constitutional provisions, there are the system of laws and orders to guarantee the local autonomy. That is,

1. The Local Autonomy Law – this law is the basic statute concerning the local government system containing provisions for local tax and finance administrations.

2. The Local Financial Law – this law gives the standards of financial administration of local public entity.

3. The Local Tax Law – this law provides the standards of local taxes.

4. The Local Allocation Tax Law – this law provides the system of financial adjustment among local public entities etc. The basic framework and the standard of administration and taxation are given by these laws.

I. THE FRAMEWORK OF PUBLIC FINANCE OF LOCAL GOVERNMENT

The budget of local government is divided into „the general account”, „the public utility accounts”. In addition, many local governments are operating public corporations (Table 1).

II. THE EXPENDITURE AND REVENUE OF LOCAL GOVERNMENT

1. The expenditure

The net size of expenditure (national and local, general account only) for 1987 was 101,111 billion yen compared with GNP 351,188 billion yen of that

year. Among of this amount, the expenditure of national government was 38,878 billion yen. The total amount of expenditure of local governments (47 prefecturals and 3,275 municipalities) was 62,233 billion yen. This figure is 1.6 times of national government.

Table 1

The main function of local government

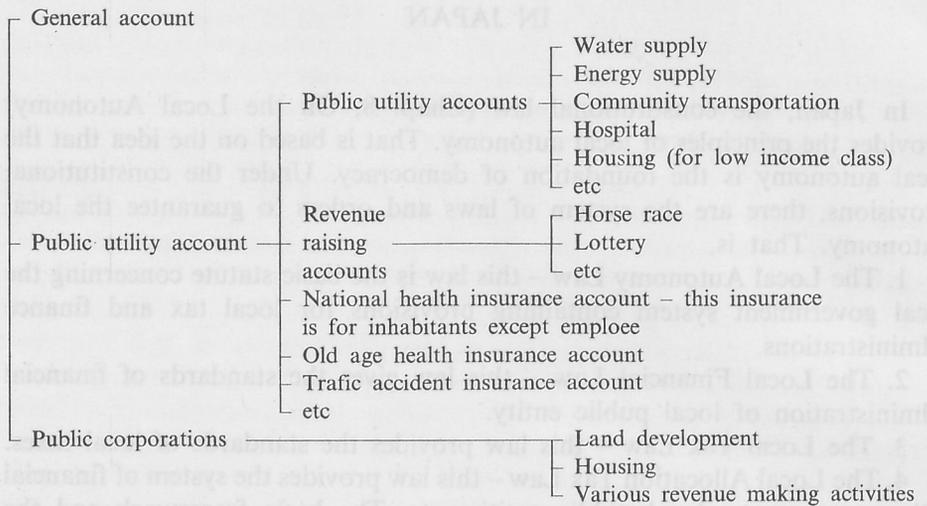


Table 2

The composition of government expenditure
(F. Y. 1987, %)

Item	Ratio to total expenditure	Share of	
		national	local
General administration, Judicial and Police	13.1	79	21
Defence	3.4	100	0
Land conservation and development	19.6	21	79
Agriculture, Forestry and Fishery	3.1	55	45
Commerce and Industry	3.9	35	65
Education	15.5	14	86
Social welfare	14.5	52	48
Public health	3.9	9	91
Housing	1.9	32	68
Loan charge	17.9	66	34

Table 2 shows the composition of expenditure by national and local government in specific fields of government service. Most of the public services, except for national defence, are executed by the local government mainly.

2. The revenue

The expenditure of local government is financed by the six categories of revenue; local tax, local allocation tax, local transfer tax, various grants by national government, local public debt and miscellaneous revenue. Table 3 presents the size and composition of revenue of local government.

Table 3

The size and composition of revenue of local government (F. Y. 1987)

Item	Amount (billion yen)	Ratio to total revenue (%)
Local tax	24,755	37.4
Local transfer tax	474	0.7
Local allocation tax	9,959	15.1
Grants	10,772	16.3
Local public debt	6,639	10.0
Miscellaneous	13,546	20.5
Total	66,145	100.0

3. The local tax

The local taxes are the principal method of financing a local government expenditure. There are many kinds of local taxes in Japan. The table 4 presents the Japanese local tax system. And table 5 and table 6 show the tax revenue structure of prefectural and municipality respectively.

Table 4

The local tax system

Prefectural tax	<ul style="list-style-type: none"> — Prefectural income tax – the standard tax rate is 2% (to the annual income under 5 million yen) and 4% (to the annual income over 5 million yen) — Enterprise tax – this is the tax on the income business enterprise. The standard tax rate is 12%. — Prefectural tobacco tax — Automobile tax — Special consumption tax – this tax is the imposition on the expense at expensive hotel and restaurant — etc.
Municipality tax	<ul style="list-style-type: none"> — Municipality income tax – the standard tax rate is 3% (to the annual income under 1.2 million yen), 8% (1.2-5 million yen) and 11% (over 5 million yen) — Real property tax – this tax is imposed on the owner of real property according to its assessed value annually. The tax rate is 1.4% — Municipality tobacco tax — City planning tax — etc.

Local tax law provides the tax base and the standard tax rate. Each local public entity could increase its tax rate in the extent provided by the local tax law and could impose a tax not provided in the local tax law by the decision of local parliament and the admission of the minister of local autonomy.

The rate of tax burden was very stable in 1950', 1960' and early 1970'. But after the late of 1970', it has a rising trend. Table 8 presents the trend of tax burden.

Table 5

The tax revenue structure of prefectural

Item	Amount of revenue (billion yen)	Ratio to total tax revenue (%)
Prefectural income tax	34,486	28.8
Enterprise tax	47,226	39.4
Other taxes	38,152	31.8
Total	119,864	100.0

Table 6

The tax revenue structure of municipality

Item	Amount of revenue (billion yen)	Ratio to total tax revenue (%)
Municipality income tax	78,432	51.5
Real property tax	49,961	32.8
Other taxes	23,783	15.7
Total	152,176	100.0

III. THE RELATION BETWEEN NATIONAL AND LOCAL GOVERNMENT

The constitutional law is guaranteeing the local autonomy that is the independent management of local public entity. But, the size of inhabitants, the level of income, the industrial structure and the level of tax revenue etc are very different among different local public entities. For example, the size of inhabitants is 12 million in Tokyo and 7 or 8 million in Osaka, Kanagawa etc. But the smallest prefectural (Tottori) has only 0.7 million inhabitants. The perhead income of Tokyo is over two times of Tottori. Then, some prefectural or some municipalities are having a sufficient tax revenue to finance their public services. But the tax revenue of another prefecturals or municipalities are insufficient to support a minimum level of public services.

In the process of high economic growth, such inequalities among different local public entities went to increase because there were the tendencies of concentration of industries and population to some limited regions.

Sofar, the national government had took some measures to correct these tendencies. One measure was to promote an economic development of underdeveloped regions through the subsidies and the weighted distribution of public expenditure for the construction of social infrastructure. But this measure had not a significant effect and the tendency of concentration of economic activities was not detained.

Then, in order to maintain the standard level of public services that is „national minimum” in every local public entities, it is necessary to establish the system of revenue redistribution among them. The local allocation tax is for this purpose. Under the provision of the local allocation tax law, the national government must reserve a certain ratio of national tax revenue (32% of the revenue of income tax, corporation tax and alcoholic beverage tax and 19.2% of the revenue of consumption tax etc) as a common fund for local

public entities. Its amount for F.Y. 1989 budget is 13,369 billion yen, 22.1% of the total expenditure of national government (60,414 billion yen). This fund is distributed to a local public entity according to its degree of financial insufficiency. In each year and for each local public entity, the national government estimates „the amount of basic financial need” (the required amount of expenditure to maintain the standard level of public service) and „the amount of basic financial revenue” (the estimation of revenue by the imposition of usual local taxes). The gap of these two amounts is fulfilled from the common fund.

This system of financial equalization had little effect to correct an imbalance among local public entities but had a sufficient effect to secure the standard level of public service in different regions.

But now, such administration of public finance is bringing serious problem. That is a deterioration of living circumstance in concentrated regions. For example, in Tokyo, we can enjoy a relative high income, a conveniency of shopping, many variety of arts and music, a convenient transportation etc. But the living environment in Tokyo is not good. The cost of land and housing is unbelievably high. Every day, many persons expense a lot of time to go their office. The congestion of road is usual condition. What is the reason of this phenomenon? Certainly, one reason is the extrem concentration of economic activity and population. But another reason is the insufficiency of social infrastructure brought by the weighted distribution of public expenditure to underdeveloped regions.

IV. THE RECENT MOVEMENT OF LOCAL AUTONOMY

In addition to this problem, the recent situation of local public finance and local administration is experiencing another change brought by the revival of economic growth.

The recent Japanese economy is transiting to new dimension. In 1950' and 1960', Japanese economy had a high rate of economic growth (the average annual rate of growth of GNP was 9.5% and 11.1% respectively). But, after the oil shock of 1973, the economic growth went slow down and the depressed economic condition continued. But, in this two or three years, the economic situation changed again. Already in this september, the rising trend of economic activity has continued 31 month. This is the long period comparable to the high growth era. Table 7 presents a rate of economic growth in recent years.

Table 7

The rate of economic growth (in real term, per annum,%)

Year	Japan	U.S.A	EC
1983	3.5	3.6	1.9
1984	5.0	6.8	2.7
1985	4.8	3.4	2.5
1986	2.5	2.8	2.5
1987	4.2	3.4	2.5
1988	5.8	4.0	2.9
1989	5.2 (estimation)		

There are following reasons of this revival of this high growth economy. That is,

The change of the behavior of enterprise	[The rise of the exchange rate of yen – the Japanese economy can get foreign materials and products at cheaper yen cost
		The internationalization of business activity – it saves a cost of production and avoids the trade friction
		The restructuring of enterprise – the industrial structure is transiting from heavy industry to high technological industry
The change of the behavior of consumer	[The need of consumer is going to the high quality products
		The increase of demand of stocks
		The increase of demand of services (over 50% of household expenditure of average worker is for the purchase of services)

As a consequence of such movements of economy, the function and administration of local public entity is changing. So far, the main function of local public entity was to supply local public goods that is school, police, fire-protection, road, park and so on. In these cases, it is not so difficult to establish a consensus of inhabitants on what kind of public services shall supply because such public goods are necessary for every one's life. In addition, there is no big difference of taste on the local public goods. Accordingly, on such functions of local public entity,

1. A local public entity could depends on the standard of function set by national government.

2. A local public entity could refer to the experiences of other local public entity.

In other word, there is model for the administration of local public entity.

However, the recent economic growth is bringing the need of many variety of public service as a result of the increase of income, the decrease of working hours or increase of leisure-time and the fullfilment of traditional local public goods. On such public services, it is difficult to establish a consensus of inhabitants on what kind of public services shall supply. Some one likes to promote a cultural activity. Some one prefers to encourage a sport. The tastes and preferences are differ among regions and person to person.

Accordingly, at present, the very important and difficult task of public entity is the choice of what kind of services they must do and who pay for it. For good performance of this task, each local public entity must decide his function himself. The local public entity could not depend the standard set by national government or could not refer to the experiences of other public entity. Now, it is not appropriate to apply same standard of function to every public entity.

Table 8

The ratio of tax revenue to national income (%)

Fiscal year	National	Local	Total
1955	13.4	5.5	18.9
1965	12.2	5.8	18.0
1975	11.7	6.6	18.3
1980	14.2	8.0	22.2
1985	15.4	9.2	24.6
1986	16.2	9.3	25.5
1987	17.4	9.9	27.4

In this situation, the system of financing of local government and the relation between nations and local government shall change. We are now in the transition era of local autonomy.

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PUBLICZNE LOKALNE FINANSE A WZROST GOSPODARCZY W JAPONII

Konstytucja japońska w rozdziale ósmym określa lokalną autonomię w myśl zasady, iż właśnie autonomia jest podstawą demokracji. Zakres autonomii lokalnej wyznaczają ponadto ustawy regulujące organizację i strukturę władz lokalnych, finanse lokalne i przepisy dotyczące lokalnego prawa podatkowego.

Do głównego zakresu działań władz lokalnych należy zapewnienie sprawnego działania służby zdrowia, transport publiczny, budownictwo, gospodarka komunalna i rozwój terytorialny.

Zadania te finansowane są natomiast z kilku podstawowych źródeł przychodu, którymi są: podatki lokalne, środki przyznane ze szczebla centralnego, lokalne długi publiczne i różne inne źródła. Jednostki samorządu terytorialnego różnią się między sobą liczbą mieszkańców, poziomem dochodów, strukturą uprzemysłowienia, źródłami przychodów itp. Dysproporcje te między poszczególnymi jednostkami lokalnymi pogłębiają się w wyniku koncentracji w kilku regionach znacznej liczby ludności i przemysłu. Sytuacja taka zmusza władze centralne do podejmowania środków zmierzających do niwelacji dysproporcji w rozwoju ekonomicznym poszczególnych regionów, co czyni się przez przyznawanie subsydiów i dodatkowych środków na rozbudowę infrastruktury. Innym środkiem do likwidacji dysproporcji w rozwoju gospodarczym poszczególnych jednostek terytorialnych jest ustalenie tzw. minimum narodowego, na który składa się określony procent wpływów z podatku dochodowego, konsumpcyjnego, od korporacji i, napojów alkoholowych. Z utworzonego w ten sposób funduszu rząd przydziela środki jednostkom terytorialnym wymagającym pomocy finansowej, celem usunięcia dysproporcji w rozwoju gospodarczym.

Wraz z wszechstronnym rozwojem ekonomicznym zmienić powinny się funkcje administracji lokalnej. Powinny powstawać nowe służby publiczne, które obok dotychczas istniejących zajmują się szkolnictwem, porządkiem publicznym, transportem, powinny dodatkowo organizować mieszkańcom danego terenu wolny czas, życie kulturalne i rozwijać aktywność kulturalną i sportową ludności.

Współcześnie bardzo ważnym problemem dla organów lokalnych jest wybór, jakie służby lokalne należy rozwijać i skąd wziąć na ten cel pieniądze.

Abstract: The current expenditure. After a critical discussion, a model of local authority expenditure change is estimated for the year on year change in local authority budgets for three periods of years: 1962/3 to 1981/2; 1983/4 to 1982/3 and 1984/5 to 1983/4. Results from modelling year on year change in local government expenditure have policy implications for the present government, which, since it came to power in 1979, has been concerned to control the level of local government expenditure. The discussion of expenditure modelling is introduced in a section that surveys the recent expenditure modelling literature. The remaining part of the paper is used to develop a model of local authority expenditure change and test it.

¹ Department of the environment, 1986, p. 25; S. Smith, D. Squire, *Local Taxes and Local Government*, London 1987.