

Administrative Reform and the Rationalisation of Specific Purpose Grants*

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The role of specific purpose grants (*Kokko Shishutsukin*) in Japanese public finance increased in importance throughout the 1960s and 1970s. The increase in the amount of specific purpose grants and corresponding expansion in the size of the public sector created management difficulties for both national and local public finance. This paper examines attempts to halt the growth of specific purpose grants, especially through administrative reform in the 1980s. I explore the impact of administrative reform on the rationalisation of specific purpose grants and the participation of local bodies implementing the program of public sector reform.

Administrative reform in the postwar period

Administrative reform has been proposed regularly throughout the postwar period, as the central government grappled with the ongoing problem of managing a burgeoning public sector and restructuring its inelastic financial relationships with local governments. Of the many attempts at administrative reform aimed at curtailing public expenditure and limiting personnel growth, most had only limited success. It was not until the early 1980s that administrative reform successfully

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tackled the issues of reorganisation of the public sector, improvement of administrative efficiency, rationalisation of specific purpose grants and decentralisation of central–local relationships.

The administrative reform of the early 1980s was effective in tackling financial issues faced by both the central and local governments at the time; it was particularly successful in reducing the fiscal deficits of the central government and in halting spiralling expenditure on specific purpose grants. However, the reform still failed to address underlying weaknesses in the relationship between the central and local governments: excessive centralisation of administrative functions, and lack of local government autonomy. Instead, the central government has been dealing with these issues on an *ad hoc* basis, through one-off block grants to strengthen local government autonomy over financial decision-making, for example.

Table 1 summarises the chronology of administrative reform in the postwar period. Three major reforms, the Shoup Mission, the Commission for Rationalising Specific Purpose Grants in the First Administrative Reform, and the Second Provisional Commission for Administrative Reform, had a large impact on the role of specific purpose grants and also on intergovernmental financial relationships. The aims of these reforms have been described by Katō and Hyōdō (1988) and are discussed briefly below.

The Shoup Mission was set up by the Allied Occupation Administration in 1949 to install a new fiscal system in postwar Japan. Its aim was to establish a democratic and decentralised intergovernmental financial structure in preparation for independence. The Shoup Mission presented a set of recommendations covering tax reform as

Table 1 Chronology of major postwar administrative reforms proposing rationalisation of specific purpose grants

Year planned	Year applied	Names of commissions and major recommendations
1945	1950	<p><u>Shoup Mission</u></p> <p>Suggested a shift from specific purpose grants to block grants and equalisation grants on the basis of the following principles of local public finance: (1) clarification of administrative responsibility; (2) efficiency in local public finance; and (3) financial priority of local governments (especially local municipalities) in intergovernmental financial relationships.</p>
1950	1951	<p><u>Kanbe Commission</u></p> <p>Recommended the rationalisation of specific purpose grants on the basis of local autonomy.</p>
1953	1953	<p>A number of specific purpose grants, for example, for compulsory education, child care and public works, were established to compensate for the difficulty in administering equalisation grants.</p>
1953	1954	<p><u>Research Council of Local Public Finance System</u></p> <p>Suggested:</p> <ol style="list-style-type: none"> (1) the abolition of small-sum specific purpose grants and across-the-board cuts in grants; (2) switching specific purpose grants to unconditional grants (such as local allocation tax); and (3) simplification of grant procedures and compulsory stipulation of specific purpose grants provision in law to clarify estimation procedures and links with expenditure.
1963	1964	<p><u>Commission for Rationalising Specific Purpose Grants*</u></p> <p>(First Provisional Commission for Administrative Reform)</p> <ol style="list-style-type: none"> (1) Attempted to clarify the financial and administrative responsibilities of both the central and local governments. (2) Delivered new policies for rationalising the provision of Japanese specific purpose grants through: <ul style="list-style-type: none"> • abolition of inappropriate specific purpose grants relating to ineffective national policies; • examination of specific purpose grants and consideration of their substitution with unconditional grants (such as local allocation tax and local transfer tax); and • clear delineation between specific purpose grants used to provide national public goods via local governments, and spe-

		<p>cific purpose grants used to provide local public goods, both in the administrative and financial fields.</p>
1977	1977	<p>Commission for Examining Financial Institutions^b</p> <p>(1) Confirmed the contribution of specific purpose grants in coordinating the individual policy objectives of local governments and national policy needs.</p> <p>(2) Put forward concrete plans for rationalising specific purpose grants through an examination of administrative undertakings.</p> <p>(3) Suggested three criteria for rationalising specific purpose grants provision:</p> <ul style="list-style-type: none"> • appropriateness of the central government's intervention in the subsidised undertakings of local public finance; • examination of alternative financing methods to achieve the same goals; and • examination of the suitability of formulas for calculating grants and amounts of grants.
1979	1980	<p>Plans for the Rationalisation of Specific Purpose Grants</p> <p>Suggested four concrete steps for rationalising specific purpose grants:</p> <ul style="list-style-type: none"> • abolition of 25 percent of existing specific purpose grants within four years beginning in 1980; • prompt reduction of specific purpose grants provision by integrating financial sources; • introduction of 'sunset procedures' for newly established specific purpose grants; and • establishment of the Provisional Commission for Rationalising Specific Purpose Grants^c to follow up these plans.
1981-1983	1983	<p><u>Provisional Commission for Rationalising Specific Purpose Grants</u> (Second Provisional Commission for Administrative Reform^d)</p> <p>Reports were provided for four stages of discussion. The following two were influential regarding the rationalisation of specific purpose grants provision.</p> <p>(1) Third report (30 July 1982)</p> <p>Recommended:</p> <ul style="list-style-type: none"> • abolition of specific purpose grants supporting national policies that had become inappropriate from the viewpoint of socioeconomic conditions; • substitution of specific purpose grants with unconditional grants (such as local allocation tax and local transfer tax);

		<p>and</p> <ul style="list-style-type: none"> • switching existing specific purpose grants into public loans or grants incorporating cost-benefit principles. <p>(2) Final report (14 March 1983)</p> <p>Recommended:</p> <ul style="list-style-type: none"> • abolition not only of inappropriate specific purpose grants but also of related inappropriate public expenditure, both in the central and local governments; • examination of functions of specific purpose grants with regard to the mid-term and long-term, and not just the short-term, economic situation; and • delivery of concrete methods for rationalising specific purpose grants provision in categories of public expenditure, particularly taking into account (a) the changing socioeconomic environment, (b) simplicity and efficiency, and (c) security of reliable public services for promoting public goods having specific purposes.
1983-1986	1986	<p>Provisional Commission for the Promotion of Administrative Reform* (First)</p> <p>With regard to implementing reform, the commission recommended:</p> <p>(1) Continual and prompt implementation of recommendations on the reform of public finance and administration emphasising a reduction of unnecessary specific purpose grants; and</p> <p>(2) Examination of specific purpose grants provision with reference to the sharing of financing by the central and local governments.</p>
1987-1990	1990	<p>New Provisional Commission for the Promotion of Administrative Reform^f (Second)</p>
1990		<p>The Third Provisional Commission for the Promotion of Administrative Reform*</p>

- Notes:
- a Commission for Rationalising Specific Purpose Grants is a translation of *Hojokin Gōrika Shingikai*.
 - b Commission for Examining Financial Institutions is a translation of *Zaisei Seido Shingikai*.
 - c Provisional Commission for Rationalising Specific Purpose Grants is a translation of *Hojokin Seiri Gōrika Suishin Kyōgikai*.
 - d Provisional Commission for Administrative Reform is a translation of *Rinji Gyōsei Chōsakai*.
 - e Provisional Commission for the Promotion of Administrative Reform is a translation of *Rinji Gyōseikaikaku Suishin Shingikai (Kyu Gyōkakushin)*.
 - f New Commission for the Promotion of Administrative Reform is a translation of *Rinji Gyōseikaikaku Suishin Shingikai*.

tion of *Rinji Gyōseikaikaku Suishin Shingikai* (*Shin Gyōkakushin*).

- g The Third Commission for the Promotion of Administrative Reform is a translation of *Daisanji Gyōseikaikaku Suishin Shingikai* (*Daisanji Gyōkakushin*).

- Sources:
- Gyōseikanri Kenkyusentā (1992) *Dētabukku Nihon no gyōsei 1992* (Data book: Japanese public administration 1992), Tokyo: Gyōseikanri Kenkyū-sentā.
 - Ishihara, N. (1984) *Chihō zaisei chōsei seidoron* (Fiscal equalisation in Japanese local public finance), Tokyo: Gyōsei.
 - Katō, G. and Hyōdō, K. (1988) *Shimpan hojokin seido – sono shikumi to unyō* (Governmental grants in Japan: their structure and management, new edition), Tokyo: Nihon Densan Kikaku Kabushikigaisha.
 - Yonehara, J. (1981) *Local Public Finance in Japan*, Research Monograph No.36, Centre for Research on Federal Financial Relations, Canberra: The Australian National University.

well as reorganisation of the intergovernmental financial system.

The Mission advocated far-reaching reform of specific purpose grants, which had become the main tool for controlling local public finance in the prewar centralised fiscal system. The main proposals put forward in the Mission's recommendation were: a drastic shift in the pattern of intergovernmental grants from specific purpose grants to equalisation grants (*Heikō Kōfukin*), the function of which was to be closer to general revenue grants (the function of specific purpose grants, meanwhile, to be limited to national treasury grants-in-aid); abolition of the central government's obligatory share in order to clarify the responsibilities of administrative organisations and achieve the appropriate engagement of central and local public administrations; and establishment of a fundamental plan for the healthy administration and allocation of finances by central and local governments on the basis of a decentralised fiscal system.

The reform trimmed specific purpose grants and strengthened local government control over its own funding in the form of local taxes and equalisation grants. However, the revenue thus obtained was

not sufficient for local governments to meet the increasing expense of administrative activities during the period of economic recovery and growth in the 1950s. Local governments increased deficits and borrowing but eventually came to rely on specific purpose grants from the central government. The resurgence of specific purpose grants was formalised in the Law on Special Measures to Promote the Reconstruction of Local Public Finance in 1955 (Local Autonomy College 1990).

The Commission for Rationalising Specific Purpose Grants was set up in 1963 as part of the First Provisional Commission for Administrative Reform. The commission was constituted to consider the financial and administrative relationship of the central government and local governments through an examination of the tax system and of patterns of specific purpose grants during the period of high economic growth. The commission's views on rationalising specific purpose grants were as follows:

Increasing and diversifying specific purpose grants complicates the public administration and financing of both central and local governments. It also increases public expenditure and brings about blurred administrative responsibility-sharing among governments. Therefore, it is important for governments seeking modern public administration to rationalise the complicated specific purpose grants system, maintain autonomous local administration and promote an efficient system of public finance (Katō and Hyōdō 1988: 50).

Careful consideration was given to tax-sharing and fiscal equalisation among governments. The commission basically proposed that unnecessary specific purpose grants should be abolished. It also recommended the maintenance of some specific purpose grants that

would be acceptable from the viewpoint of demonstrating a balanced financial commitment between the central government and local governments. The commission was in favour of providing financial support to local governments in such areas as: obligatory works carried out by local governments, the content and costs of which were prescribed in detail by law; new projects of local governments that the central government particularly wanted to encourage; works by financially disadvantaged local governments; and works having a temporary need for additional financing.

The reform, however, was not carried out. This was because the commission failed to consider the feasibility of the reform in its public choice process. The commission's attempt to promote the reform through a strong top management system (reinforcing the functions of Cabinet, central ministries and agencies) was in conflict with traditional Japanese methods of management and administration (Kumon 1984). As a result, the reform failed to gain the support and cooperation of the administrative divisions, both at the central and local government levels, that would be responsible for implementing it.

In the early 1980s, the Second Provisional Commission for Administrative Reform proposed drastic reforms aimed at improving the efficiency of the public sector and rationalising specific purpose grants. The need for the establishment of this second commission became apparent in the late 1970s, a time of fiscal crisis in the public sector.

Learning from the experience of previous attempts at administrative reform, the commission tackled the reform of public finance and administration in a broadly based way, recommending a rationalisation of specific purpose grants, financial cuts affecting both central and

local governments and the privatisation of public corporations.

Cooperation in promoting administrative reform was obtained from both the private sector and the public sector itself. In the wake of the second oil shock, the private sector was in favour of budgetary tightening. According to Noguchi (1991), this was partly because business leaders were dissatisfied with the results of the expansionary policy of 1977-78 and partly because they were concerned about future tax increases which would be directed at corporate income. There was also a strong push for reform from the public sector. In particular, the Ministry of Finance and the Administrative Management Agency looked on the reform as a way of overcoming the central government's financial difficulties without increasing taxes. These two ministries took the lead in promoting efficiency in fiscal management and reforming government organisations. The reform also had strong governmental support and was under the personal leadership of Prime Ministers Suzuki and Nakasone.¹⁾

Administrative reform in the 1980s

Japan experienced a fiscal crisis in the late 1970s the magnitude of which was reflected in a huge and accumulating national debt. This fiscal crisis brought about an increased desire among the Japanese people for structural reform of public finance at both national and local levels.

The seriousness of the fiscal crisis is confirmed statistically by data

1) Prime Minister Suzuki's resolution to succeed in implementing the administrative reform is revealed in his speech on 24 March 1981, at the LDP (Liberal Democratic Party)'s conciliation meeting.

on fiscal deficits in the public sector. In the late 1970s and early 1980s, the deficit hovered at around 4 percent of GNP. In the late 1970s, the central government compensated for fiscal deficits by issuing government bonds; this practice continued right up until 1990. Central government bond issues were worth a total of 100 trillion yen in 1983 (170 trillion yen in 1991).

Yamamoto (1988) has examined Japan's heavy reliance on financing through government debt compared with other countries (**Table 2**). The first column of Table 2 shows long-term government bond financing as a percentage of the public sector's total fiscal revenue.

Table 2 Dependence on government bonds in Japanese public finance

Long-term government bond financing as a percentage of total fiscal revenue of the public sector	Bond interest payments as a percentage of public expenditure	Accumulation of long-term government bonds as a percentage of GNP
JAPAN 19.4	JAPAN 20.2	JAPAN 51.6
FRANCE 11.9	USA 13.6	UK 47.1
USA 10.5	W. GERMANY 11.5	USA 41.1
W. GERMANY 8.5	FRANCE 9.4	W. GERMANY 20.8
UK 4.4	UK 7.7	FRANCE 9.9

Notes: JAPAN 1987 budget
 USA 1988 budget
 UK 1986 prospective budget
 FRANCE 1987 budget
 W. GERMANY 1987 budget

Source: Yamamoto Y. (1988) *Zaisei zeisei ga wakaru hon* (Introduction to the Japanese public finance and tax system), Tokyo: Chuō Keizaisha, p. 7.

Japan recorded a figure of 19.4 percent, far higher than the 4 to 12 percent recorded by comparable OECD countries. The second column shows interest payments on government bonds as a percentage of public expenditure. Japan's interest payments reached 20 percent, compared with 7 to 14 percent for other OECD countries. The third column shows accumulation of long-term government bonds as a percentage of GNP. Once again Japan has the highest rate (51.6 percent). These figures indicate that the Japanese fiscal system had structural inefficiencies incorporated into it, resulting in a large public sector and public sector deficit.

There are several explanations for the fiscal crisis (Noguchi 1981, 1987, Ishi 1982, Muramatsu 1983). Most emphasise structural inflexibilities built into the Japanese public finance system, inflexibilities that were incompatible with rapid changes in private economic performance. Three factors are commonly stressed.

First, many new social welfare programs had been built into the fiscal system since 1973.²⁾ Welfare expenditure increased by 20 to 40 percent annually throughout the 1970s, a higher level than in any other postwar decade. This growth in social welfare expenditure was propelled by the policy decision to increase social security benefits such as health insurance and public pensions, a policy reflecting welfare state ideals (Noguchi 1987, Muramatsu 1983).

Second, regional income redistribution via specific purpose grants was fixed structurally and implemented through the general account of the central government. In the 1960s and 1970s, specific purpose grants as a share of the central government's general expenditure reached 45

2) Noguchi (1987) calls fiscal year 1973 the 'first year of the welfare era'.

percent. These grants were in response to the endless accumulation of funding requests from interest groups and voters/citizens, and politicians' desires to fulfill these in view of electoral considerations (Muramatsu 1983).

Third, the income taxation scheme could not be relied upon to meet growing financial needs. This was partly due to political constraints against increasing tax revenue during an economic slowdown, and partly due to inequalities inherent in the tax system stemming from the difficulty of identifying all sources of taxable income accruing to different classes of tax-payers.³⁾

Two strategies were initially pursued to tide the central government over the fiscal crisis. First, the central government set strict ceilings on budget growth and tried to restrict the size of the public sector. Cabinet first put a ceiling on the central government's budget in 1961 in response to economic and financial conditions. A zero ceiling (in 1982) and minus ceiling (since 1983) were set to overcome the fiscal crisis and restore healthy public finance. Second, a new consumption tax was proposed in 1979. The proposed consumption tax became a controversial issue in the lead-up to the 1979 Lower House election. The ruling party fared disastrously, winning only 248 seats, compared with more than 270 seats until the early 1970s. This poor general election result for the ruling party because of its tax reform agenda forced the government to take an alternative course, with the result

3) This divergence is called '*ku* (90 per cent) - *ro* (60 per cent) - *yon* (40 per cent)', meaning that 90 per cent of the income of salaried workers, but only 60 per cent of the income of the self-employed and 40 per cent of farmer's income, is assessed by the tax office as taxable income (Ishi 1989).

that public sector expenditure was finally targeted in the reform.

The commission met regularly during the early 1980s. Research was carried out by organisations and individuals representing various sectors of society, including business, trade unions, a public sector union, the civil service, the media and the academic world (Itō 1988). The fundamental politico-economic objectives of the administrative reform were presented in five reports published by the commission (*Gyōseikaikaku Taikō*) and are summarised in the following three points:

- The report emphasised the efficiency of the public sector itself. Cuts in public expenditure and privatisation of public utilities were recommended.
- The report encouraged a reassessment of intergovernmental financial relationships. It focused on the allocation of finances between the central and local governments with a strong emphasis on rationalising the provision of specific purpose grants. Highly subsidised specific purpose grants, such as those for welfare and construction, became targets for reduction.
- An overall examination of the purpose and function of the public sector was also proposed. The report mentioned the role of public finance and administration in the politico-economic situation facing Japan in the new era, the achievement of which required creation of an 'active welfare society' in the domestic economy, and 'contributing to international relationships' in international society.

The rationalisation of the public sector was promoted through the slogan 'fiscal consolidation without raising taxes' (*zōzeinaki zaiseisai-ken*). In intergovernmental financial relationships, specific purpose grants were re-examined from the viewpoints of simplicity, efficiency and reliability.

Policies to streamline the provision of specific purpose grants were

proposed in bills concerning the compilation of budgets submitted to the Diet in 1981, 1983, 1985 and 1986.⁴ Most of the bills were brought up *en bloc* for discussion and were strongly opposed by the opposition parties, thus delaying their passage through the Diet.

The bills were aimed at drastic rationalisation of both subsidy and contribution rates in specific purpose grants provision (*Nihonkeizai Shinbun* 3/12/84 and *Chihō Jichi Shiryō* 1/2/85).⁵ The content of the bills included: reduction of specific purpose grants for welfare, especially affecting pensions, mutual benefit trusts, and poverty relief; reduction of specific purpose grants for education, both compulsory and private; reorganisation of specific purpose grants for public works and construction; reduction of specific purpose grants to promote local industry; and an across-the-board ten per cent cut for specific purpose grants with subsidy rates exceeding 50 percent.

The bills targeted two areas in particular. The first was local public expenditure in a wide range of areas. The growth of democracy in postwar Japan had established the leadership of a range of interest groups in promoting local projects, and thereby local public expenditure, in line with the demands of voters/citizens (Muramatsu 1983). The reform thus had to obtain a consensus on the rationalisation of grants from a broad spectrum of interest groups including voters/citi-

4) These bills are called *Hojyokin Ikkatsu Hōan* (Bills for Rationalising Specific Purpose Grants). Shindō (1986) comments on the bills from a critical perspective.

5) *Hojokin Mondai Kentōkai* (Commission for Examining Specific Purpose Grants) itemised issues regarding the rationalisation of specific purpose grants. However, the constructive arguments and comments of the commission were not fully implemented due to administrative and political constraints.

zens.

The second area targeted was specific purpose grants with high subsidy rates (over 50 percent in the 1985 budget). There are several reasons why specific purpose grants with high subsidy rates are likely to cause inefficiencies in the management of public finance. Katō and Hyōdō (1988: 95), identify the following four. First, specific purpose grants with high subsidy rates often destroy the incentive for the grantee to manage finances efficiently, and grants are likely to result in wasteful expenditure on expanded public activities. Second, high subsidy rates should only be applied after comprehensive examination of both national and local financial conditions, and local administrative capacities. There had been a big change in the need for grants having high subsidy rates compared with when these grants were first provided. Third, high subsidy rates are not essential, particularly for local bodies with a good financial performance. And finally, against a background of national budgetary difficulties, maintaining high subsidy rates limits the central government's options for carrying out its policy schedule.

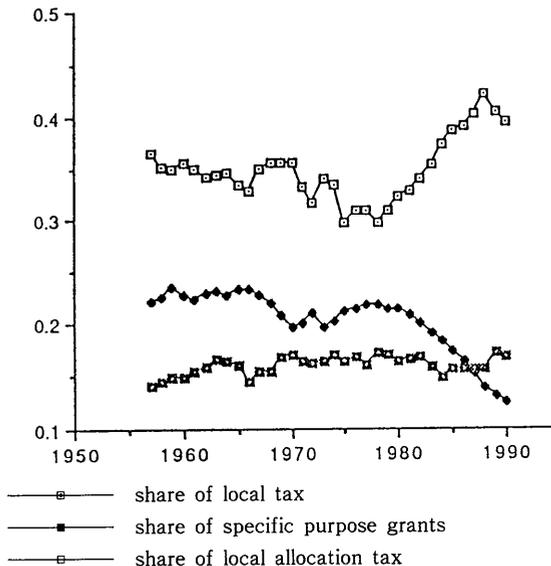
Statistical profile

The impact of the Second Administrative Reform on intergovernmental grants provision can be examined statistically both from a macro and a micro viewpoint. First, at a macro level the reform resulted in the substitution of other financial sources for specific purpose grants. Local governments have three main sources of revenue: specific purpose grants; local allocation tax; and local taxes. **Figure 1** shows the changes in the shares of these different categories of revenue sources

for local governments during the postwar period. It demonstrates the sharp reduction in the share of specific purpose grants and the increase in the shares of local taxes and local allocation tax that have occurred since 1980. The share of local taxes in local financial revenue had increased to as much as 40 percent of total revenue in the late 1980s. Since the administrative reform of the early 1980s, local governments have steadily raised a larger proportion of their own funds, becoming increasingly more autonomous and efficient in the management of local public finance and demonstrating increased financial accountability.

Figure 1 Shares of local tax, specific purpose grants and local allocation tax in local government revenue

Share in total revenue
of local governments



Source: *Nihon tôkeinenkan* (Japan statistical yearbook), Tokyo: Statistics Bureau Management and Coordination Agency, various issues.

The impact of the administrative reform at a micro level is revealed by focusing on categories of specific purpose grants. Specific purpose grants fall into five categories, namely national treasury grants-in-aid (*kokko hojokin*), national treasury obligatory shares (*kokko futankin*), national treasury exceptional subsidy (*kōfukin*), national treasury supplementary compensation (*hokyūkin*) and national treasury delegation payment (*kokko itakukin*).

Table 3 shows how the funding of these different categories of specific purpose grants has changed. The share of national treasury grants-in-aid, which offer the most discretion for funding from the

Table 3 Changes in types of specific purpose grants (¥ billion)

Type of grants	1984		1985		1986		1987		1988	
	amount	%	amount	%	amount	%	amount	%	amount	%
NTGIA	9868	67.8	9456	65.5	9226 (4732)	65.4 (33.5)	4676	33.2	4664	32.8
NTOS	2749	18.9	2839	19.7	2904 (7399)	20.6 (52.5)	7684	54.2	7819	55.1
NTES	853	5.8	966	6.7	1016	7.2	1005	7.2	1008	7.1
NTSC	962	6.6	1018	7.1	820	5.8	599	4.3	592	4.2
NTDP	133	0.9	152	1.0	141	1.0	113	0.8	118	0.8
Total	14565	100.0	14430	100.0	14109	100.0	14078	100.0	14200	100.0

() shows the re-examined value based on new categorisations account from 1987.

Notes: NTGIA = national treasury grants-in-aid
 NTOS = national treasury obligatory share
 NTES = national treasury exceptional subsidy
 NTSC = national treasury supplementary compensation
 NTDP = national treasury delegation payment

Source: Katō, G. and Hyōdō, K. (1988) *Shimpan hojokin seido - sono shikumi to unyō* (Governmental grants in Japan: their structure and management, new edition), Tokyo: Nihon Densan Kikaku Kabushikigaisha, pp. 32-3.

central government, declined sharply from 67.8 percent in 1984 to 32.8 percent in 1988. To offset this, there was an increase in the national treasury obligatory share, which is regulated by law, from 18.9 percent in 1984 to 55.1 percent in 1988, demonstrating the increase in institutionally supported specific purpose grants. National treasury grants-in-aid have, however, been partly absorbed into national treasury obligatory shares since 1987, after an adjustment of the accounting method (Katō and Hyōdō 1988).⁶⁾

Many smaller grants-in-aid are provided by the bureaucracy, reflecting sectional disputes between ministries. Most of these are non-statutory grants supporting the policy objectives of the bureaucracy concerned, and the discretion of the central government in providing them is easily obtained. Administrative and political intricacy in the provision of grants-in-aid had often been criticised because it brought about inefficiencies in intergovernmental financial relationships (Hirose 1981). The reform, therefore, mainly concentrated on rationalising minor national treasury grants-in-aid.

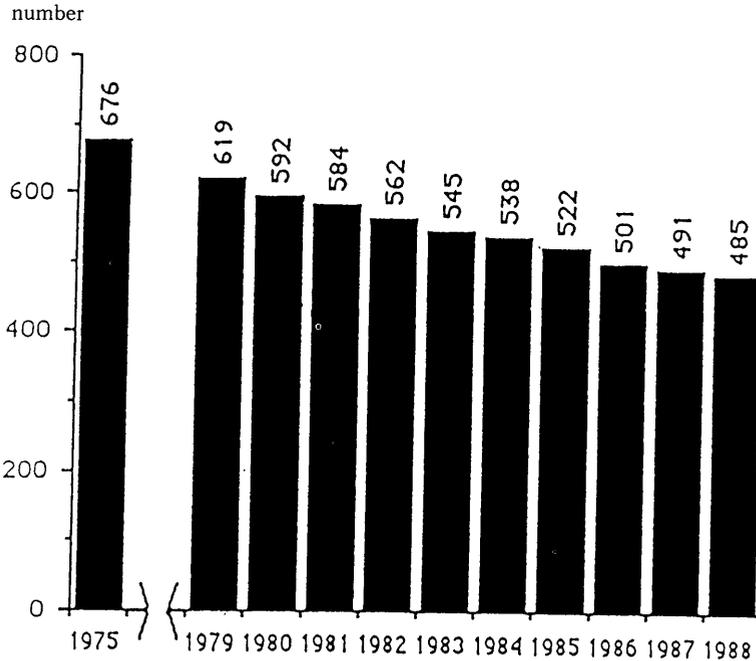
The changing pattern of national treasury grants-in-aid can be examined in two ways: according to the number of types; and by calculating the effective subsidy rates of grants-in-aid.

Figure 2 shows the sharp reduction in the number of national treasury grants-in-aid from 676 in 1975 to 485 in 1988. This reduction was due in part to minor grants-in-aid being integrated with larger ones, and also demonstrates that the rationalisation of minor national

6) Shindō (1986) also comments on this absorption and criticises the effectiveness of reforms on public finance and public administration since 1980.

treasury grants-in-aid was actively promoted during the reform.

Figure 2 Number of national treasury grants-in-aid



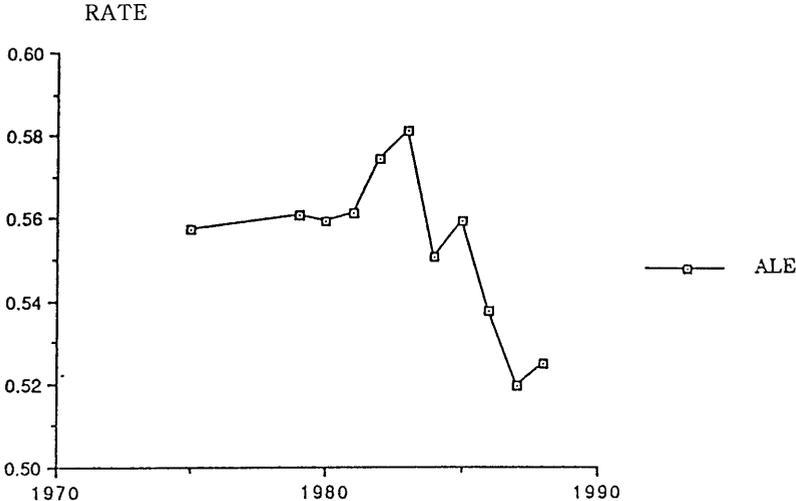
Source: *Hojokin sōran* (Statistics of governmental grants in Japan), Tokyo: Nihon Densan Kikaku Kabushikigaisha, various issues.

The effective subsidy rates of national treasury grants-in-aid have been measured to calculate the magnitude of the reduction in high subsidy rates as a result of the administrative reform. Grants-in-aid are categorised according to types of local expenditure. Effective subsidy rates for 1975-88 were calculated based on *Hojokin sōran* (Statistics of governmental grants in Japan) following Ishi et al. (1983). Methods used in calculations and notations are explained in Appendix 1.

Figures 3(a) to 4 show the shift in effective subsidy rates in

specific purpose grants provision since 1975. Figure 3(a) shows changes in the effective subsidy rates of aggregated local public expenditure. There has been a sharp reduction in effective subsidy rates since 1983 indicating that the reform contributed to the rationalisation of specific purpose grants at the aggregated level of local public expenditure.

Figure 3a Effective subsidy rates for aggregated local expenditure, 1975-88



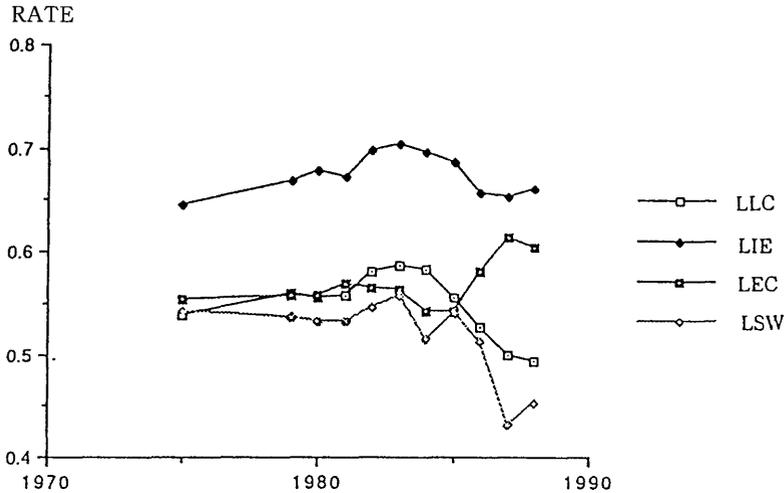
Note: ALE = effective subsidy rate for aggregated local expenditure

Source: *Hojokin sōran* (Statistics of governmental grants in Japan), Tokyo: Nihon Densan Kikaku Kabushikigaisha, various issues.

Figures 3(b) and 3(c) show effective subsidy rates for different categories of local public expenditure. A sharp reduction is apparent in effective subsidy rates for social welfare and for local public expenditure on national agential tasks (expenditure incurred on behalf of the central government in such areas as national elections, the judiciary, police, fire fighting, maintaining the Imperial Household, etc.), reflecting

large cuts in subsidies for local welfare expenditures, particularly in the areas of national health insurance and child care. The effective subsidy rates for local expenditure on industry and the economy and on land development and conservation also fell. However, the participation of industry groups in the public choice process of the administrative reform and political pressure from industry resulted in relatively high subsidy rates for this category (consistently above 0.65 since 1975). There was also a reduction in effective subsidy rates for local expenditure on education and culture in the early 1980s, though expenditure in this

Figure 3b Effective subsidy rates for local expenditure on land development and conservation, industry and economy, education and culture, and social welfare (based on categorisation 1), 1975-88

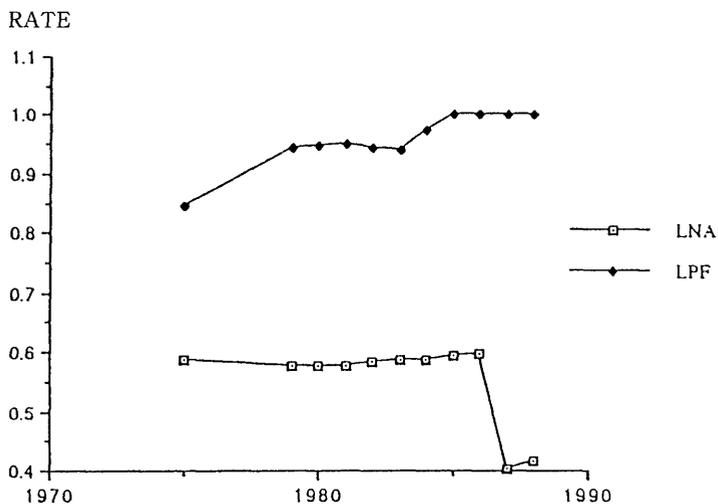


Notes: LLC = effective subsidy rate for local expenditure on land development and conservation
 LIE = effective subsidy rate for local expenditure on industry and economy
 LEC = effective subsidy rate for local expenditure on education and culture
 LSW = effective subsidy rate for local expenditure on social welfare

Source: *Hojokin sōran* (Statistics of governmental grants in Japan), Tokyo: Nihon Densan Kikaku Kabushikigaisha, various issues.

area has increased since 1986. The main cause of the reduction was the rationalisation of financial aid for the construction of educational facilities and management of private schools. The increase since 1986 seems to have been caused by the integration of subsidised education programs. The subsidy rate for the financial management of local public finance remained steady throughout the 1980s. This was because expenditure in this area did not become an issue during the discussion of administrative reform.

Figure 3c Effective subsidy rates for local public expenditure on national agential tasks and the financial adjustment of local public finance (based on categorisation I), 1975-88



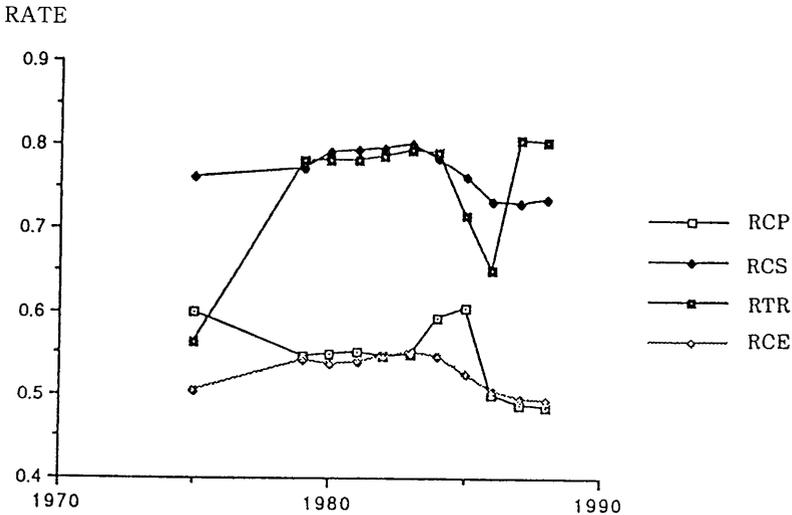
Notes: LNA = effective subsidy rate for local public expenditures on national agential tasks
 LPF = effective subsidy rate for financial management of local public finance

Source: *Hojokin sōran* (Statistics of governmental grants in Japan), Tokyo: Nihon Densan Kikaku Kabushikigaisha, various issues.

Figure 4 shows the changes in effective subsidy rates for local

public expenditure, categorised by economic objective. Effective subsidy rates for current purchases of goods and services, current subsidies, transfers and capital expenditures on goods and services tended to decrease throughout the 1980s. The extent of these cuts became apparent around 1985, when the examination of programs was complete and cuts finalised. The sharpest reductions were experienced in current purchases of goods and services, and transfers.

Figure 4 Effective subsidy rates for current subsidies of and current local expenditure on the purchase of goods and services, local expenditure on capital goods and services, and local transfer expenditure (based on category II), 1975 to 1988



Notes: RCS = effective subsidy rate for current subsidies
 RCP = effective subsidy rate for current local expenditure on the purchase of goods and services
 RCE = effective subsidy rate for local expenditure on the purchase of capital goods and services
 RTR = effective subsidy rate for local transfer expenditure

Source: *Hojokin sōran* (Statistics of governmental grants in Japan), Tokyo: Nihon Densan Kikaku Kabushikigaisha, various issues.

Policy implications for local public finance

Both the central government and local governments have cooperated in carrying out administrative reform in the 1980s. Their efforts have resulted in improvements in the efficiency of the public sector and its financial management, particularly with regard to rationalising specific purpose grants and curtailing both national and local public expenditure.

This section discusses the contribution local governments have made in promoting administrative reform and examines the policy implications of reform on the relationship between the central government and local governments.

Local participation and cooperation in the accomplishment of reform took place on several levels. The following are the most significant. First, local governments were involved from the beginning in instituting reform. All 47 prefectures and 98.2 percent of local municipalities (3209 bodies) made submissions on how best to achieve administrative reform (*Chihōjichi Shiryō* 1/7/89). Their submissions contained a common agenda in their concern for reviewing administrative and financial relationships between the central government and local governments, rationalising labour unions in the public sector, setting an appropriate level of employment for the public service, improving the efficiency of the public service, and adjusting public sector salary awards. With regard to the rationalisation of specific purpose grants in particular, it was to the advantage of local governments to promote improvements in the efficiency of local public finance and increased local discretionary funding such as local tax and local allocation tax.

Second, the proposed content of the reform was discussed at a number of meetings between local government and central government officials (Itō 1988; *Sōmuchō Gyōsei Kansatsukyoku* 1987). The hearings were a forum for practical dialogue between the central government and local governments, providing local governments with advance information and the central government with useful feedback. In addition, the proposed content of reform and the timetable for its implementation were made public (*Chihōjichi Keieigakkai* 1985; *Sōmuchō Gyōsei Kansatsukyoku* 1987).

From the viewpoint of local governments, the reform failed to deal with crucial issues. Concentrating on policy issues such as the rationalisation of specific purpose grants and the improvement of efficiency in public finance, the reform did not touch on intrinsic issues affecting the central-local relationship such as the decentralisation of administrative and financial functions to local governments, and the strengthening of local autonomy.⁷⁾

These problems were subsequently considered by three successive Commissions for the Promotion of Administrative Reform. These commissions looked closely at the problematic areas of the intergovernmental system and provided a long-term vision for future financial relationships. Their recommendations included: (1) a re-examination of the sharing of costs between the central and local governments, taking into account the differing fiscal capacities of local governments; (2) the

7) Only the third report of the committee responsible for administrative reform considered such fundamental issues as financial and administrative burden sharing between the central government and local governments, strengthening local autonomy and the integrated administration of several prefectures.

improvement and promotion of autonomous administrations in pivotal local cities; and (3) the introduction of a highly decentralised financial system along the lines of the federal system, and of a decentralised regional bloc fiscal system (*dō shū sei*).

These proposals have not yet been implemented. However, several innovations were made in grants policies in the late 1980s. One was a financial transfer, provided for in the national budget, to all local governments. This was carried out under the Takeshita administration in 1989, when all local governments, regardless of size, received a 100 million yen payout as an untied transfer, and was recommended again in 1990. This transfer program gave local governments the opportunity to realise their potential in making autonomous financial decisions.

The tax base of the local allocation tax was also expanded, improving local discretionary funding. Two sources of tax revenues, consumption tax revenue and tobacco tax revenue, were introduced to secure funding for local allocation tax. The revenue collected through local allocation tax thus increased by 20 percent in 1989 compared with the year before. This increase made up for the reduction in sources of finance caused by cuts in specific purpose grants and contributed to the improvement of local government discretion over finances.

Conclusion

According to Itō (1988), the administrative reform of the 1980s, when viewed from a broader historical perspective, can be said to have had two goals. The first, short-term goal was to restore financial balance in the central government and reduce public sector deficits by eliminating

inefficiencies in public expenditure and the specific purpose grants system. The second, long-term goal was to bring forth a new system of public policy formulation, based on a restructured and healthier central-local relationship in the areas of public finance management and public sector administration.

The reform restricted the growth of the budget and held down deficits at the central government level through its rationalisation of specific purpose grants. The efficiency of public sector management was also enhanced, without corresponding increases in taxes.

The evidence confirms that the reform was successful in the first area identified by Itō. There was indeed a shift in the composition of intergovernmental grants, away from specific purpose grants and towards local allocation tax and local taxes; local government discretion in public finance was strengthened as a result. Administrative efficiency in intergovernmental financial relationships was enhanced by the consolidation of smaller specific purpose grants.

At the same time, specific purpose grants for social welfare and land development and conservation – areas excessively subsidised through national treasury grants-in-aid – were drastically reduced. Both the central government and local governments recognised that the rationalisation of specific purpose grants was necessary to get rid of central government budget inflexibility and to improve the financial accountability of local governments.

The reform was less successful in its second goal. Fundamental issues in long-term central-local relationships – decentralisation of administrative and financial functions to local governments and the strengthening of local autonomy, for example – made little headway.

The reformers recognised the need to examine further the feasibility of proposals for long-term reform; councils set up after the reform continued to debate these for some years, and innovations began to be seen in the late 1980s.

Local participation was a feature of the administrative reform's public choice process. Local decision-making bodies such as local bureaucracies, local interest groups and the electorate, were able to express their views through the submission of requests, setting up local advisory bodies and holding local hearings to publicise problems. The resolution of difficulties resulting from the reform and the reform's smooth implementation were in large part due to successful coordination between these decision-making bodies.

Appendix 1 Method of calculating effective subsidy rates

Effective subsidy rates are calculated on the basis of data provided in *Hojokin sōran* (Statistics of governmental grants in Japan). Due to the diversified channels for intergovernmental grants provision in the general account, effective subsidy rates have to be estimated by putting them into categories, based on several accounting focuses. Ishi (1985) and Ishi et al. (1983) initiated calculation of effective subsidy rates. Extending their approach by incorporating different categories and considering longer time periods would be of use to an understanding of historical changes in effective subsidy rates.

Eleven digit number codes are given in the general account for different channels of national treasury grants-in-aid provision, distinguished according to the type, objective, economic function, etc., of the subsidised local public expenditure. Categories of national

Category 1: Expenditure objectives (1975, 1980-88)

CODE	OBJECTIVE	NOTATION
010 to 019	National agential task	(LNA)
020 to 029	Financial adjustment of local public finance	(LPF)
050 to 059	Land development and conservation	(LLC)
060 to 069	Industry and economy	(LIE)
070 to 079	Education and culture	(LEC)
080 to 099	Social welfare	(LSW)
100 to 199	Miscellaneous	(LMC)

Note: Codes correspond to the number codes for categorising objectives of subsidised local public expenditure used in *Hojokin sōran* (Statistics of governmental grants in Japan).

Category 2: Economic functions (1980-88)

CODE	FUNCTION	NOTATION
from 10 to 15, and 81	Current purchases of goods and services	(CP)
40 and 85	Current subsidies	(CS)
50, 60, 70, 71, 72, 73, 83 and 84	Transfer expenditure	(DR)
20 and 82	Capital expenditure for goods and services	(CE)

Economic functions (for 1975)

CODE	FUNCTION	NOTATION
1	Current purchases of goods and services	(CP)
4	Current subsidies	(CS)
6	Transfer expenditure	(DR)
2	Capital expenditure for goods and services	(CE)

Note: Codes correspond to the number codes for categorising economic function of subsidised local public expenditure used in *Hojokin sōran* (Statistics of governmental grants in Japan).

treasury grants-in-aid and local public expenditure can be sorted using these number codes. I employed two categorisations for national treasury grants-in-aid, based on: the objective of the subsidised local public expenditure (category 1) and the economic function of the

subsidised local public expenditure (category 2). I added the amount of national treasury grants-in-aid and the amount of local public expenditure in each category, and obtained the effective subsidy rate by simply dividing the former by the latter.

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