

The Paradox of Centralization and The Paradox of Decentralization: Institutional Impact of Central- Local Relations on Local Governance in Postwar Japan

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The article touches on the impact of decentralization reforms on local governance in postwar Japan. It delves into the politics of central-local relations before and after the passage of the Packaged Act of Decentralization of 2000. It also takes into account the problems and issues which might have undermined the local administrative capacity. The author concluded his findings by presenting an analytical framework based on what he refers to as the "vigorousness and autonomy" model of local democracy, which explains local government development under a centralized unitary system. This model can be used by developing countries in reexamining their respective local government systems.

Introduction

The purpose of the study is to explain the impact of the decentralization reform on local governance in a unitary state. To understand the magnitude of recent institutional changes in central-local relations, it is useful to compare the institutional configuration before and after the decentralization reform in Japan.¹

The *Packaged Act of Decentralization of 2000*, which was carried into effect on 1 April 2000, generated drastic changes in central-local relations, reducing central government's commitment to provision of public services at

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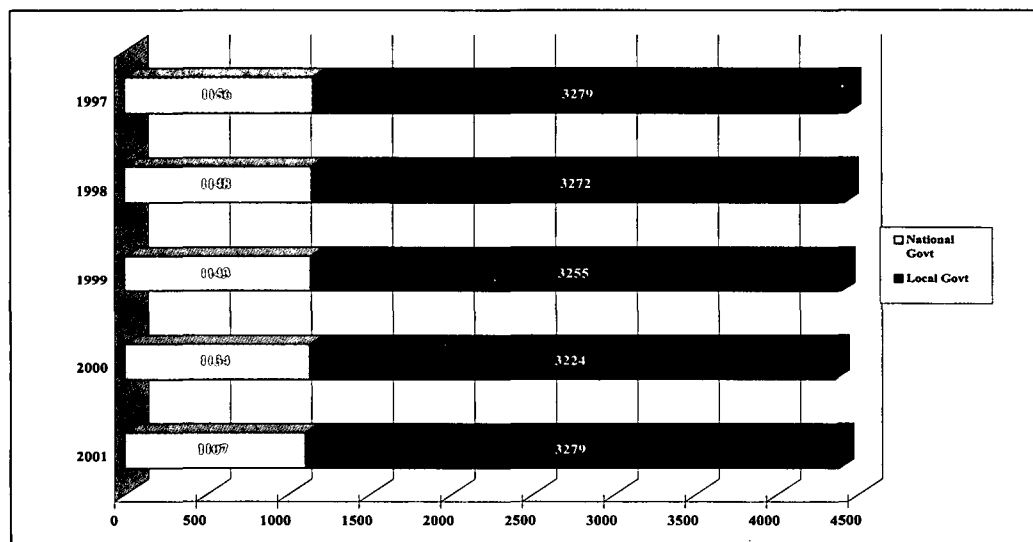
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the local level. Under the new system, local authorities are now expected to take the initiative in making and implementing public policies, although they still cooperate with central ministries in the policy process to some extent. Thus, the decentralization reform of 2000 in Japan can be regarded as the reform to give local government greater policy autonomy from central government in delivering public policies.

Interestingly, however, one of the most important advocates of decentralization recognized, before the decentralization reform, that Japan had achieved a high level of local government performance in the sense that local government played a significant role in providing a wide variety of public services (Nishio 1999: 106). Indeed, almost 75 percent of the total number of government officials was local public servants, working at local authorities, and more than two thirds of the total amount of government expenditure were spent by local authorities. In the predecentralization period, local government was so vigorous that it acquired a high level of administrative capacity (Figures 1 and 2). It can be noted that the Japanese local government system developed and flourished even under a highly centralized unitary system.

Figure 1. Trend in the Number of National and Local Government Staff



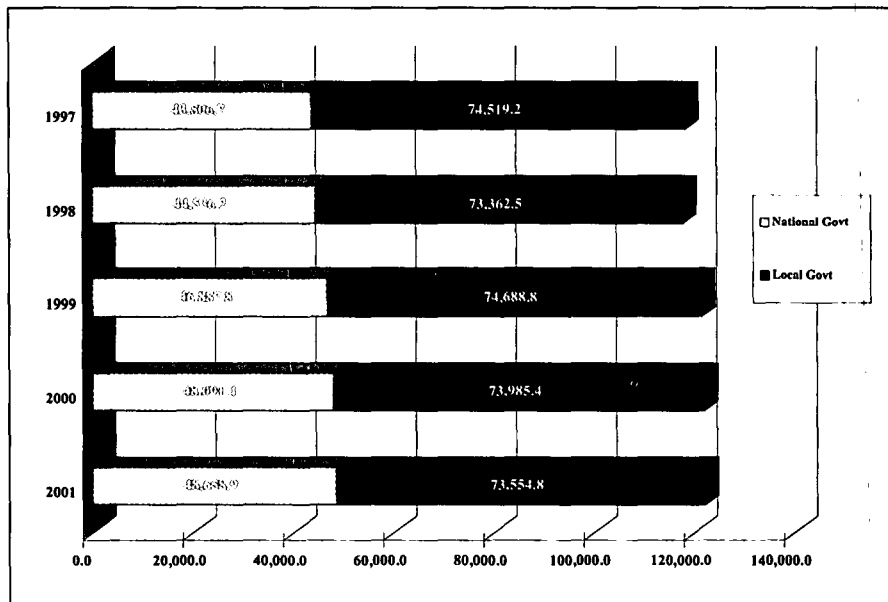
[Unit] Thousand.

Source: National Personnel Authority, *White Paper on Public Servants*, each year.

This analysis specifies recent changes produced by the decentralization reform, and also shows how the reform has affected local governance. The main points developed in the following chapters are divided into three parts.

The first part looks into the politics of central-local relations before the Packaged Act of Decentralization was brought into effect in 2000. It argues that under a highly centralized unitary system, Japanese local authorities obtained sufficient financial resources transferred from central government, and that they successfully increased their administrative capacity.

Figure 2. Trend in National and Local Government General Expenditures



[Unit] Billion yen

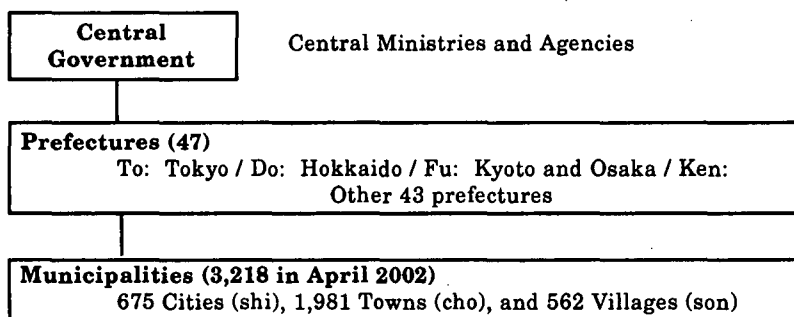
Source: (MoF 2001).

In the second part, the impact of the decentralization reform on local governance is captured. What is shown here is that, while the decentralization reform legally granted local authorities greater policy autonomy from central government, it generated serious problems that might undermine local administrative capacity. Similarly, it seems that the reform makes urban-rural cleavages salient and visible in the political scene.

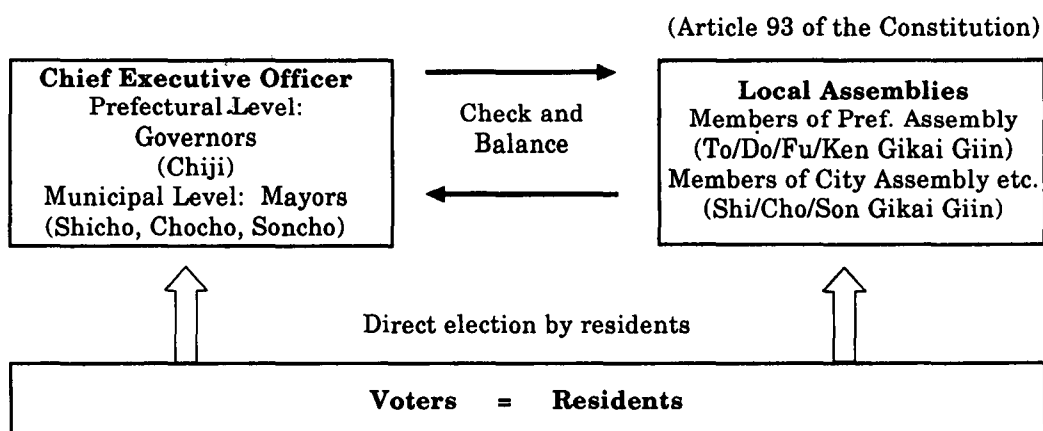
The third part offers a tentative analytical model, based on the findings of the case study. This model helps explain the development of local government under a centralized unitary system. The two-dimensional model, which is composed of "vigorousness" and "autonomy," is advanced. This generalization of the development of Japanese local government might be useful for developing countries as they reexamine the institutional design of their local government systems.

Before turning to the main topic, it is necessary to explain the fundamental framework of the Japanese local government system. The Japanese local government system is a two-tier system. The upper-tier local government is called prefectures, or "To-Do-Fu-Ken," and the municipal one called city, town, and village, or "shi-cho-son." The number of prefectures and municipalities is approximately 3,200. Basically both prefectures and municipalities have the same structure, and, according to the Local Government Act, both are legally of equal standing. The chief executive officers as well as local councilors are directly elected by residents. It can be called the "Dual Representation" system, which is quite similar to the Presidential system (Figures 3-1 and 3-2, Tables 1 and 2).

**Figure 3-1. The Japanese Local Government System
(1): Two-Tier System**



**Figure 3-2. The Japanese Local Government System
(2): Presidential System**



**"Cumul des mandates" prohibited

* Check and balance between local assemblies and executives

- Chief Executive Officers: the right to dissolve the Assembly
- Local Assembly: resolution of no-confidence.

Table 1. The Number of Municipalities in Japan

	<i>City</i>	<i>Town</i>	<i>Village</i>	<i>Total</i>
1888	0	*	*	71,314
1922	91	1,242	10,982	12,315
1947	210	1,784	8,511	10,505
1953	286	1,966	7,616	9,868
1975	643	1,974	640	3,257
1999	671	1,990	568	3,229
2002	675	1,981	562	3,218

[Note] In 1888, there were no differences among municipalities.
 Source: Data of the Ministry of Public Management, Home Affairs,
 and Posts and Telecommunications on Municipal
 Amalgamation.

Table 2. The Largest and Smallest Population of Local Government (2000)

	<i>Largest</i>	<i>Smallest</i>
Prefecture	Tokyo (12,064,101)	Tottori (613,289)
Municipalities	Yokohama (3,426,651)	Tomiyama (209)

The Paradox of Centralization: Central-Local Relations Before 2000

It has been traditionally pointed out that Japan is one of the most bureaucratically centralized states in advanced democracies. Japanese local government has been seen as faithful agents of central government. It seems helpful, to begin with, to reconsider the traditional "centralization" thesis in terms of the following two points.²

First, under the system of Agency-Delegated Functions (ADFs), directly elected governors and mayors were in a subordinate position to the central ministries concerned, and were supposed to implement the ADFs as "agents of central ministries" with no discretionary power granted. The ADFs were the functions that were to be delivered legally by central government but which were actually delivered by local chief executive officers. The growing number

of the ADFs throughout postwar Japan was paralleled by the spread of the concept of "national minimum" which means that the government should maintain the same quality and quantity of public services across the regions (Table 3).

Table 3. Number of Agency-Delegated Functions

	1952	1962	1974	1991	1994	1995
Delegated to prefectures	160	283	365	356	383	379
Delegated to municipalities	96	125	157	178	183	182
Total	256	408	522	534	566	561

[Note] The number of the ADFs is determined in the Local Government Act.

Source: Narita 1998: 38.

The ADF system was fiercely criticized by researchers and journalists for its symbolic character of centralization. For one thing, under the ADF system, local authorities were not allowed to modify the content of the ADFs to meet local demands, and were legally obliged to deliver the ADFs exactly in the way that central ministries requested them to do. What is more, local authorities were required to share expenses with central ministries concerned in implementing the ADFs. It was only central ministries that could determine the ratio of burden sharing. In some cases, central ministries impose more than half of the total costs on local government in implementation of the ADFs.

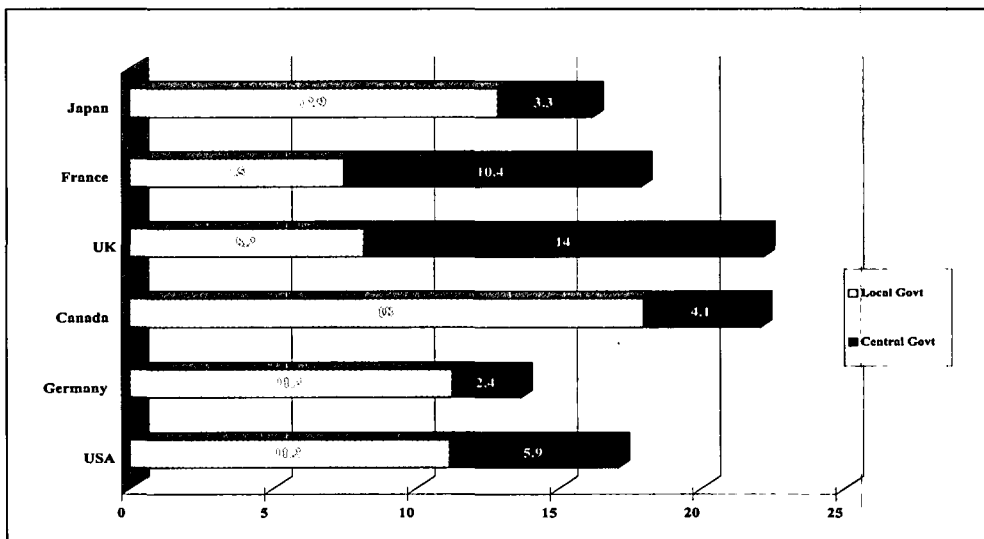
Second, the Ministry of Home Affairs (MoHA) arbitrarily and strongly controlled local government and its finances. The MoHA, which inherited bureaucratic prestige from the Ministry of the Interior under the prewar imperialist regime, was the central ministry that was exclusively responsible for local government.³ Like the ADF system, the MoHA was also criticized by researchers and journalists for some reasons. In order to control directly local authorities, the MoHA sent its candidate-executives into local authorities as administrative managers, and exercised its overwhelming power to approve the issuance of local government bonds, the creation of new local taxes, and changes in the existing tax rates. Local authorities were in an organizationally and financially subordinate position to the MoHA.

Consequently, traditional theorists reached a conclusion, from what has been said, that the Japanese local government system is underdeveloped and

even immature (Tsuji 1969, for example). They worshipped the separationist and federalist model of central-local relations.

However, the traditional theory obscures the fact that centralization does not logically lead to stagnation of local government. It cannot be emphasized too strongly that centralization might help local government develop in the sense that it raised administrative capacity of local government.⁴ Japanese local authorities have delivered a wide variety of public policies so vigorously, dealing somehow with local matters, even under a centralized unitary system (Figures 4 and 5).

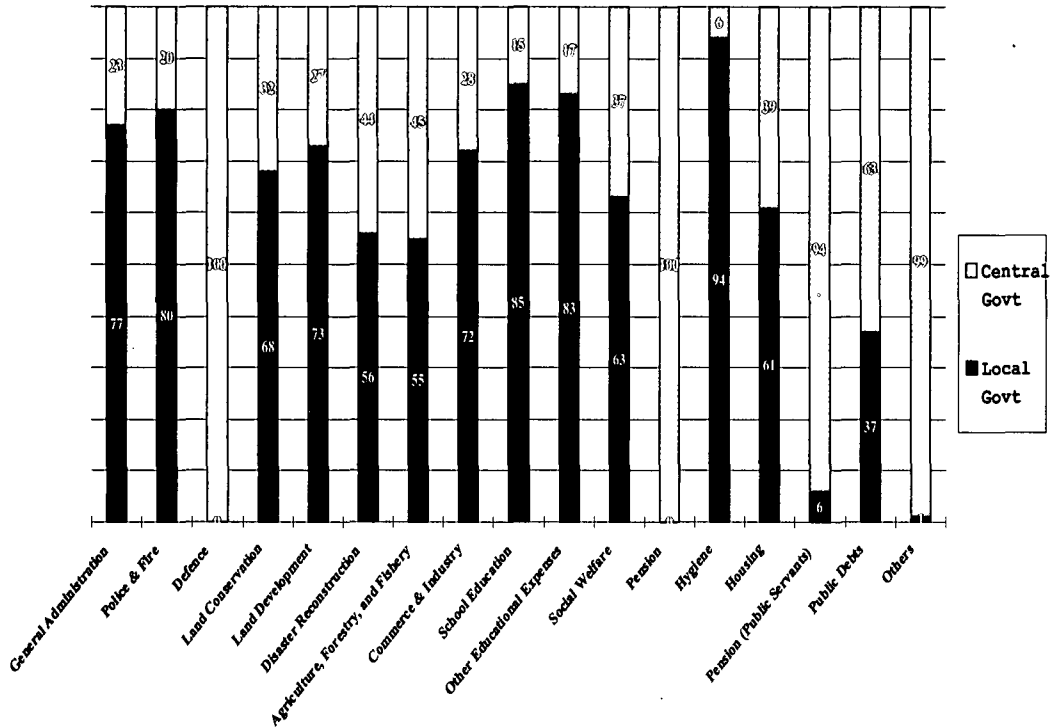
**Figure 4. The Ratio of Local Government Expenditure to Central Government Expenditure (1997)
(As a percentage of GDP)**



Source: MPHP 2002.

Why has the Japanese local government provided a wide range of public services so vigorously under a centralized system? The clue to solve the question lies in the institutional paradox that centralization has contained for a long time. Generally speaking, the more centralized system central government adopts in order to provide public services, the greater responsibilities it will take for preserving the stability of local government finance. For central government to count on the allegiance of local government in delivering public policies, it is indispensable to provide sufficient and stable funds to local government, no matter how painfully central government groaned under the weight of serious fiscal deficits. It was under a centralized government system that Japanese local authorities

Figure 5. Division of Policy Expenses between Central and Local Government, 2000



Source: MPHP 2002.

enjoyed an increase in fiscal transfers in spite of serious fiscal deficits at the central level.

Reconsidering further the Japanese local government financial system from a different angle, can illuminate the very complex relations between central and local government in Japan. It might be unreasonable that local authorities were required to implement the ADFs, which were basically assigned to central ministries concerned, and also to share a certain part of their implementation costs. Looking more carefully into the financial problems, however, central government substantially financed local spending on the ADFs by raising the amount of the Local Allocation (Tax) Grant, an unconditional lump-sum grant or a general grant. In other words, although central government did not always cover each specific expense of implementing the ADFs, it increased the amount of the Local Allocation Grant to finance the total implementation costs.

It is also true that the MoHA financially controlled local authorities. Local government has been dependent on central government in making an annual estimate of its revenues. Thus, there have been strong criticisms among scholars concerning financial subordination of local authorities to the MoHA. But, paradoxically, the encroached local financial autonomy assumed greater responsibilities of central government for guaranteeing stable financial resources. In making the annual Local Finance Plan at the national level, the MoHA must cover the decreasing revenue sources of local authorities.⁵ The overwhelming predominance of the MoHA had led to the financial stability of local government under the financial crisis.

From the viewpoint of local accountability, the MoHA, while it assured local authorities of necessary financial resources, monitored efficient provision of public services by local authorities. The Local Public Finance Bureau of the MoHA played an important role in providing various guidelines for cost-cutting and rationalizing local expenditures, which improved local governance.⁶

It should be fairly noted, as we have seen, that the MoHA was not just an oppressive ministry of centralization. The MoHA had been legally granted exclusive power to make the Local Finance Plan, which successfully made local interests reflected in the national policymaking and repulsed the attack by the Ministry of Finance (MoF). It is worthwhile examining the bargaining process between the MoHA and the MoF over local government finance from the late 1970s to the early 1980s more closely (Kitamura 1999; 2000a).

During the period between 1975 and 1984, central government in most advanced democracies groaned under the weight of serious fiscal deficits. Confronted by the financial crisis in the late 1970s, it inevitably attempted to curtail the amount of general grant to local government. On the contrary, the Japanese central government even increased the amount of the Local Allocation Grant to local government, by issuing deficit bonds. As a result, among advanced democracies, it was only in Japan that the financial debts deteriorated at the central level.

MoHA strongly requested MoF to raise the amount of the Local Allocation Grant. The MoF, which was seen as the most prestigious and influential ministry in Japan, immediately rejected the request of the MoHA in terms of macroeconomic management. Fiercely opposing the MoHA, the MoF insisted on the curtailment of public spending with no exception, under the serious fiscal crisis. In the budgetary game, the MoHA was the agent of local government at the national level, while the MoF was the guardian of national interest.

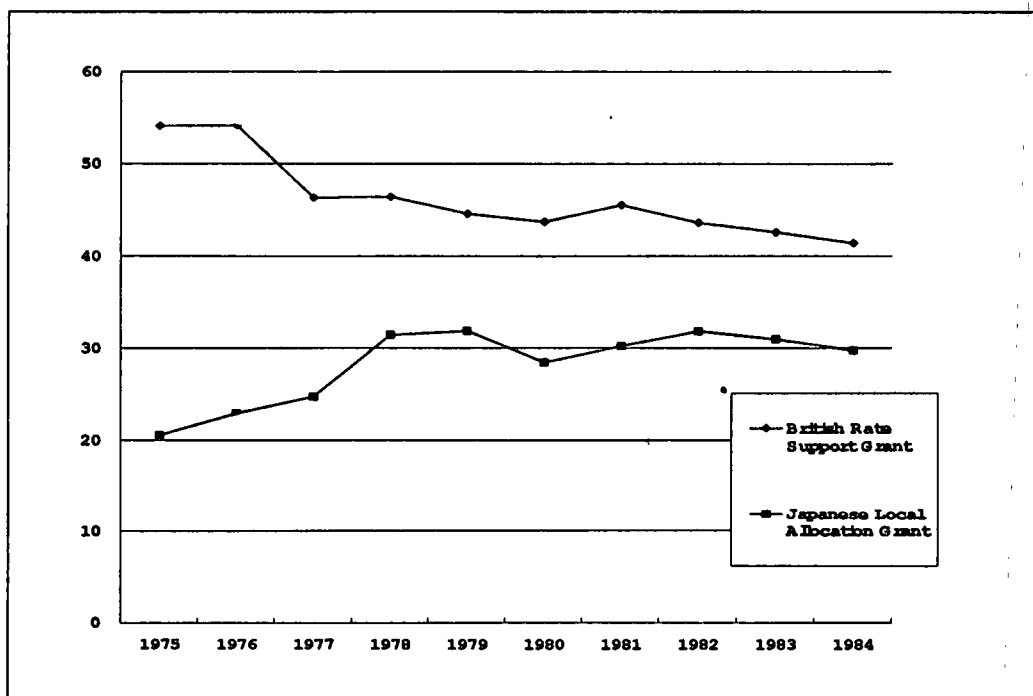
The MoHA defiantly argued against the MoF that it was unreasonable for central government to curtail the transferred financial resources, while it forcefully imposed its implementation of central functions on local government through the ADFs system. The MoHA stressed again and again that central government delegated implementation of central functions, such as social welfare, education (including 9-year-long compulsory education), road construction, and fire protection, to local government.

In addition, the MoHA strategically formed a "spending coalition" with other spending ministries like the Ministry of Construction on the one hand, and implicitly asked the ruling politicians to settle the problem, when necessary, on the other. The ruling Liberal Democratic Party (LDP) was not the "fair arbitrator," as it took advantage of malproportional allocation of Diet-members' seats in favor of rural and poor areas. The LDP had no political option to accept the curtailment of the Local Allocation Grant, which would inevitably lead to retrenchment of daily public services in rural areas, like social welfare delivered by local authorities. As a result, overwhelmed by strong opposition, the MoF reluctantly satisfied the MoHA's claims for a substantial increase in the Local Allocation Grant by issuing deficit bonds.⁷

It is helpful here to look carefully into the British case from a comparative perspective in order to illuminate the point being considered (Rhodes 1988; Stoker 1991). Britain has been seen as an institutionally typical state of a parliamentary governmental system and a centralized unitary system, like Japan. In the late 1970s, Britain also suffered from serious fiscal deficits, and Her Majesty's (HM) Treasury attempted to curtail public expenditure, responding to the strong International Monetary Fund recommendation. Before going forward to a detailed analysis of the British case, it is outlined here that the Treasury succeeded in curtailing the amount of the Rate Support Grant, a general grant to local authorities, unlike the Japanese Ministry of Finance (Figure 6).

Why did the HM Treasury successfully curtail the Rate Support Grant? The answer can be found in the institutionally separationist system between central and local government. The first point is that British local authorities enjoyed almost full financial autonomy. They claimed a right to vary the local tax rates independently. Central ministries had their own branches at the local level to deliver their own functions. There were no institutional relationships between local authorities and local branches of central ministries. It meant that central ministries had almost no interest in local government. The second point is that the Department of the Environment (DoE) had a wide variety of responsibilities such as public works, environmental regulations, transport, railways, and local government.⁸ The responsibility for local government and its finance was merely one of the responsibilities the DoE had. Even inside the DoE, there were not a few "veto

Figure 6. Japanese Local Allocation Grant and British Rate Support Grant 1975-1984



Note: Total local revenue in 1975 equals 100 in each country, adjusted by inflation rates.
Sources: MoHA various years (JPN); CSO various years (UK).

points" that prevented a group of topocrats of the DoE from reflecting local interests in the ministerial policymaking.⁹ The third point is that the DoE had no such exclusive power to make the aggregate local finance plan at the national level. On the contrary, the Treasury seized the initiative in making the local finance plan at the Consultative Council on Local Government Finance. Thus, the amount of the Rate Support Grant was easily curtailed in Britain, which then led to retrenchment of public services at the local level in the early 1980s.

The contrast between Japan and Britain concerning the local government finance reveals that a high degree of local autonomy does not always have a positive impact on the development of local government, while a low degree of it does not have a negative impact on that local government. It seems that there lies a paradox in a centralized unitary system that, the stronger ministry for local government there is at the central level, the more effectively the development of local government might be promoted.

Japanese local authorities were less autonomous in terms of introducing new local taxes and issuing local bonds. They were under the control of the MoHA. Paradoxically, however, the MoHA strongly felt responsible for guaranteeing financial resources for local authorities to make them implement faithfully central functions at the local level. In the budgetary game at the central level, backed by the other spending ministries and ruling politicians, the MoHA succeeded in an increase in the amount of the Local Allocation Grant in order to fill the gap between the decreasing tax revenues and the increasing expenditures. It can be said that the MoHA played an important role in institutionalizing and stabilizing vigorous local government in Japan.

Japanese local authorities provide residents with a wide variety of public services that are indispensable for their daily lives, such as social welfare, education, hospitals, public transports, and so on. Guaranteed stable financial resources, local authorities across the country successfully enhanced community welfare, in spite of the fact that tax revenue sources are scattered so unevenly that most of them are still financially vulnerable to economic fluctuation, particularly in the rural areas.

Moreover, as local authorities delivered many central functions as the ADFs, they radically improved their administrative capacity. At the early stage of economic development, local authorities did not hesitate to rely totally on central officials sent by central ministries, as they lacked policy expertise. However, as the Japanese universities like the University of Tokyo and University of Kyoto produced well-trained graduates year after year, local authorities gradually recruited them and replaced central officials with locally recruited officials. It can be noted that large authorities, in particular, are not inferior to central ministries in terms of administrative capacity. Some local authorities, like Mie Prefecture, are famous in unveiling new policies in advance, anticipating the new age.

Consequently, under a centralized unitary system, cooperating with central ministries in delivering public services, Japanese local authorities were able to improve their vigorousness, which led to their acquisition of administrative capacity. It can be stressed here again that, as local government raised administrative capacity, it was ready to accept more responsibilities under the decentralization reform in the late 1990s (Table 4).

Table 4. Local Government Finance in Japan and the United Kingdom, 1975-1984

	<i>Japan</i>	<i>United Kingdom</i>
National political system	*Parliamentary Cabinet system *Unitary system (supremacy of Parliament/Diet)	
Public finance	Serious fiscal deficits, particularly since 1975	
Central ministry responsible for local government	* Ministry of Home Affairs (MoHA) - Specified responsibility for local government - Exclusive power to make the Local Finance Plan	* Department of the Environment - Wide variety of responsibilities (public works, environment) - Overwhelming power of HM Treasury in making local government finance plan
Local financial autonomy	Limited (MoHA control)	Autonomous tax varying power
Local government's deficits	Increase in the amount of the Local Allocation Grant - stable provision of public services	Curtaiment in the amount of the Rate Support Grant - retrenchment of local public services

The Paradox of Decentralization: Turbulence in Local Governance since the Decentralization Reform

Internationalization and Decentralization

Internationalization has affected domestic configuration of interests, which, in turn, led to the government reform (Jun and Wright 1996; Keohane and Milner 1996; Levy 1999). Policymakers in a unitary state redesign the government system. The Decentralization Reform of 2000 in Japan can be understood in this context.

First, the business community preferred decentralization in the early 1990s. Completing corporate decentralization triggered by internationalization in the 1980s, most large companies became increasingly sensitive to economic opportunities at the regional and local level. It was unendurable for companies to wait for a permit to construct the factory, for instance, from Tokyo. It took a long time, approximately one year, to get permits from concerned central ministries in Tokyo. Under the system of the Agency-Delegated Functions, nothing can be legally done at the local level without

official permits issued by central government. As the business community demanded quick decision, it strongly requested central ministries to decentralize their power to local authorities.

Second, since the early 1990s when local government finance fell into crisis again, local government preferred the decentralization reform in order to attract external investment. For local authorities to respond to companies' demands immediately, they needed the missing ingredient, that is, local autonomy. Under the ADF system, local government was unable to make a quick decision at the local level, as it was obliged to submit matters for the approval of central ministries in Tokyo. It was not until the 1990s that local government regarded the ADFs as a dysfunctional system.

Consequently, the business community and local authorities formed a "coalition" supporting the decentralization reform, particularly demanding the abolition of the ADF system. Confronted with the strong demand from two important political power bases, the ruling LDP carefully carried out the decentralization reform, delegating to academic researchers the power to make a series of reform plans and recommendations.¹⁰ As a result, the Packaged Bill of Decentralization, which consisted of more than 500 individual measures, was finally approved in July 1999. The Packaged Act of Decentralization was then carried into effect on 1 April 2000. The ADFs in the existing 351 measures were completely scored out (Figure 7 and Table 5).

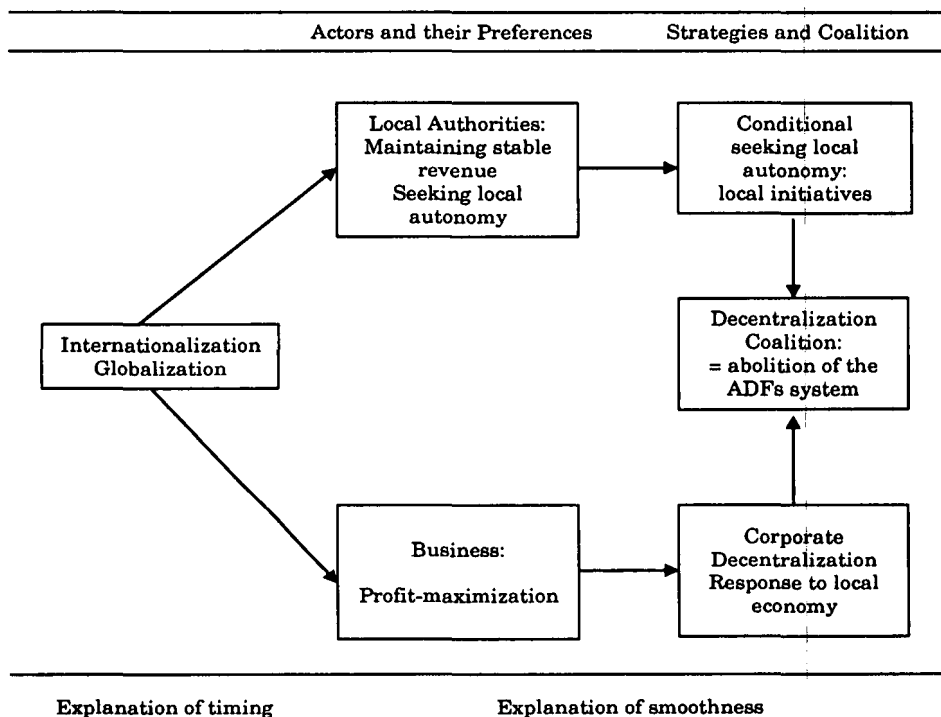
The point to remember is, therefore, that the decentralization reform in 2000 was intended to enhance the autonomy of local government from central government.

Impacts of Decentralization

The *Packaged Act of Decentralization* changed the institutional arrangement of central-local relations. First, as we have seen, the system of the ADFs was abolished.¹¹ Half of former ADFs are called "Locally Proper Functions," which are completely devolved to local government. The others are "Legally Entrusted Functions," which local government is expected to implement on behalf of central government and yet on the basis of equal consultation between central and local government.

Second, the system of "supra-legal tax" was institutionally expanded. The Amended Local Taxation Act in the Packaged Act enables local authorities to introduce the new tax, besides the legally defined tax items, through consultation with the Ministry of Public Management, Home Affairs, Posts and Telecommunications (MPHP is the organizational descendant of the MoHA since 2000). The Amended Local Tax Act created the new "Earmarked supralegal tax"

Figure 7. Coalition Formation in the Politics of Abolition of the ADFs System



system, in addition to the existing “Ordinary supralegal tax.” The MPHP is legally tasked to approve proposals of local authorities to introduce the supra-legal tax, with the exception of only three cases defined in the law.¹²

This portion of the study considers the decentralization impact on local governance by focusing on the three current issues in the Japanese political scene: a curtailment of the Local Allocation Grant, a burst of supra-legal tax plans, and municipal amalgamation. Before turning to a closer examination of the impact of the reform, it can be summarized that, since the decentralization reform in 2000, local government has encountered political and administrative turmoil that it had never experienced before 2000.

First, confronted with the serious fiscal debts in the public sector, the Japanese central government ultimately decided to reduce the total amount of the Local Allocation Grant in June 2002 (Figure 8). Since the decentralization reform was delivered, it has been an open secret that the Local Allocation Grant system might be in crisis. The giant MPHP can no longer be expected to be a guardian of local government in determining the total amount of the Local Allocation Grant, and other spending ministries have less and less interest in local government.

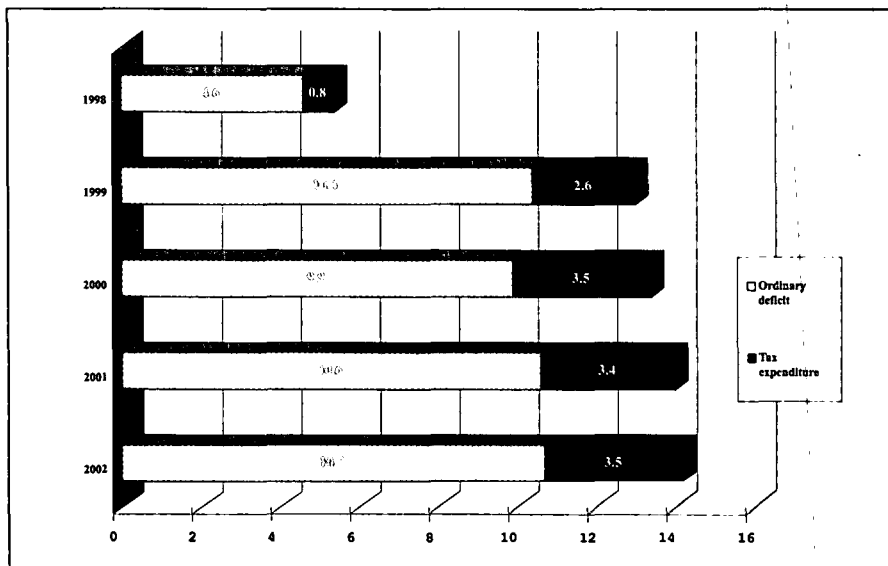
Table 5. Chronological Table of the Decentralization Reform in the 1990s

How did the business-localities coalition, or the so-called "Decentralisation Coalition" achieve the abolition of the ADFs system?

<i>Year</i>	<i>Cabinet (Parties)</i>	<i>Events</i>
July 1993	Miyazawa (LDP)	Unanimous Resolution of the Promotion of Decentralization in the Diet
October 1993	Hosokawa (8 Parties)	Final Report of the Government Advisory Council of Administrative Reform (AR)
May 1994	Hata (5 Parties)	Decentralization Committee (DC) in the Headquarters of AR
September	Murayama (LDP, SDP, Sakigake)	Proposal for the Promotion of Decentralization (PPD) "local general will"
November		DC's Working Paper on Decentralization
December		Cabinet Decision on General Principles on Decentralization
May 1995		Promotion of Decentralization Act (5 years validity)
July		The Committee for the Promotion for Decentralization (CPD), (Chairman, Mr. Ken Moroi)
December		Tentative Plan of the CPD
March 1996	Hashimoto (LDP, SDP, Sakigake)	CPD: Interim Report on Decentralization
April		CPD: Workshop on Administrative Institutions
May		CPD: Workshop on Local Government Finance
October		CPD: Draft on the total decentralization reform
December	Hashimoto (LDP, SDP, Sakigake)*	—Start of Group Hearings and Negotiating—
January 1997		CPD: the First Recommendation Report (Abolition of the ADFs system)
July		CPD: Workshop on local institutions
September		CPD: the Second Recommendation Report (Local government finance system)
October		CPD: the Third Recommendation Report (Abolition of the Government local officers)
May 1998		CPD: the Fourth Recommendation Report (Mediation central-local disputes)
June		Cabinet Decision on the First Decentralization Plan
August	Obuchi (LDP)	CPD: the First Draft on Public Works
September		CPD: the Second Draft (Public Works)
October		The LDP's subcommittee on Decentralization in the Construction Committee
November		CPD: the Fifth Recommendation Report (Public Enterprises)
March 1999	Obuchi (LDP, Liberal Party)	Packaged Bill on Decentralization (PBD) (475 in total)
May		Cabinet Decision on the Second Decentralization Plan
June		PBD submitted to the Lower House
July		PBD passed and sent to Upper House
April 2000	Obuchi (LDP, Liberal, Komei)	PBD passed and enacted in the Upper House
		Enforcement of the Packaged Acts of Decentralization

*The SDP and Sakigake supported the Second Hashimoto Government outside the Cabinet during the period between December 1996 and July 1998. On 1 April 2000, the Liberal Party split into the two groups, one of which, led by Mr. Ichiro Ozawa, left the Government.

**Figure 8. Local Government Deficit
(Local Finance Plan, 1998-2002)**



[Unit] Trillion yen.

[Note] If the national income tax rate were reduced, the local residents' tax is automatically to be reduced.

Source: MPHP, Local Finance Plan, each year.

The current Koizumi government attempts to break with the political taboo. In the package of the Koizumi Structural Reform, the curtailment of the amount of the Local Allocation Grant draws public attention, as Prime Minister Jun'ichiro Koizumi himself declared it was one of the main curtailment targets (House of Councilors on 21 May 2001). The Council of Economic and Fiscal Policy (CEFP) chaired by the Prime Minister reached a controversial conclusion that the principle of curtailment in total public spending should be applied to the Local Allocation Grant without exception. On 21 June 2002, the CEFP published the document "Basic Principle on Economic and Fiscal Policy, and Structural Reform 2002," to unveil the principle. Then the full Cabinet meeting formally endorsed the CEFP's decision on 21 June that the total amount of the Local Allocation Grant should be substantially curtailed, although the latest Local Finance Plan is estimated to be in deficit by 14 trillion yen in FY 2003.

The shift of local government finance policy means the end of the "convoy system" in a world of local government, which enabled smaller local authorities to deliver public services at the same level of larger ones in the urban areas. In Japan, like Britain, macroeconomic policy of curtailment in deficit spending at the central level has precedence over stable provision of public services at the local level. Since the decentralization reform, spending

ministries have had less concern about defending local interests at the central level, and even the MPHP, which is responsible for local government, has been gradually less affectionate to local authorities than what the MoHA used to be before the reform.

The second issue is a boom of local taxation schemes (Table 6). With the growing disillusionment with the system of the Local Allocation Grant, local authorities intentionally began to explore the tax sources inside its jurisdiction. The "supralegal tax" system provided good institutional opportunities for local authorities to raise their revenue. Many local authorities, both prefectural and municipal, unveiled the earmarked supra-legal taxes, such as a supermarket's nylon bag tax, a fishing tax, a hotel tax, an industrial waste tax and so on. Most local taxation schemes have common targets: non-residents, like visitors, tourists, and nationwide large companies.¹³ Local authorities attempt to minimize transaction costs in levying a tax on residents. The first earmarked supralegal tax is the "visiting-fishers tax" of three municipalities on the lake Kawaguchi in 2001, which visitors must pay in order to enjoy fishing in the lake. The "hotel-guests tax" of the Tokyo Metropolitan government in 2001 also targeted the hotel guests as taxpayers. Kawaguchi municipalities and Metropolitan Tokyo strategically avoided taxation on their residents for political reasons.

Table 6. The Taxation Plans at the Prefectural Level (May 2002)

<i>Prefecture</i>	<i>Taxable Item</i>
Hokkaido	Automated Teller Machine Pachinko (Gambling Machines)
Miyagi	Pleasure Boats
Tokyo	Hotel Guests
Yamanashi	Mineral Water
Mie	Industrial Waste
Shiga	Jet Skis on the Lake Biwa
Tottori	Drinkers of Public Water (namely, almost all residents)
Kagawa	Eaters of Japanese Noodle UDON
Kagoshima	Climbers of Mt. Yaku

Source: *The Asahi Newspapers*, Tuesday, 28 May 2002.

Although many local authorities throughout the country enthusiastically unveiled the new supralegal tax policy, they did not expect its revenue-raising effect. It is important to note that the supralegal tax annually raised less than one percent of total revenue of each local authority. For example, the revenue

generated by the industrial waste tax of Mie is estimated to be approximately 0.4 billion yen, while the total revenue of Mie Prefecture annually amounts to 840 billion yen. The transaction cost of collecting a new tax exceeds the benefit of introducing it.

Furthermore, taking into consideration the fact that tax revenue sources are basically scattered unevenly throughout the country, it is almost impossible for local authorities in rural areas to introduce a new tax and/or to raise existing tax rates. Ideally, in terms of enhanced local autonomy, local government spending should be covered by its own tax revenue and its own bonds as much as possible. However, if the Local Allocation Grant system does not work well and local authorities are forced to collect local taxes, imbalance among local authorities will be seriously expanded. Some local authorities in rich and urban areas will enjoy full public services, while other authorities in poor and rural areas will be forced to curtail public spending on basic human services and even to abandon provision of public services at the "national minimum." The gap between the urban and rural standards of public services will widen soon, which will bring about poor performance of local government in providing basic public services and will also make local government vulnerable to economic fluctuations.

The third issue being discussed seriously is municipal amalgamation. Municipal amalgamation is expected to increase the efficiency of provision of public services. This helps cause the curtailment of the number of local officials and the budget. Under the amalgamation, several municipal offices will be merged into a single office, and many municipal branches will be closed. Thus, streamlining the way of delivering public services at the local level will be accomplished through municipal amalgamation. Particularly, some municipal authorities in the mountainous or fishing areas, confronted with serious fiscal deficits and debts, began to negotiate with neighboring authorities over amalgamation.

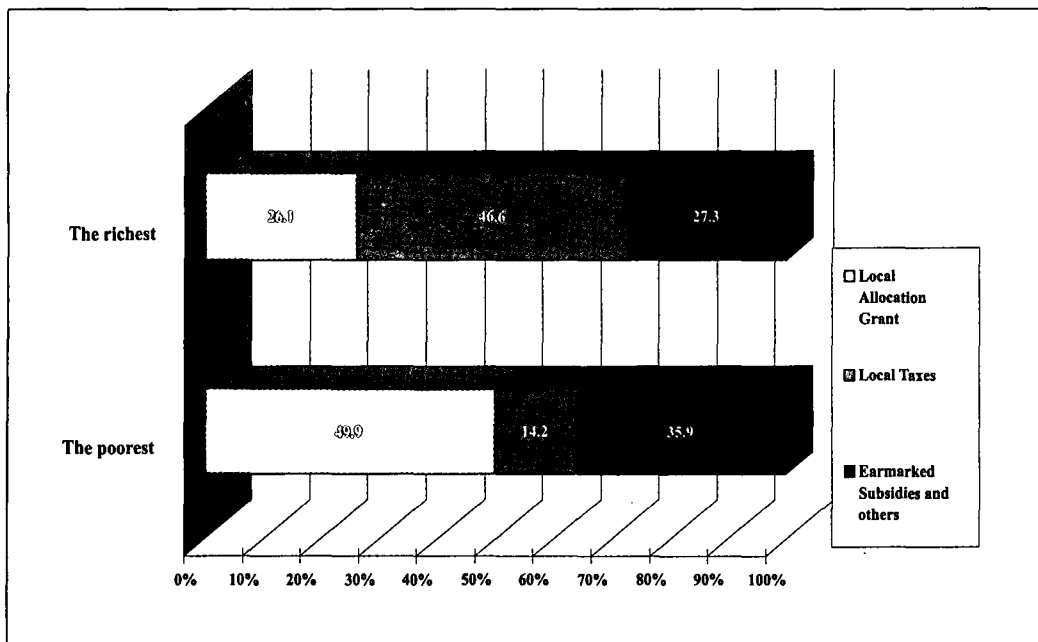
But, the fact that can hardly be ignored here is the physical and psychological distance between the local government office and residents. In an amalgamated local authority, the local government office, including a local assembly, will be remote from its residents.¹⁴ Although the administrative boundary could be changed through municipal amalgamation, the natural boundary could not be changed. The natural boundary such as a river and ridge, physically and psychologically divides the range of people's economic and social activities. Even after amalgamation, several local branches might be needed to meet local needs, which offset the benefits of amalgamation. In this case, fiscal deficits of local authorities will further deteriorate.

There is another concern about municipal amalgamation in terms of local democracy. As local government becomes larger in terms of its spatial size, local residents might make less commitment to local government. It is very

probable that they feel less identified with a larger local community created by amalgamation. The social capital theory suggested that institutional performance of local government would drop off without a close linkage or network in the community (McKay 1996; Putnam 1993, 2000).

Decentralization, which makes local government more autonomous, will gradually cause disputes and conflicts among local authorities. In particular, serious cleavages have emerged among local authorities. The poor local authorities have come into antagonism with the rich ones, and the urban authorities have been confronted by the rural ones. If financial resources transferred from central government were to be drastically reduced, small towns and villages in an underpopulated and underdeveloped area could no longer implement basic public policies like compulsory education at the "national minimum" (Figures 9 and 10). As a result of the decentralization reform, such cleavages are becoming politically salient.

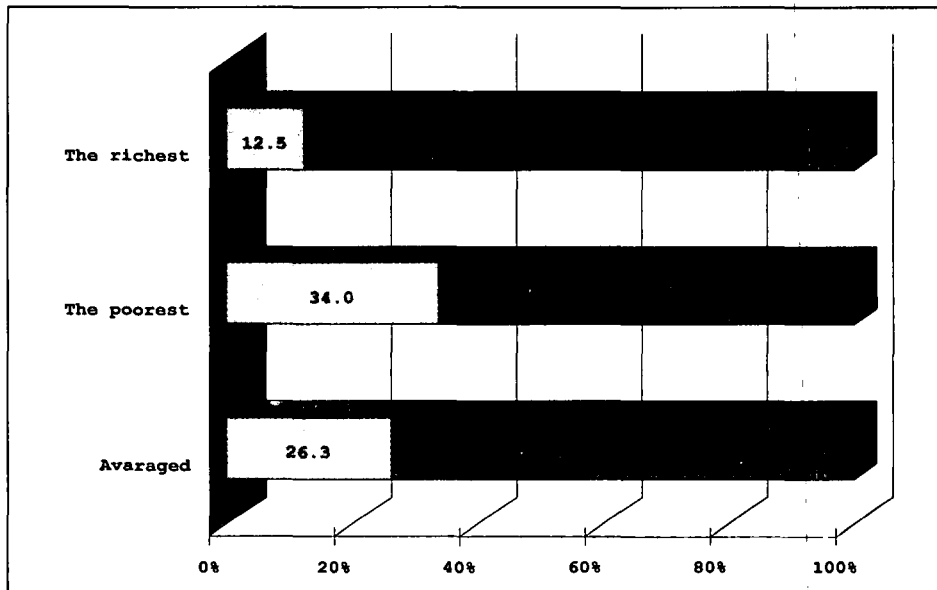
Figure 9. The Gap in the Ordinary Revenue Sources among 47 Prefectures (2000)



[Note] The richest prefectures are Aichi, Kanagawa, and Osaka, except for the Tokyo Metropolitan Government. The poorest prefectures are Wakayama, Miyazaki, Tokushima, Akita, Okinawa, Tottori, Shimane, and Kochi.

Source: MPHP 2002.

Figure 10. The Gap in the Ordinary Revenue Sources among Towns and Villages (2000)



[Note] The richest municipalities mean those whose population is more than 35,000. The poorest ones are those whose population is less than 3,500.

Source: MPHP 2002.

Conclusion: Dilemma Between Vigorousness and Autonomy of Local Government?

The Japanese Experience

It is widely recognized that decentralization contributes to efficient provision of public services. Under a decentralized government system, local residents will have an incentive to monitor how local government spends public funds on public services. The “monitoring” of government by taxpayers seems to be one of the key concepts in order to achieve “good governance.”

But the Japanese experiences might shed light on the other aspects of centralization as well as decentralization. In a unitary state, central government was in a powerful position to influence the subcentral government’s revenue and expenditure. With little fiscal latitude, local government depended financially on general grants and subsidies from central government. But the evidence from the past several decades suggests that, under a centralized unitary system, central government guaranteed stable financial resources to local government, even in the period of serious fiscal deficits, in a very paternalistic way. The guarantee of financial resources to local government substantially enabled it to deliver a wide

variety of public services. In the long run, it is not rational for central ministries to impose the "unfunded mandates" on local authorities, as long as they expect local authorities to implement faithfully central functions.

Paradoxically, the intertwined central-local relations in Japan obliged central government to cover a huge deficit of local government. Local authorities which attempted to make local interests reflected in the central policymaking process emerged, by making most of the asymmetry of information between the center and the localities. Local authorities aggregated pieces of information necessary to make and implement public policies. With no doubt, Japanese local government has been vigorous, and it subsequently obtained a high level of administrative capacity.

On the contrary, under a highly "decentralized" government system, local government would make policy decisions independently. It would enjoy a high level of policy autonomy from central government. But, it is most unlikely that central government would transfer sufficient funds to local government under serious fiscal deficits. Central government would have little interest in autonomous local government.

*A Two-Dimensional Model for Local Democracy:
Vigorousness and Autonomy*

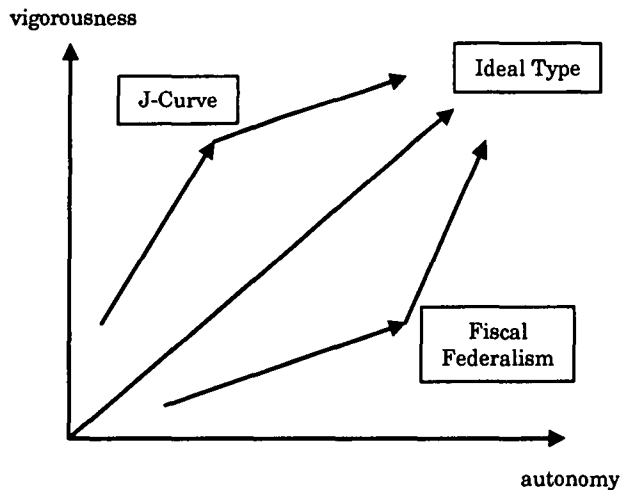
The theory of fiscal federalism suggests that "good governance" will be achieved by devolving central functions and transferring tax sources to sub-central government. It is also argued that, the more autonomous local government becomes in delivering public services, the more efficiently it will provide local public services under the monitoring of local residents as taxpayers.

As we have seen, however, the Japanese experience throws doubt on remedies of fiscal federalism at the early stage of modernization. The development of Japanese local government implies that top priority should be given to administrative capacity of local government. It is important to make local government deliver a wide variety of public services under the control of central ministries in institutionalizing local government. The more vigorous local government becomes in the provision of public services, the higher capacity it obtains. If confronted with the rising demand for decentralization after achieving modernization, central government will then undertake the decentralization reform.

Theoretically, there are two dimensions in considering the developmental paths to "ideal" local government. One dimension is "vigorousness" of local government, which indicates the degree of local

government's commitment to the provision of public services. The purely vigorous local government would acquire a high level of administrative capacity, through delivering a wide variety of public policies. The other dimension is "autonomy" of local government from central government, which specifies the degree of local government's discretionary power. The purely autonomous local government could pursue its own interest in making and implementing any area of public policy within its jurisdiction, completely free from central interventions. In the two-dimensional model, "ideal local government" can be defined as one at the high level of both vigorousness and autonomy (Figure 11).

Figure 11. The Vigorousness and Autonomy Model: Developmental Path to "Ideal" Local Democracy



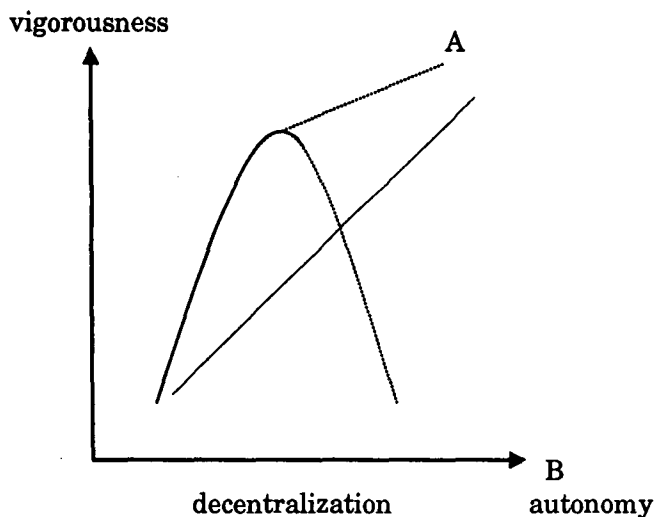
This study posits the following three paths available to central policymakers in the developing countries. It is ideal to follow a linear developmental path to an ideal situation by raising vigorousness and autonomy simultaneously. It is often said that international organizations like the United Nations Development Program suggested to the developing countries that they should give priority to local autonomy first. It is also said, however, that in some developing countries without a strong state, radical decentralization strengthens the patronage of traditional local elites, which increasingly causes inequality, inefficiency, and corruption.

On the contrary, the Japanese experience might stress "vigorousness first and autonomy second."¹⁵ Japanese local authorities have gradually raised vigorousness by cooperating with central ministries in delivering a wide variety of public services. Furthermore, they have also acquired policy

expertise and skills by accepting brilliant central bureaucrats and later by succeeding in the recruitment of young graduates of the most prestigious universities. In the late 1990s, when local authorities acquired sufficient administrative capacity, they strongly requested central government to deliver the decentralization reform, and they finally won the drastic reform to increase local autonomy. The remedy for developing countries in the institutional design of local government is, therefore, to raise administrative capacity by making local government vigorous under the supervision of central government, and then to devolve central functions to local government if people wish the reform.

At the present stage, however, it is fair to say that Japan stands at the crossroads (Figure 12). In institutionalizing local democracy, Japan might be able to present an institutional option other than fiscal federalism to the developing countries, which is "Vigorousness first under the supervision of central government, and policy autonomy second after reaching a certain level of vigorousness." However, Japan might present just a trade-off between vigorousness and autonomy of local government. The more autonomous local government becomes after the decentralization reform, the less vigorous it might be in delivering public services. It is very probable for them to decrease the degree of vigorousness as a result of raising policy autonomy from central government. In this case, it depends on people's choice as to which should be stressed. Some countries would stress local autonomy from central

Figure 12. Two Possible Scenarios of Japanese Local Democracy



(Path A or B?) At this moment, no one can predict which way Japanese local democracy will develop.

government and others would stress a stable revenue source that enables local government to deliver vigorously public policies with no troubles.¹⁶

Endnotes

¹ To discuss why decentralization reform occurred in Japan is beyond the scope of a brief study. In this study, based on the author's previous study, the explanation to the question can be mentioned only summarily (Kitamura 2000b).

² As Muramatsu acutely pointed out, it is totally false and irrelevant to argue that the Japanese local government system was labeled as a highly centralized type without taking into consideration the political channel between the center and localities (Muramatsu 1988;1997). Most of us would accept the importance of political influence local politicians have had on the national policymaking process. What this study would like to stress is however, that the institutional mechanism, which enables local government to pursue its interests, was embedded even in the administrative legal channel between the center and localities.

³ The Ministry of Home Affairs, which was established in 1961, became the Ministry of Public Management, Home Affairs, Post and Telecommunications in January 2000. The English name is too long, but it reflects its wide range of responsibilities.

⁴ See in particular Kume's analysis of the ADFs, and also see Inatsugu's research on staff transfers (Kume 2002; Inatsugu 2002).

⁵ The Local Finance Plan comprised the budgetary plans of 3,200 local authorities, which can be seen as the total aggregate budget of local government.

⁶ Over the past decade, a considerable number of studies were made concerning local or urban governance in Japan. However, little attention has been paid to the fact that the central government monitors local government. In case local government still receives a large amount of grants and subsidies from central government even under a decentralized system, central government must take responsibility for monitoring how local government spends on public services, together with local taxpayers, to ensure "good governance."

⁷ Moreover, the Ministry of Finance was required to purchase deficit bonds issued by local authorities and to pay the interest of local bonds.

⁸ The DoE was created in 1970 under the Health government and was seen as the "giant department" or "dinosaur." Since 2001, the newly created Department of Transport, Local Government, and the Regions has been responsible for local government and its finance. The fact that the responsibility for local government is one of the responsibilities inside the giant ministry has not been changed.

⁹ See Beer 1978 for a concept of "topocrats."

¹⁰ The decentralization reform pleased both the business community and local government on the one hand, and discouraged the central ministries and the ruling politicians who relied in making and implementing their policies on the other. For the LDP leaders, it was politically important to deliver the reform while not incurring bureaucrats' rancor against the LDP.

¹¹ The number of functions local government must deliver after decentralization is the same as what it used to be under the pre-decentralization system. The changes lie in who takes the initiative in the policy process.

¹² The Amended Local Taxation Act states that the MPHP shall reject the following local tax proposals: (1) extremely high tax rates; (2) impeding of the mobility of goods and capitals across local jurisdiction; and (3) contradicting the national economic policies.

¹³ The exceptional case is the industrial waste tax of Mie Prefecture, carried into effect in April 2002. The Prefecture targeted the corporate residents within its jurisdiction, like large chemical companies and small and medium sized companies as main taxpayers.

¹⁴ One of the difficulties in municipal amalgamation is to decide where the local government office should be located. There are disputes over it among municipal authorities. In Shiga Prefecture, for example, Moriyama city insists on using its city hall, while Yazu and Chuzu towns both consistently persist in constructing a new hall in the "center" of the three authorities. The negotiation over amalgamation of the three municipalities came to a deadlock on 27 August 2002.

¹⁵ Senior officials of the Republic of Korea admitted that the Korean government intentionally follows the J-curve in the institutional design of the local government system. (Interviewed in Japan in 2001 by Professor Michio Muramatsu of Kyoto University)

¹⁶ Ashford once argued in his comparative study of French and British central-local relations that interfused central-local relations were more appropriate in a unitary state than separationist ones. He said that, under the modern welfare state, there is a trade-off between local financial autonomy and stable revenue source, and that local democracy never existed without a stable revenue source (Ashford 1982).

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