

Regional Disparities and Reform of Local Public Finances

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I. Regional Disparities and Local Public Finances

1. The trend of regional disparities

Recently, the public's concerns over economic inequality and now regional disparity are stronger than ever. The possible indicators to measure economic disparities could be income, consumption, assets, employment and wages. To measure the regional economic gaps there are various kinds of indexes available depending upon the point of view of the problem. For example, Hatta & Tabuchi (1994) has pointed out six main causes of the unipolar concentration in Tokyo which were as follows: 1) economies of scale; 2) economies of scope; 3) economies of localization; 4) economies of urbanization; 5) centralized government system; and 6) international and regional division of labor. These six main causes have also been the primary factors of regional disparities¹. Thus, not only the economic but also political and other factors have led to the regional inequalities. However, this paper is not intended to focus on this issue, but rather to confirm the facts of recent regional disparities by using several indices.

First of all, according to the OECD, Japan ranked 24th among the 26 member countries surveyed in terms of the size of regional disparities. This result shows that the disparities in Japan are considered as the smallest among all the other countries (See Table 1).

Figure 1 shows the transition of the Gini coefficient of prefectural income per capita from 1955 to 2003. This figure demonstrates that regional gaps increased from 1955 to 1961, and then declined during

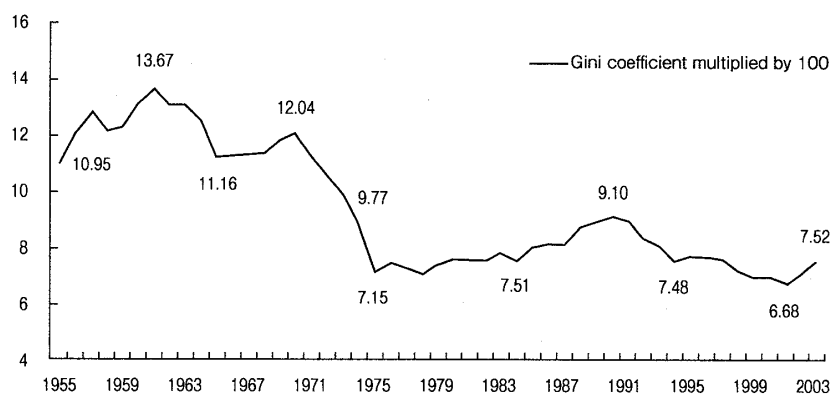
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¹ Hatta, Tatsuo and Takatoshi Tabuchi (1994), Causes of Unipolar centralization to Tokyo and its Countermeasure, in Hatta, T. (ed.), *Economic Analyses of Unipolar Centralization to Tokyo*, Nihon Keizai Shinbun Co.

Table 1 Regional disparities (2003)

	Rank	Gini coefficient of per capita GDP		Rank	Gini coefficient of per capita GDP
Turkey	1	0.27	Italy	14	0.13
Mexico	2	0.26	Germany	15	0.12
Slovak Republic	3	0.22	Spain	15	0.12
Belgium	4	0.19	Czech Republic	15	0.12
Hungary	4	0.19	Denmark	15	0.12
Poland	6	0.18	Norway	19	0.11
Korea	6	0.18	France	19	0.11
Ireland	8	0.17	Finland	21	0.10
United Kingdom	9	0.16	Netherland	21	0.10
Canada	10	0.15	Australia	21	0.10
Austria	10	0.15	Greece	24	0.09
Portugal	12	0.14	Japan	24	0.09
United States	12	0.14	Sweden	26	0.05
OECD Average					0.15

(Source) OECD, *Region at a Glance: 2007 Edition*, p.59.

Figure 1 Transition of Gini coefficient of per capita prefectural income (1956–2003)

(Source) Kaji, Yoshito (2006), *The Transition of Regional Disparities and its Background*, Reference, Vol. No.4.

the period of rapid growth of the economy until 1975, having slightly increased around 1970. After a gradual rise up to 1990 it then began

to decrease, and it has started to rise again since 2001². This result indicates that the transition of regional disparities correspond to the major stages of economic developments after World War II³.

There are many indices, except per capita income, mentioned above that can be used when verifying regional disparities. Table 2 describes a transition of population by regions. The number of people moving into the three major metropolitan areas of Japan continued to increase dramatically after World War II. However, since the late 1970s people have begun to move out of the Osaka metropolitan area, and even the Nagoya area population slightly decreased during that time. In the 1980s, the Tokyo metropolitan area was the only place where people continued to move in and showed a consistent increase in population. When looking closely at the Tokyo Metropolis

Table 2 Trend of population by regions (%)

	1975	1980	1985	1990	1995	2000	2005
Hokkaido	4.8	4.8	4.7	4.6	4.6	4.5	4.4
Tohoku	10.5	10.3	10.1	10.0	9.9	9.8	9.5
Kanto-Koshin	31.7	32.2	32.8	33.5	33.8	34.2	34.7
Hokuriku	2.6	2.6	2.6	2.5	2.5	2.5	2.4
Tokai	11.4	11.4	11.4	11.5	11.6	11.6	11.7
Kansai	16.7	16.5	16.5	16.4	16.3	16.3	16.3
Chugoku	6.6	6.5	6.4	6.3	6.2	6.1	6.0
Shikoku	3.7	3.6	3.5	3.4	3.4	3.3	3.2
Kyushu	11.1	11.1	11.0	10.8	10.7	10.7	10.6
Okinawa	1.0	1.0	1.0	1.0	1.0	1.1	1.1
3 Major Metro.Areas	44.5	44.7	45.2	45.8	45.9	46.4	47.1
Tokyo Area	23.9	24.3	24.9	25.6	25.8	26.2	26.8
Tokyo Metropolis	10.1	9.7	9.6	9.4	9.2	9.4	9.7
Nagoya Area	6.7	6.8	6.8	6.8	6.9	7.0	7.1
Osaka Area	13.8	13.6	13.5	13.4	13.3	13.2	13.2
Rural Area	55.5	55.3	54.8	54.2	54.1	53.6	52.9
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

(Note) On March 31, each Fiscal Year.

(Source) Association of Land & Geography, *Handbook of Population by Basic Inhabitant Ledger*.

2 Kaji, Yoshito (2006), *The Transition of Regional Disparities and its Background*, Reference, Vol. No.4.

3 Tanizawa, Hiroki (1998), *The Trend of Regional Disparities and Regional Development Policy*, in Hokkaido-Tohoku Finance Corporation (ed.), *Quarterly Report Tohoku*, No.50.

alone, its share of the population dropped from the 1980s to 1990s, but it has again renewed population growth since 1997, showing a unipolar concentration in Tokyo.

Based on Table 3, the unequal regional economic development

Table 3 Trend of unemployment rate and effective ratio of job openings to job applicants (% , people)

	1970	1975	1980	1985	1990	1995		2000		2005			
						A	B	A	B	A	B	The unemployed	Workforce
Total	1.4	2.3	2.5	3.4	3.0	4.3	0.63	4.7	0.59	6.0	0.95	3,893,712	65,399,685
Hokkaido	1.5	2.1	2.6	4.4	3.6	4.4	0.54	4.8	0.46	6.5	0.57	181,523	2,785,794
Tohoku	1.1	1.8	2.1	3.0	2.6	3.5	0.81	4.3	0.59	6.1	0.73	383,908	6,263,474
Kanto-Koshin	1.2	2.1	2.2	3.0	2.7	4.3	0.57	4.6	0.62	5.6	1.11	1,280,841	23,058,037
Hokuriku	0.8	1.6	1.7	2.2	2.1	2.9	0.99	3.4	0.80	4.5	1.14	74,851	1,673,185
Tokai	0.9	1.7	1.8	2.5	2.4	3.5	0.78	3.9	0.77	4.6	1.41	373,352	8,065,503
Kansai	1.5	2.7	2.9	3.9	3.6	5.3	0.49	5.8	0.48	7.2	0.92	742,186	10,291,887
Chugoku	1.2	1.9	2.2	3.0	2.6	3.5	0.88	4.1	0.72	5.0	1.10	197,893	3,918,791
Shikoku	1.9	2.9	3.1	4.3	3.8	4.5	0.82	5.0	0.66	6.8	0.84	139,236	2,054,146
Kyushu	2.3	3.2	3.3	4.6	3.7	4.6	0.57	5.1	0.48	6.7	0.70	444,550	6,653,019
Okinawa	4.0	8.1	7.7	7.6	7.7	10.3	0.18	9.4	0.28	11.9	0.43	75,372	635,849
3 Major Metro.Areas	1.3	2.4	2.5	3.4	3.1	4.7	0.50	5.0	0.55	6.0	1.11	1,845,412	30,919,896
Tokyo Area	1.3	2.3	2.4	3.2	2.9	4.6	0.48	4.8	0.55	5.6	1.11	990,273	17,678,111
Nagoya Area	0.9	1.7	1.9	2.5	2.5	3.6	0.68	4.0	0.72	4.6	1.60	224,110	4,854,560
Osaka Area	1.5	2.8	3.1	4.1	3.7	5.6	0.47	6.1	0.47	7.5	0.94	631,029	8,387,225
Rural Area	1.4	2.2	2.4	3.4	3.0	3.9	0.74	4.5	0.62	5.9	0.84	2,048,300	34,479,789

(Note) On October 1, each year. A & B mean unemployment rate and effective ratio of job openings to job applicants, respectively.

(Source) Ministry of Internal Affairs and Communication, *Census Report*; Ministry of Health, Labour, Welfare, *Annual Report of Labour Statistics*.

can be spotted from the transition of the unemployment rate and the effective ratio of job openings to job applicants. In the past the unemployment rate has remained at an extremely low level. However, it deteriorated rapidly in the Heisei depression during the 1990s and reached 6%, which meant there were 3.9 million unemployed in 2005. In the 1990s, the unemployment rates in the three major metropolitan areas exceeded those in rural areas because that in the Osaka area rose to well above the national average. In the Tokyo area and especially in the Nagoya area it significantly fell below the national average. On the other hand, in rural areas such as Okinawa the unemployment rate was the highest of all, and those in Hokkaido, Shikoku and Kyushu also deteriorated rapidly in 2005.

In terms of the effective ratio of job openings to job applicants it was rather higher in rural areas than in the three major metropolitan areas in the 1990s. However, the situation has changed since 2001. While it has dramatically improved in the three metropolitan areas, the ratio in rural areas has fallen below the national average. The Nagoya area has been in the best condition among the three metropolitan areas, while the Osaka area has been below the national average. It is the worst in Okinawa among the rural areas, with Hokkaido, Tohoku, Kyushu and recently Shikoku having also fallen far below the national average. Therefore, these facts show that the regional economies are experiencing uneven development, both between similar metropolitan areas and between metropolitan and rural areas.

In short, the regional disparities, which were once showing a tendency to narrow, have recently started to expand its gap. What factors are behind these changes? It can be distinguished by two explanations from the preceding study.

One explains the regional disparities by the prefectural income and the local industrial structure. For example, Tanizawa (1998) pointed out how they have developed in each period of time. First, they narrowed due to the increase in compensation of employees by attracting industries during a rapid growth period. Second, they were expanded by the development of the service economy in the urban areas in the 1980s. Third, in the 1990s when corporate incomes in the urban areas fell drastically from the sharp decline in their asset value, they have been narrowed by the economic damage that urban areas

incurred⁴. In this explanation, it lays the emphasis on the factors which had an impact on regional disparities in each time, respectively, as follows: effects of employment and income expansion on the regional economy that invited manufacturing companies brought about during the time of rapid growth; industrial predominance in the urban over rural areas generated by the service economy in the 1980s; and deterioration of corporate income by the collapse of the bubble economy in the 1990s.

The other explanation is that the provision of the social overhead capital by the community development policy operated effectively on the development of the regional economy through productivity effects (stock effects) and the effects on demand creation (flow effects), helping to narrow the regional disparity⁵. However, recently the economic effect of the social overhead capital gradually deteriorated in a change of the industrial structure and the regional economy, and is believed not to lead to the improvement of total factor productivity⁶. In this sense, it is commonly recognized today that the public investment policy in our country should be reexamined.

Tanizawa pointed out several problems about the community development policy in Japan. First, even though the policy of attracting factories succeeded to create employment opportunity and increased incomes to some extent, it was inadequate for the local technical development and acceleration. Second, even local governments which did not have enough financial resources gave the provision of equipment and facilities high priority over promoting the intangibles. Third, "the actual policy effects were poor and the purposes of the policy were not clarified". He also criticized that the policy did not succeed in making borrowed technology take root in areas by inviting factories. In effect he regarded the regional development policy or public investment policy as exogenous and questionable. In this sense, to be endogenous and sustainable is essential for regional autonomous development.

4 *Ibid.*

5 Takagi, Kikuo (2005), *Fiscal Analysis of Regional Disparities*.

6 Policy Research Institute, Ministry of Finance (2002), *The role of Government in Stimulating Economic Activities in Prefectures*.

2. National minimum and local public finance

The reason why this article takes up the problem of a national minimum is that this concept is inseparably related with the financial equalization system to adjust the inequality among regions. The difference of economic strength among regions inevitably brings financial strength differential between them. However, this means that the central government should secure sources of revenue and/or financial adjustment for local governments in a weak financial position in order to guarantee minimum public services. In this sense, the financial equalization system is indispensable to local government finance, and the local allocation tax has been the system which provides this role in Japan.

Originally, the concept of the national minimum was conceived by the Webs from Great Britain in 1897 for legal minimum standards for such things as working conditions or wage levels. After that, this concept was spread widely and was accepted when it was used as a concept to indicate the standard of subsistence cost in the Beveridge Report in 1947⁷. In Japan this concept was introduced initially by GHQ (the General Headquarters of occupying nations) in 1946 as a guiding principle for social welfare reform. It contained three principles; namely, national responsibility, indiscrimination and equality, fulfillment of necessities. Thereafter, it is assumed that it has been diverted and applied to other public services from the minimum cost of living⁸.

On the other hand, an idea has been growing recently that demands the central government should cut its grants to local governments since the national minimum has already been achieved. The typical examples of such a view are the "Proposition on the FY 2002 Budget Formation" (November, 2002) by the Fiscal System Council and the opinions of expert members at the Council on Economic and Fiscal Policy. For example, the proposition of the Fiscal System Council stated that the national minimum was already achieved in many fields, and insisted that one of the two roles of the local allocation tax to guarantee revenue for local governments, which

7 Nishio, Masaru (2005), Decentralization reform needs complete reconsideration of 'national minimum,' *Urban Problem*, Vol.96, No.5.

8 *Ibid.*

they thought led to a moral hazard for local financial administrations, should be abolished and only the second role to adjust imbalances in the revenue sources of local governments be maintained. They claimed that it is necessary to clarify the relationship between the benefits and the burden in regional finance. Furthermore, the report titled “The point at issue on the relationship between central and local governments” (18 May 2001) submitted by expert members, Jiro Ushio and Masaaki Honma, to the Council on Economic and Fiscal Policy also had a similar view and emphasized that by reviewing the roles of central and local government administration, fiscal transfer from the central government to local governments, or the local allocation tax grant and national government disbursements (specific grants), should have been reduced to the minimum necessary. In that case, differences in the level of public services among the regions might occur. From now on, Ushio and Honma continued, the former unified national minimum should not be secured, but the differences among regions be approved.

The prescription here is the idea of “competitive decentralization” based on neo-liberalism. It leads to the notion of local allocation tax grant reduction or abolition. Advocates of competitive decentralization have some opinions in common. First, a process of administration such as the calculation of the basic fiscal needs or the decision of the total sum of the tax grant is opaque. Second, dependence on the tax grant of the local governments promotes a moral hazard and inefficiency in the financial administration. Third, in order to rectify the problem, it is necessary to raise the transparency of the administration by simplifying the calculation of the basic fiscal needs and to restrict the discretion of the Ministry of Internal Affairs and Communications. Fourth, at the same time, redistribution of financial resources among regions is to be limited (and abolished in the end) by reducing the scale of the tax grant⁹.

However, this ‘reform’ scheme would not be able to solve the current community affairs or the regional disparities that Japan faces. The fundamental plan of the reform must be “decentralization on resident autonomy”, not “competitive decentralization”. Such a plan is

9 Akai, N., T. Sato & K. Yamashita (2003), *Economics of Local Allocation Tax*.

specified in the thinking and concept of 'The European Charter of Local Self-Government'. The Charter was adopted by the Committee of Ministers, Council of Europe in 1985. It is the multilateral convention which went into effect in 1988, and it is the first one in the world to declare the principles of local autonomy in the form of an international agreement.

The principles are enshrined in the preamble of the Charter. First, the local authorities are one of the main foundations of any democratic regime. Second, the right of citizens to participate in the conduct of public affairs is one of the democratic principles that are shared by all member States of the Council of Europe. Third, it is at the local level that this right can be most directly exercised. Fourth, the existence of local authorities with real responsibilities can provide an administration which is both effective and close to the citizens. Fifth, the safeguarding and reinforcement of local self-government in the different European countries is an important contribution to the construction of a Europe based on the principles of democracy and the decentralization of power. Sixth, this entails the existence of local authorities endowed with democratically constituted decision-making bodies and possessing a wide degree of autonomy with regard to their responsibilities, the ways and means by which those responsibilities are exercised and the resources required for their fulfillment¹⁰. It goes without saying that these principles can be basically applied to areas outside of Europe.

In accordance with the spirit of the Charter, it clarifies the concept of the local autonomy in Article 3 in that local self-government denotes the right and the ability of local authorities to regulate and manage a substantial share of public affairs under their own responsibility and in the interests of the local population. In Article 4, it is stipulated that local authorities shall have full discretion to exercise their initiative with regard to any matter, that public responsibilities shall generally be exercised, in preference, by those authorities who are closest to the citizen, and that powers given to local authorities shall normally be full and exclusive. Furthermore, in Article 9 the principles of fiscal autonomy are provided as follows: 1) entitlement of local authorities to adequate financial resources of their own; 2) empowerment to local

10 Council of Europe (1985), *European Charter of Local Self-Government*.

authorities to determine the rates of local taxes and charges; 3) security of diversity and buoyancy of financial resources; 4) protection of financially weaker local authorities by the institution of financial equalization schemes or equivalent measures; 5) vesting local authorities with the right of proposal for the allocation of financial resources; 6) denial of earmarked grants and the basic freedom of local authorities to exercise policy discretion. Therefore, the Charter has declared that local autonomy based on democracy consists of the comprehensive empowerment of local authorities, the principle of subsidiarity, organizational autonomy, and fiscal autonomy and the like¹¹.

Taking the Charter as a guiding star, Jinno and Ikegami (2003) have set five criteria for formulating a plan for local allocation tax reform¹². First, specified grants should be reduced as much as possible. Second, assuming the limitation of subsidized projects, financial resources should be redistributed between central and local governments in accordance with the distribution of responsibilities between them. Third, financial resources should be guaranteed to correct fiscal disparities among regions and accomplish the minimum of public services allocated to the local governments. Fourth, the method used to correct fiscal disparities among regions and to guarantee minimum public services must not restrict the decision-making of the local governments. Fifth, the decision-making as to what extent to correct fiscal disparities and where to set the minimum standard should be entrusted to the people, and at the same time the people should be empowered to give their opinion to the local governments.

Based on these criteria, Jinno and Ikegami suggested a local allocation tax reform plan. First, the total amount of the local allocation tax should be set from the viewpoint of the vertical financial adjustment, and which taxes should be put into the local allocation tax and how they should be transferred need to be examined. Second, simplification of the calculation of basic fiscal needs does not always improve the problem. The content of a national minimum and the method to

11 Sugihara, Y. et al.(ed.) (2003), *Research Materials : Modern Local Self-Government*, p.83.

12 Jinno, N. and T. Ikegami (2003), *The Local Allocation Tax: What are the Problems?*

calculate the financial resources necessary for the maintenance and achievement of the national minimum always need to be renewed depending on changing situations. Third, inclusion of specified fiscal needs in the calculation of the local allocation tax to encourage the local government toward specific types of projects should be abolished. Fourth, It is necessary to let local authorities participate in the decision-making process of the local allocation tax.

This suggestion basically deserves recognition. It is against the democratic rules and principles of local autonomy to decide one-sidedly from the top, or to reduce the local allocation tax asserting without enough inspection that the national minimum has been achieved. The following conditions must be premised when initiating the reform: 1) thorough disclosure of information; 2) security of transparency; 3) shift from the discretion of the executive branch to a rule; 4) arrangement for an equal consultation between local and central governments; 5) security for the participation of the inhabitants.

II. The 'Trinity Reform' and Local Public Finances

1. Outline of the 'trinity reform'

The primary purpose of the 'trinity reform' is to review the fiscal relationship of the central and local governments and to strengthen the fiscal autonomy of the local authorities through the transfer of tax revenues from national to local taxes, reform of the central government specific grants, and of the local allocation tax system. The first stage of decentralization reform began with the 'Resolution of Promoting Decentralization' in the Diet in 1993, and ended with enforcement of the Omnibus Decentralization Act in 2000. The 'trinity reform' has been regarded as the second stage of decentralization. If the result of the first stage was the abolition of the system of delegated functions, though not quite satisfactorily, the urgent task of the second stage was to incarnate fiscal decentralization by promoting the transfer of tax revenues from the central to local governments¹³.

The purpose to promote decentralization was to create 'a society

13 Jinno, N. (ed.) (2006), *Trinity Reform, Local Public Finances and Local Taxes*.

in which you can actually feel comfortable and fulfilled' or 'a community which is full of vitality and individuality' as was enshrined in the 'Resolution of Promoting Decentralization' and the Omnibus Decentralization Act. The substance of society or the blueprint of the community assumed there is not exactly clear. If regeneration of the community and the life of local residents was taken into consideration, the 'trinity reform' should have given the highest priority to strengthen the financial bases of local governments and to promote the transfer of tax revenues and an increase of general revenue sources in order to strengthen the right to self-determination of local governments and local residents. However, the 'trinity reform' that was actually carried out deteriorated into the reconstruction of central government finances rather than pushing fiscal decentralization to the local governments.

Table 4 presents the overall picture of the 'trinity reform'. In addition to a reduction of specific grants of about ¥4.7 trillion, local allocation tax was reduced by ¥5.1 trillion. On the other hand, since the sum of the transfer of tax revenues was only about ¥3 trillion, the net reduction of ¥6.8 trillion was left for local governments to raise. Failure in the security of local revenue sources by the central government has had the result of triggering bankruptcy or fiscal difficulties for local governments.

2. The assessments of the 'trinity reform'

For the present 'the first-term reform' of the second stage has come to an end. The problem now is how the result of 'the reform' should be evaluated?

First, not only realizing the transfer of tax revenues of ¥3 trillion from income tax to the individual inhabitant tax, but also advancing it together with the reduction of specific grants as one indication of strengthening of fiscal autonomy, deserves appreciation. Second, because the transfer of tax revenues works to the advantage of urban areas and there is a possibility of conflict between urban and rural areas. It was an important proposal in terms of the development of cooperation between urban and rural areas for local governments to think of reliable fiscal support from the local allocation tax as a prerequisite for the reform. Third, an association of six local government organizations (hereinafter six locals) was united to the

Table 4 Targets and results of 'Trinity Reform' (¥ Trillion)

	Reform of Specific Grants	Transfer of Tax Revenues	Reform of Local Allocation Tax
FY 2002	Reduction of the Sum of Local Allocation Tax 0.8 Start of Reduced Revision of Cost Differential per Unit and of Working Expenses The 'Trinity Reform' Decided (Basic Policies for Economic and Fiscal Policy Management and Structural Reform 2002)		
FY 2003	Temporary Reduction 0.6 Goal of Reduction (Basic Policies 2003) 4.0	0.2	Reduction 1.5
FY 2004	Reduction 1.0 "have local governments propose reform plan" (Basic Policies 2004)	Transfer 0.5 Goal of Amount Transferred (Basic Policies 2004) 3.0	Reduction 1.2 (Reduction of 2.9 If Provisional Bond for Replenishing Revenue Included)
FY 2005	Reduction 1.8	Transfer 1.1	The same Amount as Last Year's (Reduction of 1.0 If Provisional Bond for Replenishing Revenue Included)
FY 2006	Reduction 1.8 (Amount Decided in 2004 0.6; that in 2005 1.2)	Transfer 1.2 (0.6 Amount Decided in 2004 and 2005, Respectively)	Reduction 1.0 (Reduction of 1.3 If Provisional Bond for Replenishing Revenue Included)
Total	Reduction 4.7 (Do Not Include the Amount Carried-out in 2003)	Transfer 3.0 (Include the Amount Carried-out in 2003)	Reduction 5.1 (2004-06. Provisional Bond for Replenishing Revenue Included)

(Source) Zensho Okamoto Web site.

end and continued demanding better treatment from central authority. It was an important process in history to obtain a certain amount of results¹⁴. It indicated the predominance of the policy for the local side to have worked out "a reform plan about specific grants" twice over. It deserved appreciation for the six locals to appeal to public opinion as a group against the central government which had been negative in

14 Kanazawa, Fumio (2006), From the Trinity Reform to the Third Stage of Decentralization, *Local Public Finance (Chiho-zaisei)*.

the 'decentralization reform'. Fourth, it was an epoch-making result to establish a common ground for equal consultation between local and central governments.

Nevertheless 'the first-term reform (trinity reform)' failed to realize the desired result, judging from the aims that local governments originally claimed in decentralization reform.

First, the scale of tax revenues transferred did not reach 40% in terms of the scale which the six locals had originally expected (¥8 trillion). Second, according to the data which the six locals presented, the reduction of specific grants realized in this 'reform' was only 38% or so out of ¥3.2 trillion of specific grant reductions that the six locals suggested, and only 12% without those associated with compulsory education (see Table 5). It did not contribute to the expansion of self-reliance or independency of local authorities. Third, not only the amount of money was reduced, but also the substance, where the reduction of specific grants was carried out in many cases by a cut in the grant rate. In this sense, the central government can still dominate local government expenditures by means of a statutory control and centrally determined grants-in-aid. Therefore, it is against the idea of "the true decentralization reform". Fourth, measures really taken in

Table 5 Extent of realization of six locals plan

(¥ Million)

	Decision in FY 2004			Decision in FY 2005			Total
	Local Plan	Response by Ministries	Result	Local Plan	Response by Ministries	Result	
Grants (Current)	5,742	229	980	2,185	421	421	
National Treasury Obligatory Shares (Current)	6,437	581	1,232	2,584	591	591	
Provision of equipments and facilities	5,712	0	0	5,203	0	670	
Public Works	5,889	0	0	0	0	0	
Compulsory Education	8,504	0	8,500	0	0	0	
Subtotal	32,284	810	10,711 33.2%	9,973	1,012	1,682 5.2%	12,393 38.4%
National Health Insurance	—	—	6,851				
Carried-out in FY 2004			7,093				
Children's Allowance and the Like					166	4,862	
Total	32,284	810	24,655	9,973	1,178	6,544	31,199

(Source) Zensho Okamoto Web site.

the process of decentralization were inconsistent, in many respects, with the aims of “the true decentralization reform”. Giving some examples, the abolition of specific grants without a transfer of tax revenues or a cut of grants by using a “budget ceiling” were put into force on the pretense of “streamlining”. Or there were attempts to authorize the central government and to withhold revenue sources by establishing subsidies that have the “same or similar purpose/ content” while abolishing specific grants¹⁵. Fifth, the reduction of the welfare benefits grant rate was withdrawn this time by the objection of the six locals. But the government and ruling parties’ agreement at the end of 2005 stated that “local governments will grapple seriously with making the welfare benefits reasonable. With that in mind, if it is not effective, the national (government and the ruling parties) and local governments shall examine necessary reform immediately and carry it out”. This could well trigger another dispute between national and local governments. Finally, though the ‘trinity reform’ advocated reform of specific grants, transfer of tax revenues and the local allocation tax as a package, how to reform the local allocation tax is still not clear. In the meantime, the local allocation tax of ¥5.1 trillion was reduced against the background of thoughts that the role of the local allocation tax to guarantee revenue for local governments should be abolished, or that security of revenue sources to local governments should be limited only to the equivalence of the national minimum. The six locals demanded the financial resources from the local allocation tax, but how the local allocation tax could be reformed has not been made clear yet. As already mentioned, the ‘first-term reform’ came to an end, and there are fears that confrontation will intensify among local entities concerning how to reform the local allocation tax. It is an urgent priority to decide on a policy.

There are many problems to be solved regarding the ‘decentralization reform’. ‘The European Charter’ declares to improve the inhabitants welfare through establishment of the principles already mentioned. If the aim of the ‘trinity reform’ had been to establish fiscal autonomy, its terminus ad quem is still a long way from these principles that the

¹⁵ Japan Association of Six Local Government Organizations (2004), *Reform Plan on National Treasury Obligatory Shares and the Like*.

'Charter' holds up. The tasks to be solved in decentralization reform still remain. The questions are as follows: To what extent could the six locals challenge the national government to arguments about decentralization policy?; Can the future 'decentralization reform' open up its prospects by developing 'the second-term reform' as an extension of the first-term reform?; Is it possible to carry out the reform of the local allocation tax necessary for stable administration of local finances?; Is it possible for the reform to get support from the public?; Is it possible to establish a common ground for an equal consultation between local and central governments in the future?

III. Municipal Mergers and Local Autonomy

In Japan the national government has always carried out large-scale municipal mergers whenever they planned to change the system of local administration. Since the middle of the Meiji era (1868-1912) there were two major waves in municipal mergers. The Great Merger of Meiji, which occurred from 1888 through 1889, was the first with the aim of enabling local governments to deal with newly created administrative responsibilities, including tax collection, civil engineering, and especially the compulsory education system. Along with this reform, towns and villages were established as local municipalities. The second was the Great Merger of Showa, which was executed from 1953 through 1956 in an attempt to fulfill the newly entrusted local governments' tasks of establishing and managing junior high schools, administering local fire-fighting organizations, operating local government police, and providing for the services of social welfare, health and hygiene¹⁶.

At present, the third wave, the so-called "Great Merger of Heisei", is in progress. How the number of municipalities classified by their populations has changed is shown in Table 6. In this merger, local governments whose population were less than 10,000 decreased most in number, and the number that had a population from 10,000 to 30,000 exclusive declined the second most. In sum, for the most part

16 Council of Local Authorities for International Relations (2006), *Municipal Mergers in Japan*, CLAIR Fact Sheet, No.9.

sparsely populated towns and villages were driven to merge in the name of making administrative operations more effective, enforcing the financial power in order to provide effective public services for residents, and so forth. Due to municipal mergers of Heisei era, cities have grown from 90.36 million (76.8% of the total population) to 105.55 million (88.5%) in population and increased their covered area from 4,923 km² (28.3% of the gross national area) to 207,659 km² (55.9%). It may be argued that the city-centered municipal system has been strengthened on the whole because of the growth of the population and the area that cities occupy. But this recognition is doubtful. Because the population density of cities has fallen considerably and immense rural areas that have no urban infrastructures have been artificially incorporated into urban jurisdictions. It means that rural areas are to be treated as urban areas. But it is impossible to provide the same public services for rural areas as for urban districts for both administrative and financial reasons. It is feared that regional disparities will widen and peripheral areas will be left behind by the development and prosperity in artificially expanded urban jurisdictions.

The purposes of the Great Merger of Heisei have been explained above, but it seems that the real intention is to reduce local government expenditures and to rebuild the local finances by increasing the scale of local governments. But the mere reduction of local budget deficits

Table 6 Change of the number of municipalities by scale of population

	31 March 1999		31 March 2006	
	Number	%	Number	%
500,000 and over	21	0.6	26	1.4
From 300,000 to 500,000 Exclusive	43	1.3	46	2.5
From 200,000 to 300,000 Exclusive	41	1.3	40	2.2
From 100,000 to 200,000 Exclusive	115	3.6	150	8.2
From 50,000 to 100,000 Exclusive	227	7.0	276	15.2
From 30,000 to 50,000 Exclusive	262	8.1	265	14.6
From 10,000 to 30,000 Exclusive	986	30.5	514	28.2
less than 10,000	1,537	47.6	504	27.7
Total	3,232	100.0	1,821	100.0

(Source) Yokomichi, K. (2007), The Process, Result, and Tasks of the Great Merger of Heisei, *Regional Policy—From Mie*, No.22, p.10.

will drive many communities into peril and widen regional disparities.

Both national and local governments are in financial difficulties. Accordingly, it is essential to encourage residents to participate fully in local governance and to form partnerships among the public sector, cooperatives, trade unions, non-profit organizations and private sectors in order to stimulate community development and revitalize local self-governments. In addition fiscal autonomy of local governments which supports residents' autonomy must be secured.

Decentralization still remains an "unfinished reform" in Japan. We are once more facing a big task to carve out new horizons on how to establish local and fiscal autonomy and to realize endogenous development for a sustainable society.