TRENCH WARFARE ON THE TAX FIELDS:
FISCAL SOCIOLOGY AND JAPAN'S CENTRALIZED TAX STATE

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Abstract

According to the World Bank, over 80 countries currently plan some form of fiscal decentralization. This group includes Japan, a highly centralized tax state, which in 1995 put in place a law and associated high-profile institutions to promote fiscal and administrative decentralization. But the process in Japan has quickly become bogged down.

This dissertation asks why there are hurdles confronting fiscal decentralization in Japan. My research uses the fiscal sociology approach and highlights bureaucratic interests in Japan's intergovernmental tax regime, one that is especially interesting in comparison with other advanced industrial countries.

Fully 70 percent of all government spending in Japan is done by subnational levels of government, and 51 percent of the central state's current operating expenditures are transfers downward that serve to support that high rate of local spending. And though Japan is a centralized state, over a third of its taxation is collected locally. In consequence, Japan is quite anomalous when set alongside a representative sample of federal and unitary states. No other country among the nine OECD nations used, for comparative purposes, in this dissertation combines such high fiscal transfers with heavy levels of subnational spending and taxation.
And no other country gives close control over a large terrain of subnational taxation to a central-state agency (the Ministry of Home Affairs). The ministry's vast bureaucratic turf brings it into conflict with the Ministry of Finance, as both seek to maintain or expand their fiscal jurisdiction. They are thus not interested in fiscal decentralization in large part because they are busy fighting “trench wars” with each other on these tax fields.

This dissertation hence undertakes a detailed analysis of intergovernmental fiscal history in Japan, focusing in particular on the Ministry of Home Affairs' ambiguous role in the Japanese state. The case studies of inter-bureaucratic fiscal politics include the Local Allocation Tax (a large general subsidy) as well as an array of taxes on the fields of income, assets and consumption.
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Preface

Being Canadian, I most certainly did not head for Tokyo in the winter of 1993 to research Japan's intergovernmental tax politics. As Donald Smiley\(^1\) once wryly observed, Canadian fiscal federalism is a field that "I once tried to comprehend but which, I am now convinced, is so complicated that one should either cultivate it as a full-time specialty or leave it alone entirely." Federal-provincial fights over fiscal resources are, as is disturbingly clear in the erosion of Ottawa's capacity to bind the country, of great pith and moment in the long run; but the micro-politics of the short run are even more excruciatingly complicated and boring than Canadian debates on the Constitution. Thus I would have thought, in 1993, that only masochism would motivate one to study similar processes elsewhere.

But on an especially cold and wet Sunday in October of 1993, I was fortunate to read a newspaper piece on taxation that quoted Jinno Naohiko, an expert on Japanese fiscal history at Tokyo University's Department of Economics. His comments bore the unmistakable flavour of fiscal sociology, the once obscure but now resurgent approach to the tax state pioneered by the likes of Joseph Schumpeter and added to by other such luminaries as Richard Musgrave and James O'Connor. Though I was in fact researching only a few

dozen metres from the Economics building, I think it unlikely that I would otherwise have met Professor Jinno, since his work focuses on the intergovernmental fiscal regime. So I am immensely glad I bought that copy of the *Nikkei* when I had nothing better to do, read the article, and wrote the letter introducing myself and explaining my delighted surprise at reading his remarks.

Professor Jinno's boundless patience and often hilarious tales of Japanese intergovernmental tax politics kindled my interest in a way that no amount of reading ever could have. And now, oddly enough, I find myself fascinated by intergovernmental fiscal politics anywhere, even in Canada. His is the singular gift of real teaching, and I can only hope to return a fraction of what I have received by similarly motivating my own students.

There are others I want to thank for helping me through this project. Lonny Carlile, the co-chair of my committee, arranged my stay at Tokyo University’s Institute of Social Science (Shaken) and stuck by this work, giving me invaluable advice, though he had no obligation to do so having taken up a new position in Hawaii. I have also benefited very much from the close readings, heavy criticism, and supportive comment the other members of my committee, Philip Resnick and Alan Siaroff, gave to my work. I should also like to express my gratitude to John C. Campbell, David Edgington, Nina Halpern and Masaru Kohno for their instructive and insightful comments. Shibagaki Kazuo and Shibuya Horoshi of Shaken sponsored my two and a half year stay.
there, providing me with useful introductions and assistance throughout. Other
Shaken faculty, including Hiwatari Nobuhiro, Kudo Akira, and Fujiwara Yukichi,
helped me at crucial points in my research and related activities. And the
Shaken librarians as well as those in the Economics Department were most
helpful as well as patient with my inexcusable habit of wanting to borrow
things a minute or two after closing.

After Shaken, I went to the Australia-Japan Research Centre at Canberra's
Australian National University. I am fortunate that I did, and want to thank the
director, Peter Drysdale, and the staff and students, as I benefited from giving
seminars in the department and discussing ideas with them. I was also lucky to
be permitted access to the literature in the nearby Federalism Research
Centre. The Centre itself is now defunct, apparently the victim of an
unappreciated critical perspective, but its works on federalism and fiscal
history remain a gold mine of international academic exchange. A similar
institution clearly needs to be established, and protected from the politicians.

Others to whom I owe many thanks for advice and encouragement are Junko
Kato, Tsuyoshi Kawasaki, David Leheny, Fujita Kuniko, Hayden Lesbirel,
Jonathan Lewis, Steven Reed, and Sven Steinmo. My interviewees, including
personnel from the ministries of Finance and Home Affairs, were also most
helpful and patient with my questions, and I owe them much gratitude.
Special thanks to two people in particular who, some years ago, got me interested in fiscal sociology and fiscal politics. Isabella Bakker’s graduate courses on State Finance introduced me to an unforgettable literature that, it turns out, is perfectly suited to the fiscal history of Japan. Also, Neil Brooks gave me much more of his time than I deserved, and for me made fiscal politics something you study not only because it is of course of fundamental and unparalleled importance, but much more than that because at the end of the day it is just so damned funny.

I also want to thank my wife, Mie Takahashi, whose patience, support, and presence are my anchor. This is for her and for our wonderful little daughter Monika, whose birth at the end of 1996 was just the jump-start needed to get this dissertation pruned and in the mail.

As to finances, this work was supported by fellowship monies from the University of British Columbia and from Canada’s Social Science and Humanities Research Council. Other sources I dare not mention, lest some hard-hearted tax official read this far.

Of course, the shortcomings, errors, and so forth in the present work are my own fault.
Abbreviations

CIT Corporate Income Tax
CRD Chihou Roku Dantai
FAT Fixed Assets Tax
LAT Local Allocation Tax
GTAC Government Tax Advisory Commission
LCT Local Consumption Tax
LDP Liberal Democratic Party
LDPTAC Liberal Democratic Party Tax Advisory Commission
LVT Land Value Tax
LSAC Local System Advisory Commission
MITI Ministry of International Trade and Industry
MOF Ministry of Finance
MOHA Ministry of Home Affairs
PA Principal-Agent
PIT Personal Income Tax
SCAP Supreme Commander Allied Pacific
VAT Value Added Tax

Note that books and articles written in Japanese and by Japanese are cited, as is customary in Japan, with the author's family name first, but materials written in English by Japanese and by non-Japanese with Japanese names are cited as the name appears on the item in question.
Chapter 1

Introduction

Decentralization...is viewed as the "third major reform" in modem Japanese history following the Meiji Restoration and the postwar reforms...The Ministry of Home Affairs is committed to seeing that this project is a success.

Ministry of Home Affairs

Decentralization is all the rage in contemporary Japanese politics. By apt coincidence, this trend waxes in the twilight of a century of aggressive centralization, which fostered Japan's singularly goal-oriented political economy and propelled it past an astonishing array of milestones. Japanese reformists have long advocated devolution for more habitable and democratic communities, and lately assert that ageing and internationalization make more diversified local services imperative. But the novel aspect of the 1990s is that even the conservative establishment, the heirs of the developmentalist state, openly blame their illustrious legacy for the stalled economy and stifling uniformity that typify the nation's enervation at century's end.¹ Hence many observers believe the 1995 Law to Promote Decentralization (Bunken Suishin

¹ A good recent example of progressive argument is that of Social Democratic Party of Japan politician Iwamoto Hisato, Chihoubunken de wa nakereba, Nihon wa dame ni naru [Without Decentralization, Japan is Done For], Tokyo: Diamond, 1996. A review of the broad range of arguments for
Hou) heralds -- to recycle a hoary cliche -- the sunset of Japan's centralized state.

But beneath the flood of supportive discourse, evidence from the pragmatic world of Japanese politics suggests that numerous hurdles confront decentralization and especially its sine qua non, fiscal decentralization. The 1980s campaign of "administrative reform" looked to conservative decentralist ideals and thus largely cut fiscal resources rather than devolve control over them. Moreover, the 1995 enactment of the Law to Promote Decentralization, the structure of its associated deliberative committee, and the committee's continuing research on the various facets of decentralization have all been subjected to incessant rear-guard action by central-state bureaucrats and their political allies. Fiscal decentralization is an especially difficult area, because the powerful ministries of Finance (MOF) and Home Affairs (MOHA) oppose...
decentralized taxation and are not, at present, eager to confront other ministries and their allied politicians over cuts in targeted subsidies. The continuing lack of progress belies the ostensible consensus on decentralization, and strongly suggests that the topic merits detailed study.

Fiscal Sociology and Fiscal Politics

The gap between rhetoric and action gives ground enough to study the politics of fiscal decentralization in Japan, but a larger reason is the unparalleled importance of fiscal politics. The budget of the modern state is a massive fulcrum that shapes economy and society, thus affecting the lives of all citizens, whether rich, middle-class or poor. Moreover, the state's taxes and transfers produce almost diametrically opposed politics. Most people would readily pass the buck when it comes to paying the "the price of civilization," but -- in an ironic display of moral hazard -- even the most loyal acolytes of laissez-faire find a good appetite at the public trough. So spending is usually welcomed,

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4 According to a member of the committee, who must remain anonymous, opposition to serious reform greatly attenuated its March 29, 1996 mid-term recommendations. The report avoided specific goals concerning fiscal decentralization, whereas an earlier draft proposal, leaked to the Mainichi Shinbun, contained much stronger recommendations; see "Kokko hojofutankin, zeizaigen kaikaku yoso youshi" [The main points for reform of taxes and subsidies], March 23, 1996, p. 2). The mid-term report and comments on it can be found in "Zeizaigen nado, guttaian shimezu: chihou bunken suishinin chuukan houkoku" [The mid-term report of the Committee for Promoting Decentralization: No concrete proposals for finances and other areas], Mainichi Shinbun, March 30, 1996, p. 2. See also "Bunya betsuni guttaian: chihou bunken chuukan houkoku, kongo no giron ni nayami" [Mid-term report on decentralization: the debate is bogged down], in Mainichi Shinbun, March 16, 1996, p. 3, Sano Masato, "Chihoubunkenin no chuukan houkoku: Juumin jichi no hasson ga kihaku" [Mid-term report on decentralization: Dilution of the ideal of popular democracy], Nihon Keizai Shinbun, April 1, 1996, p. 7, and Aoki Shisei, "Chihou bunken suishinin, hiaringu shuuryou: shouchou no teikou, izen netsuyoku" [Hearings wrap up for Committee on Decentralization: central agency opposition strong as ever], in Nihon Keizai Shinbun, June 24, 1996, p. 31.
and often heartily encouraged, at least by its recipients. Yet woe betide the
government that would enact or increase a levy deemed by the many or
eough of the powerful to be onerous or unfair. Taxes are therefore politically
fascinating because they must be imposed, lest the state collapse and the
social order, too, for want of the state; but perhaps more than any other
instrument of government, taxes can mobilize overpowering opposition,
whether from corporate boardrooms or otherwise politically atomized citizens.

Fiscal instruments influence the state as well. The most spectacular
expression of this influence arises when opposition to taxes brings down
governments or forces sweeping changes in bureaucratic agencies and their
cherished traditions. On the other hand, political coalitions' strong support of
expenditures bolsters the bureaucratic and political institutions that manage
them. A relatively unhindered capacity to extract levies from fertile tax fields
will further bind this reciprocal pattern of supportive interests. Control over
plentiful fiscal resources can thus advance some state agencies,
strengthening them like well-trained muscles or, where fiscal discipline is
lacking, merely enlarging them like corpulent limbs, often at the expense of
atrophy elsewhere. Fiscal instruments are particularly germane to research on
the politics of intergovernmental divisions within the state, as the flow of
resources carries more explanatory force, for example, than the often merely
nominal provisions of constitutions and the nomenclature that confidently
distinguishes federal from unitary forms of government.
At a higher level of abstraction, such pluralist and institutional fiscal politics manifest themselves within a tax regime. Rudolph Goldscheid, the founder of fiscal sociology, sought to express this concept as he wrote in 1917, pondering the fiscal collapse of the Austro-Hungarian Empire. Goldscheid focused on “the degree to which the characteristic features of the State as such depend on the evolution of public finances.” Joseph Schumpeter soon followed Goldscheid’s lead with a masterful account of the “crisis of the tax state,” noting that:

The public finances are one of the best starting points for an investigation of society, especially though not exclusively of its political life. The full fruitfulness of this approach is seen particularly at those turning points, or better epochs, during which existing forms begin to die off and to change into something new, and which always involve a crisis of the old fiscal methods.

Close attention to fiscal issues, from the various levels of analysis, can therefore reveal progressively deeper currents of interest beneath the froth that constitutes so much of politics. One would expect, then, that economists’ high regard for the importance of public finance has flowed copiously over disciplinary boundaries and reached a proportionate level especially in the field of political science. But taxation in particular remains a marginal area of

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political study, leaving a vast terrain for fruitful and necessary research. The politics of intergovernmental fiscal relations are even more neglected than fiscal politics in general, as the work that does exist largely takes the central state’s tax regime as the point of departure. This is in spite of the seemingly inexorable increase in the role of subnational governments within vastly different fiscal regimes.

However, the flourishing literature in the once-dormant interdisciplinary space occupied by fiscal sociology promises to expand our understanding of the socio-political effects of taxes and transfers.6 The concept of the fiscal regime has returned, for some scholars because the contemporary period is -- like Goldscheid’s era of wartime fiscal exhaustion -- one of transition to a new and as yet unknown terrain of state finance.7 Intergovernmental fiscal relations fits well within the ambit of concern of this resurgent school of thought, which highlights the historical crisis that is the common backdrop to the great variation among intergovernmental fiscal regimes. Fiscal history provides an essential context for understanding contemporary issues and institutions8 and


7 This is the core argument of Funding the Modern American State, 1941-1995. Ed. by W. Elliott Brownlee. op. cit.

8 By "institutions," I mean meso-level organizations and fiscal instruments. This contrasts with the rational choice micro-oriented definition of institutions, which according to Randall Calvert, is "any of the rules of
the roles they play; and it can also, as we will see, unearth clues for reading the emergence of a true fiscal crisis in the current regime.

Fiscal Decentralization and Japan’s 1940 System

Of course, proposals to devolve power over the public purse have in recent years emerged in many countries. Fiscal decentralization’s appeal seems largely to stem, in structural terms, from economic globalization’s erosive effects on the role of the central state and, in political terms, from the ironic confluence between left radical paens to localism and conservative utopias of decentralized self-reliance. Thus French Socialists in the early 1980s and America’s ginger group of Gingrich Republicans in 1994 were both zealous advocates of fiscal decentralization, with the former seeking to empower the people and the latter ardent to disempower the federal state.

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10 Susan Strange discusses several trends that are undermining the role of the national state, including its fiscal preeminence, in The Retreat to the State: The Diffusion of Power in the World Economy. Cambridge: Cambridge University Press, 1996.
Even in the relatively fluid polities of North America, though, fiscal decentralization generally receives more lip service than concrete action. So perhaps Japan's lack of progress simply reflects a general tendency to inertia in the fiscal state, with an added degree of ossification from Japan's alleged cultural aversion to change. But this supposition overlooks the immense institutional differences in intergovernmental fiscal regimes. The Japanese case is particularly interesting in this respect, and worth an extended study, because of its towering and unique hurdle of inter-ministerial tax competition.\(^{11}\)

MOF and MOHA split jurisdiction over, respectively, Japan's national and local tax bases. Entrenched on these vast tax fields, the ministries naturally oppose changes that would detract from their authority. And because Diet politicians have few incentives to reform the fiscal regime, bureaucratic interests dominate the agenda in this important area of policymaking.

My argument unfolds through depicting the institutions and fiscal politics of Japan's "1940 fiscal system." Fiscal sociology work on Japan's intergovernmental tax-transfer system shows that it derives more from wartime reforms than, as is commonly believed, those of the postwar Occupation. Most countries exhibit institutional legacies from the war, in fact, but an expanding

\(^{11}\)These conflicts are generally referred to as *zeigen arasoi*, or "struggles over tax sources," as in "Kouteishisanzei age: kuni to chihou no zeigen arasoi utsusu" [Increasing the Fixed-Assets Tax: it reflects the centre-local fight over taxes], *Nihon Keizai Shinbun*, December 12, 1991, p. 3. Interestingly enough, there is little written in English or Japanese about the tax turf wars between MOF and MOHA, *per se*, as opposed to the less institutionally accurate depiction of the conflicts as being between the central and subnational levels of government. Concerning the rather common phenomenon of bureaucratic turf wars in Japan, see Chalmers Johnson, "Telecom Wars: How Japan Makes Policy for
literature suggests Japan is marked to an unusually high degree by transwar phenomena. As the term “transwar” implies, these studies trace the origins of much of the contemporary political economy back to innovations made under the press of the Pacific War and the earlier invasion of China.\textsuperscript{12}

Much of this work on Japan’s transwar institutions can and has been critiqued on empirical grounds, and I make no attempt to defend it all here.\textsuperscript{13} I do not, in any case, argue that the 1940 fiscal system is in all respects the same as the structure adopted on the eve of the Pacific War. The wartime regime itself underwent various adjustments even before Japan’s defeat in the summer of 1945 and the prompt imposition of American notions of fiscal democracy. Similar to the manner in which other students of fiscal sociology discuss regimes as frameworks, my point is that in Japan centralized fiscal control and the general structure of fiscal instruments survived U.S. Occupation reforms or were reconstructed during the postwar “reverse course” rollback of the Occupation’s doings.


\textsuperscript{13} A critique of the 1940 system argument can be found in Nagashima Osamu, “Sengo Nihon Keizaikenyuu no Shinchouryuu: 40-Nen Taiseiron o Chuushin o toshite” [The New Trend in Research on the Postwar Japanese Economy: The Focus on the 1940 System], Keizai Kagaku Tsushin, No. 80, February, 1996.
Fiscal sociology thus offers a persuasive account of the crisis of Japan's prewar tax state and its resolution through fiscal centralization. But among Schumpeter's many insights in political economy was that the state's fiscal structure is as potent an independent variable as the social forces and institutions that seek to recast it.\textsuperscript{14} My aim is therefore to build on the fiscal sociology research done on Japan through a meso-level, historical institutionalist study of the 1940 fiscal system and its contemporary tax politics. Taking my cue from Schumpeter, I examine how the preferences of Japanese bureaucratic and political institutions shape and are, in turn, shaped by the intergovernmental tax structure.\textsuperscript{15}

Thus two major claims are made here that challenge much existing political science work on Japan. The first argument is that studies of intergovernmental relations have been rather too quick to discard lessons from the older orthodoxy's rigid models of centralized dominance over local policymaking. Certainly a major contribution of the recent critical literature and its aggressively empirical approach has been to show that local governments in Japan, as elsewhere, have evolved various strategies for expanding their own policymaking autonomy within the context of a high degree of formal

\textsuperscript{14} See Joseph Schumpeter, "The Crisis of the Tax State," op. cit.

\textsuperscript{15} By comparison, note the "democratic-institutionalist" approach used by students of the US fiscal regime in order to express the influences of a broad complex of ideas (esp. "ability to pay"), social forces, and governmental institutions. See the chapters in Funding the Modern American State, 1941-1995. Ed. by W. Elliott Brownlee. op. cit., especially Brownlee's discussion of methodologies in "Reflections on the history of taxation."
centralization. But in its close embrace of a pluralist methodology, it has unduly downplayed the significance of the central state's fiscal controls.

The centre's formal and informal powers are of primary importance in shaping broad swaths of fiscal politics and policymaking in Japan, areas that bear directly on the prospects for fiscal decentralization. My case studies show that MOF and MOHA's tax competition induces them to impede moves toward local fiscal autonomy. They compete because they represent separate levels of the state in a condition - a universal one, though of varying intensity - where fiscal resources are generally scarce. In consequence, they strive to maintain, and if possible augment, their potent levers of administrative power, for complacency could mean effectively ceding them to the other ministry or to the local authorities. Inter-ministerial competition, the product of friction between fiscal jurisdictions, reduces flexibility in policymaking and conditions in large measure the choices available to local governments.

A corollary of the above is my second major claim: Studying Japan's inter-bureaucratic tax competition reveals a large area of bureaucratic discretion. Tax competition has serious economic and political consequences for national and subnational tax policymaking. To take one currently very active area of contention, discussed in detail in chapter 7, Japan underwent a property-tax revolt in the mid-1990s largely because of MOF and MOHA's struggle over asset taxation. This assertion of bureaucratic discretion challenges, for
example, recent rational choice work on Japan which dismisses, or at least severely circumscribes, the autonomous role of state agencies in policymaking.\textsuperscript{16}

Though my account centres on bureaucratic activism and preferences, I do not suggest that these alone explain outcomes in Japan's intergovernmental tax politics. Institutions matter -- in this case, bureaucratic institutions in particular do because their conflicts thunder across a vast fiscal terrain, affecting an array of taxes on the fields of income, consumption, and assets. But fiscal sociology and historical institutionalism play no favourites when it comes to selecting independent variables, and instead caution the analyst to consider a wide range of interests and contingent phenomena. Thus I would emphasize that my argument is not another partisan challenge from the "statist" side of the highly polarized and ultimately pointless debate on whether bureaucrats or politicians run Japan. Parties and politicians are powerful actors in contemporary Japan, but it is a non sequitur to insist that bureaucratic interests and influence are therefore irrelevant. The reverse equation is equally illogical, as presuming bureaucratic power does not require that one also assume elected politicians are thus enfeebled, barely able even to wield a rubber stamp. In researching intergovernmental fiscal politics such gross methodological reductionism is of little value, and thus I have opted for eclectic

\textsuperscript{16} In order to avoid a long digression from the main trend of argument in this dissertation, I have incorporated an extensive discussion of these works in the Appendix.
and nuanced approaches.\textsuperscript{17}

\textit{Comparative Tax States}

Japan's intergovernmental fiscal structure is huge, and includes over half of 1994's 86.5 trillion yen in total government tax revenues (i.e., exclusive of social security contributions\textsuperscript{18}). In 1994 local taxes collected 32.5 trillion yen, or 37.6 percent of total tax revenues, and over half of the central state's current expenditures were transfers to the local authorities,\textsuperscript{19} via the Local Allocation Tax (LAT), specific subsidies, and other means such as the Consumption Transfer Tax.\textsuperscript{20} The 31.9 trillion yen in total transfers from the central to the local governments saw 16.8 trillion yen delivered through the LAT and 13.6 trillion yen via specific subsidies.\textsuperscript{21} If we add local tax revenues and those from

\begin{quote}
\footnotesize
\textsuperscript{17} Examples include journalistic assertions of bureaucratic dominance, the "Japan Inc." model, Marxian theories of "state monopoly capitalism, and the effortless post hoc claims of political control from the rational choice principal-agent school. By contrast, note Peter Evans' defence of "the eclectic messy center" of comparative politics; in Atul Kohli \textit{et al.}, "The Role of Theory in Comparative Politics," \textit{World Politics} 48, October 1995, p. 2. See also John C. Campbell's comments on the rational choice versus statist debate in Japanese politics in \textit{Social Science Japan}, No.8, 1997.

\textsuperscript{18} Japan collects 35 percent of its tax revenues as social security contributions, and revenue statistics make it clear that contributions are increasingly important aspects of the fiscal state in most OECD countries. But social security issues are outside the intergovernmental ambit of concern of this dissertation.

\textsuperscript{19} Note that in Japanese usage, the "local authorities" or \textit{jichitai} refers collectively to Japan's 2, 586 towns and villages, 655 cities, 47 prefectures, and Tokyo's 23 wards. I will adopt this usage to refer to subnational levels of government in other states as well.

\textsuperscript{20} In 1994, total expenditures were just below 1,414 trillion yen, but because of the prolonged Heisei Recession and related income-tax cuts over 50 trillion of the necessary revenues came from public debt. See "Chihouzei Kankei Shiryou Handobukku, Heisei 8-nen, 10-gatsu" [Handbook of Materials on Local Taxation, October 1996], Tokyo: Chihou Zaimukyoukai, 1996, p. 4.

\end{quote}
the LAT together, along with the 1.9 trillion yen from the Local Transfer Tax, the result for 1994 is 52.7 trillion yen. Using the OECD's 1994 exchange rate of 102.2 yen to the American dollar, we can see that Japan's total local tax and Allocation Tax funds amounted to about 517 billion U.S dollars, a sum larger than most countries' entire annual economic output. Hence, even though Japan's total tax burden in 1994 was only 27.8 percent of GDP, as compared to the 1994 OECD average of 38.4 percent, the country's enormous economy delivered ample revenues. Indeed, Japan's tax revenues for 1994 were, when measured in American dollars, equivalent to 19.1 percent of total OECD tax revenues.22

The Japanese fiscal state's atypical features are displayed in Figure 1.1. The figure shows that 70 percent of Japan's government-sector spending takes place at the local level, but that over one-third of overall taxation is collected by the local authorities. This rate of local spending is extremely high, even in comparison with the federal states, as the American, Australian, Canadian, and West German examples indicate. In addition, the "fiscal transfer" component of Figure 1.1 measures the percentage of the central state's operating expenditures that is transferred to subnational governments as specific and general subsidies. In the Japanese case, 50.7 percent of the central state's operating expenditures are a fiscal transfer to the local

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Handobukku, Heisei 8-nen, 10-gatsu" [Handbook of Materials on Local Taxation, October 1996], op. cit. p. 54, which also describes the Local Transfer Tax.
authorities. This rate is nearly twice the U.K.'s 25.8 percent, which records the next highest fiscal transfer. In other words, Japan has a comparatively massive downward flow of funds in order to provide the resources for an unusually heavy rate of local expenditures.

**Figure 1.1: Local Expenditures, Revenues and Fiscal Transfers, 1994**

Note: US data is 1993, "Austral"=Australia.

As is also clear from the figure, Japan’s percentage of subnational taxation to total taxation, excluding social security contributions, resembles that of the federal states and Sweden more than the unitary states of France, Italy, and the U.K., whose percentages are quite low. Moreover, using OECD figures for 1994 that include social security contributions, Japan’s 24.4 percent level of local taxation as a proportion of total tax revenues is certainly well under the 31.5 percent average of all OECD federal states and the 27 percent average for the Scandinavian unitary states, including Denmark, Finland, Norway, and Sweden. But the rate of local taxation for all OECD unitary states was 11.8 percent, which Japan exceeded by more than double.

I would repeat that overall tax burdens among these states vary considerably. Japan is on the extreme low end of total tax burdens among the OECD countries, as in 1994 all levels of government in Japan taxed at a combined rate of 27.8 percent of GDP whereas the OECD average was 38.4 percent. The US tax burden of 27.6 percent was close to Japan’s, but other countries were generally much higher, with Australia taxing at 29.9 percent, Canada 36.1 percent, France 44.1 percent, W. Germany 39.3 percent, Italy 41.7 percent, the UK 34.1 percent, and Sweden 51.0 percent. The issue here, however, is not total levels of taxation, but the relative flow of tax revenues and transfers to support local government spending, which is inordinately high in Japan. Moreover, Japan’s economy is so large that even the public sector’s comparatively low tax bite represents vast sums of money with commensurate
In gross fiscal terms, then, most federal states resemble Japan to some extent in having a large scale of local spending that is in part supported by fiscal transfers from the federal government. But the point to be emphasized here is that none of the federal states approaches Japan's level of fiscal transfer. Moreover, with the exception of Australia (whose case will be examined in more detail below), subnational governments in the federal systems included in Figure 1.1 enjoy a comparatively large sphere of fiscal autonomy. Local taxes and debt flotation in the US, for example, are the prerogative of subnational governments in a system of clearly delineated powers; and so an agency like centralized Japan's MOHA, which oversees local debt and taxes, simply has no scope to exist.

Sweden, a unitary state, also has fairly high rates of local spending -- the product of concentrating a generous outlay of universal services at the local level. But compared to Japan, Sweden has no intermediary institution such as MOHA and has a much stronger tradition of local fiscal democracy. One notable sign of this tradition was the replacement of the Swedish local property tax base with the more buoyant income tax, a point discussed in the following chapter.

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As for fiscal institutions in other centralized states. France's Ministry of the Interior is often believed to wield a tight rein over local government. But there was considerable fiscal decentralization as a result of the Socialist Party commitment to refashion France in the early 1980s. Moreover, in 1994 local revenues in France were only 18 percent of total government revenues, and so offer a much smaller terrain for fiscal competition.\(^{24}\)

The U.K.'s case is even more remarkable in this regard, as the figure shows how miniscule is the weight of both local revenues and expenditures in the composition of the fiscal state. There is an exceedingly narrow base for interministerial fiscal competition, both because of the small scale of local government and because the British Ministry of Finance holds most of the jurisdictional cards in the sphere of intergovernmental taxation. Moreover, confrontation in the U.K. between local and national government is generally played out between the Conservative and Labour parties, based on their contradictory philosophies concerning the proper role of the state as well as their desire to control local party organizations.\(^{25}\)


Indeed, intergovernmental fiscal relations in the United Kingdom has a history of “particularly ruthless” strategies to marginalize local government, with Thatcherism in the 1980s being only the most recent example. For example, a century before the ascent of Thatcher serious differences in rural and urban fiscal capacities emerged, but as with “every Prime Minister since his time, Gladstone refused to give localities a more flexible tax even though a local income tax was recommended by his able financial advisor, Goschen.” By contrast, Japan’s wartime tax reform saw the Home Ministry (MOHA’s predecessor) snatch a share of the income tax for subnational government and its own institutional ends.26

Japan is also notable in that most developed countries in the postwar era decentralized their wartime fiscal systems. They did not completely dismantle centralized structures of income taxation, because of the pressures for funding the expansion of welfarism and the enlarged role of the national state in economic management. But they largely relaxed controls on their respective local tax regimes and made various reforms to institutionalize intergovernmental consultation and negotiation. Japan went rather in the opposite direction, in reaction to Occupation-era reforms and as part of the emphasis on husbanding resources for reconstruction and rapid economic

growth. Moreover, other states, including the U.K., have over time made great
cchanges to their intergovernmental regimes, but Japan’s postwar system has
been unusually stable, with only incremental changes occurring in the wake of
the rollback of the Occupation’s reforms.27

Table 1.1 gives evidence of another unusual feature of the Japanese state: its
heavy orientation towards public works spending, in particular at the
subnational level. The first column in the table shows the percentage of Gross
Domestic Product consumed by general government sector fixed capital
formation (which is largely public works). Japan’s 6.6 percent of GDP is nearly
twice that of France and Sweden, which spend 3.4 and 3.3 percent,
respectively, of GDP on capital formation, a level that is itself noticeably
greater than the rough average of about 2.0 percent for the rest of the sample.

The second column shows that gross capital formation constitutes almost a
third of Japan’s local authorities’ expenditures. This means that subnational
government in Japan is to a large extent a conduit for public works spending,
more so proportionately than in any of the other countries sampled.

27 Akizuki Kengo, “Institutionalizing the Local System, The Ministry of Local Affairs and Intergovernmental
Relations in Japan,” The Japanese Civil Service and Economic Development. Ed. by Hyung-ki Kim, et
<table>
<thead>
<tr>
<th>Country</th>
<th>General Government Fixed Capital Formation/GDP (%)</th>
<th>Subnational Fixed Capital Formation/Subnational Expenditures (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>2.0</td>
<td>9.7</td>
</tr>
<tr>
<td>Canada</td>
<td>2.3</td>
<td>6.9</td>
</tr>
<tr>
<td>West Germany</td>
<td>2.0</td>
<td>10.1</td>
</tr>
<tr>
<td>U.S.</td>
<td>1.6</td>
<td>9.1</td>
</tr>
<tr>
<td>Japan</td>
<td>6.6</td>
<td>31.8</td>
</tr>
<tr>
<td>France</td>
<td>3.4</td>
<td>23.0</td>
</tr>
<tr>
<td>Italy</td>
<td>2.3</td>
<td>10.7</td>
</tr>
<tr>
<td>Sweden</td>
<td>3.3</td>
<td>7.0</td>
</tr>
<tr>
<td>U.K.</td>
<td>2.0</td>
<td>8.1</td>
</tr>
</tbody>
</table>


Japan's immense public works spending is a core characteristic of its fiscal state. Figure 1.2 displays various countries' government-sector spending as a percentage of gross domestic product,\(^{28}\) and Japan stands out as unusual in all categories save its annual outlay to cover interest on the public debt.

\(^{28}\) The U.S figures are for 1993 and the Japanese data for the 1990s are elevated, due to anti-recession measures, from the 1980s rough average of a little over 5 percent of GDP. Other countries' data vary as well, but within narrower limits.
Figure 1.2: Government Sector Spending as a Percentage of GDP, 1994

The figure shows that the Japanese government’s final consumption expenditures (these are mostly for civil servants’ salaries) are the lowest of the nine countries, and Japan’s “social transfers” (government spending on social security and social assistance) are the second lowest, next to Australia. Japan
is therefore clearly not an interventionist welfare state of the European type, where high public sector employment, service provision, and transfers are reflected in elevated levels of spending on final consumption and social transfers. And even though the Anglo-American states are generally smaller than those in Europe, they cannot match Japan for stinginess when it comes to the number of civil servants and the limited scale of redistribution through social transfers. Nor do any of the other countries, whether Anglo-American or Continental, come close to Japan's outlays for fixed capital, especially as a proportion of total government sector spending.

Rapid ageing of the Japanese population, working in tandem with the country's generous social security programmes, does raise the possibility of a heavy expansion in income transfers. If the transfer programmes remain essentially as they are, or are enhanced, then Japan will be on a trajectory towards the European-style welfare state. But for the present the Japanese fiscal state's statistics rather confirm several critics' claim that it is a "construction state" (doken kokka), one that redistributes an inordinate amount of national wealth through regional spending on infrastructure. These critics, and others who analyze the political economy of state spending in Japan, highlight the extensive porkbarrel role of public works.

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Such claims are correct and illuminating, but from a more historical and macrosociological point of view another interesting fact is that the central state has long sought sociopolitical stability in the regions. As one expert on Japanese public finance notes, suggesting a large measure of path dependence, "aid for rural districts was a policy that originated with the bureaucracy." Funding thus flows mainly to key rural interest groups, such as builders and farmers, not only because of postwar politicization but also because the Japanese state has a tendency to innovate in political institutions and public works designed to bolster stable social structures in the local areas.\[31\]

The point here is neither to set up an argument of Japanese uniqueness nor to suggest that bureaucrats unilaterally run the Japanese fiscal state. Rather, my aim is to highlight differences relevant to a fiscal sociology account. All states are concerned with social stability, but state managers -- including top bureaucrats and ruling-party politicians -- promote it in very different contexts and with disparate levels of zeal. This is also true of economic growth: all states desire it, but some, such as Japan, have pursued it as the overriding objective of public policy. The counterpart of Japan’s relentless quest for

\[31\] The quote is from Noguchi Yukio, in "Time to Grow Beyond the 1940 System," Tokyo Business Today, September 1995, p. 9. For details on the Japanese welfare state and the state’s emphasis on maintaining stability, see Jinno Naohiko, "Nihongata Zei, Zaisei Shisutemu" [The Japanese Fiscal System], in Gendai Nihon Keizai Shisutemu no Genryuu, op. cit., and "Nihongata Fukushi Kokka Zaisei no Tokushitsu" [Characteristics of the Japanese Welfare State], Fukushi Kokka Zaisei no Kokusai
greater economic efficiency in export-oriented industries, the key to the economic miracle, has thus been a concern for political effectiveness in expenditures. Unlike the semi-authoritarian measures favoured in other high-growth regimes throughout Asia, such as stridently anti-liberal Malaysia and Singapore, the postwar Japanese state has to a large extent bought off potentially threatening opposition with the pacifier of public spending. Much of this spending has gone to public works, whose legacy includes woefully inefficient construction firms, entrenched and expanding networks of political corruption, and a monumental load of debt. The system is undergirded by the fiscal instruments of the 1940 regime, which give incentives for MOHA and MOF to oppose fiscal decentralization. But in addition, the massive flow of pork reinforces these incentives, as MOHA seeks to maintain order in local finances and MOF strives to preserve its large role in national-level fiscal policymaking.


On Asian regimes, see Political Opposition in Industrializing Asia. Ed. by Garry Rodan. London: Routledge, 1996. Also, Kent Calder argues that the ruling LDP emphasized distributory politics in order to quell opposition. Though he sees the bureaucracy as technocratic agents of rationalism and austerity, this would seem specifically the orientation of MOF. MOHA, for example, does not oppose fiscal expansion and public works so long as excessive costs are not placed on the local authorities. See Calder, Crisis and Compensation: Public Policy and Political Stability in Japan. Princeton: Princeton University Press, 1988.


Japan's top domestic news story for 1996 was the arrest of former vice minister of health and welfare, Nobuharu Okamitsu, who apparently took 60 million yen in bribes in exchange for providing government subsidies to construct old-age homes. Underlying the incident is the increasing importance of this area as yet another outlet for public works spending. See “Tokuyou, kensetsu tanka o kensa e” [Towards unit-cost construction for special-care homes], Mainichi Shinbun, January 7, 1997, p. 1.
One of the main means through which central agencies, and especially the Ministry of Construction, target public works at the local level is via specific subsidies. These subsidies are among the principal elements in the continuing debate over decentralization, and as I noted earlier provide over 40 percent of the intergovernmental fiscal transfer. Specific subsidies are much loathed in the press and by progressives because they are, as classic political pork, often wasteful means by which Diet politicians and their bureaucratic allies can impose developmentalist and other agendas on local communities. They are also carrots that subnational governments will go to great lengths to secure. Municipal governments at times get so caught up in the feeding frenzy on budgetary allocations that they spend more in lobbying the centre than the subsidy they are after is actually worth.

Moreover, many of the specific subsidies are linked to the delegated responsibilities (inin jimu) through which central agencies are able to make local authorities, and especially the local executive, act as agents for the implementation of centrally determined tasks. Critiques of this delegation of tasks centre on the problems engendered because local executives are thus removed from oversight by their legislatures and local resources and government employees are effectively put at the disposal of central agencies.
Nor are these marginal problems, as “the Local Autonomy Act specifies, in no less than 500 separate statutes, the tasks that the state requires prefectural governors and mayors to perform.”

Targeted subsidies are thus an important part of the 1940 fiscal regime because of their role in centralizing the fiscal regime, stabilizing the local areas, and mesmerizing politicians. But the present work will not discuss the subsidies in more detail than is necessary to highlight their role in the fiscal regime and especially the influence they have, in the aggregate, on MOF and MOHA’s fiscal competition. One reason I take this approach is that researching the institutional channels through which the distribution of Japan’s 2200 different types of specific subsidies is determined would expand this dissertation to an unmanageable size because many line ministries, groups of Diet politicians, local governments, and private interests are involved.

The second reason is that the subsidies supplied 15.3 percent of local revenues in 1994, down from 22.8 percent in 1979. Though statistics for 1995 and 1996 will likely show an increase due to anti-recession measures and the Liberal Democratic Party’s concern not to fall again from the grace of government, the long-range prospect is for further attrition in specific subsidies.

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36 Many works analyze the politics of subsidies in Japan. See, for example, Hirose Michisada, Hojokin to Seikentou [Subsidies and the Governing Party]. Tokyo: Asahi Shinbunsha, 1981. The number of subsidies was taken from “Hojokin no seiri, kanbandaore” [A big show of cutting subsidies], Nihon Keizai Shinbun, August 25, 1996, p. 1.
This decline means a corresponding reduction in explicitly "political" intervention in local affairs and, as I argue in chapter 5, a likely politicization of the Allocation Tax. As a result, I instead devote my attention to the politics of relevant national and local taxes, and the increasing level of general subsidies (ippet hojokin) delivered through the Local Allocation Tax (Chihou Koufuzei).

My case studies centre on the clearest examples of interministerial fiscal competition and opposition to decentralization. Though I will discuss these taxes and transfers in detail below, it is important at this point to show that they are not marginal and unrepresentative aspects of the overall tax state. The Local Allocation Tax referred to earlier transferred 16.8 trillion yen to the local authorities in 1994, or well over half of Japan's unusually high level of intergovernmental fiscal transfers. Moreover, the locally collected taxes that are also featured in my case studies provided, in 1994, 35.5 percent of total prefectural taxes and 53.5 per cent of total municipal taxes. And the interministerial struggle over control of a share of the Consumption Tax involved a tax that supplied 7 trillion yen, or over 8 percent of total national tax revenues in the same year, a level that is expected to increase greatly in the coming

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37 The 1994 figure is an increase over the 14.4 percent recoded the previous year, and reflects public works spending to stimulate the economy. See figures for 1993 and earlier in Table 12.2 "Local Finance Revenue Structure," in Kengo Akizuki, "Institutionalizing the Local System," op. cit. Note also that according to an anonymous participant on the above-noted Committee for Promoting Decentralization, the specific subsidies were among the first items for fiscal reform. Progress is stymied on this front largely because MOF feels too burdened by the scandals of 1995 and 1996 to take on other ministries and their allied zoku giin in a contest concerning further cuts in specific subsidies.
To be sure, fiscal competition and conflict between levels of government are at the very least universal tendencies, because state agencies all desire access to finite fiscal resources. But the important point is that the institutional context in which these tendencies play themselves out varies in politically significant ways. Japan, as we have seen, is unusual because it combines an enormous scale of fiscal transfers and divides central-ministry jurisdiction over vast local and national tax fields. This particular combination of features is not evident elsewhere, and in conjunction with the fiscal history discussed below, has resulted in bureaucratic manoeuvres to protect tax turf or gain control over sections of the contending agency's tax base. This phenomenon of bureaucratic tax competition, or trench warfare on the tax fields, helps maintain Japan's centralized system, as I demonstrate through my case studies.

In order to explore these issues further, some definitions and a review of the most relevant literature are in order. Hence, in the next chapter I turn to consider the concept of decentralization, in particular fiscal decentralization, and then examine how it has been treated in political science works on Japan's intergovernmental relations. Chapter three discusses in detail the

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prewar fiscal order, the wartime reforms, and the postwar revisions. Chapter four sketches the structure of interests within the contemporary fiscal regime, while chapters five, six, seven, and eight analyze how the politics of specific transfers and taxes support the thesis I am advancing. My final chapter, the ninth, summarizes the arguments made and draws conclusions concerning Japan's intergovernmental tax politics and the role of the tax structure in fiscal politics. I would also add that the Appendix reviews the relevant theoretical approaches to fiscal politics, and shows why I have opted for macro and meso levels of analysis in examining Japan's intergovernmental fiscal regime.
Local public entities shall have the right to manage their property, affairs, and administration, and to enact their own regulations within the law.

Article 94, 
The Constitution of Japan

Decentralization is generally defined as the transfer of administrative responsibilities and the finances to perform them from national to subnational levels of government. Such a shift of resources and authority is inherently political, because it concerns the question of which level of the state should wield the most effective jurisdiction in specific areas of policymaking and over particular fiscal resources. Moreover, transfers of revenues and responsibilities do not necessarily go hand in hand. Central states often delegate responsibilities while retaining control over the associated revenues, a characteristic of Japan's system of vertical administration. Hence an apparent case of decentralization might not be substantive if the subnational governments do not have the means to make reasonably autonomous
decisions in the areas placed under their administrative purview.\textsuperscript{1} For this reason I argue that fiscal decentralization is the most important and politically contentious dimension of decentralization.

I would emphasize, however, that this dissertation neither advocates nor opposes fiscal decentralization for Japan. Liberal political theory and neoclassical economics make, of course, strong normative arguments for fiscal decentralization as a means, respectively, to educate the citizen about democracy and promote the efficient allocation of resources when citizens have the opportunity to choose among a range of options.\textsuperscript{2} But these are mere assertions derived from theory and may not hold true, depending on the context, in actual practice. The kinds of interests whose representation might be enhanced through decentralization must be considered before the change can be deemed to bolster the democratic character of the state.

A notable case in this respect is the United States. America’s variant of fiscal federalism abhors centralized administration, leaving the system very much in the hands of the bond markets and highly organized groups of electors who mobilize quite readily against property taxes, the fiscal base of Anglo-American local government. Thus even wealthy American communities can be rendered incapable of taxing themselves at what non-ideologues would

\textsuperscript{1} B.C. Smith gives a comprehensive treatment of these issues in the introductory and finance-related chapters of his \textit{Decentralization: The Territorial Dimension of the State}. London: George, Allen and Unwin, 1985.
consider appropriate levels. The outcome is perfectly "rational" in the institutional environment of American local politics, because narrow fiscal self-interest is provided with a comparatively vast scope to express itself.\(^3\)

Transfers are another problem area in America. Robert Kuttner notes this concerning the wide-eyed neoliberalism that forged the 1996 welfare bill: "bipartisan blather about state flexibility and experimentation is designed to obfuscate an inconvenient key fact: Washington assumed responsibility for public assistance sixty years ago because no other level of government had either the fiscal resources or political will to consistently do so." Federal programmes such as Aid to Families with Dependent Children have always been suspect in the American political milieu, for a host of reasons that certainly includes a strong, institutionally grounded faith in the virtues of fiscal decentralization. Without some degree of federal standards and sufficient resources, a wholesale devolution of responsibilities opens the door to a recrudescence of the human tragedies that called forth the federal presence in the first place. As Kuttner reminds us, "States' rights, once a code word for discrimination and backward social policy, are in vogue again. But Justice Louis Brandeis, author of the oft-invoked phrase that states could be 'laboratories of democracy,' warned simultaneously against a 'race to the

\(^2\) See B.C. Smith's chapter on "Decentralization in Theory," *ibid.*

\(^3\) A related discussion of this point is in Sven Steinmo, "Why is the Government So Small in America?" *Governance.* Vol. 8, No. 3, July 1995.
In Canada too, recent proposals for fiscal and administrative decentralization appear quite unattractive from the standpoint of equity in society. Particularly in Ontario, under a conservative regime, plans to shift provincial responsibilities down to the municipal level seem motivated more by a simple zeal for cost-cutting rather than a larger vision of promoting local democracy.  

On the other hand, neither is decentralization a sure route to securing the goals of fiscal conservatives, as is evident in the lack of budgetary discipline among certain Canadian provinces. In constituencies that often seem institutionally prone to turn to deficit spending to support distributive politics, devotees of self-reliance are unlikely to feel “empowered” by decentralization.  

Hence I restrict my institutionalist arguments to explaining in part why fiscal decentralization has not occurred to a significant extent in Japan. I find some progressive arguments for fiscal decentralization in Japan to be persuasive,

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6 The Canadian federal level of government has been more fiscally responsible than its counterparts among the provinces in recent years, increasing its deficit to GDP ratio from 3.2 per cent in 1988 to 4.6 per cent in 1993. But the provinces, led by Ontario and Quebec, went from a fiscal surplus of 0.3 per cent to a deficit of 2.3 per cent in the same period. The data are from the table on p. 94, *Kokusai Hikaku Toukei* [International Comparative Statistics]. Tokyo: Nihon Ginko Toukeikyoku, 1995. Also, my thanks to Alan Siaroff for noting that “what is really striking about Canada is the interprovincial variations in deficits.”
but to adopt such a normative approach would clearly require a different institutional and comparative analysis than is the object of this dissertation.

Potential Technical Constraints on Decentralization

On the other hand, a related question most certainly does have to be addressed. This is the potential claim that intergovernmental fiscal regimes are dictated by virtually iron laws in economics, and that technical constraints rather than political hurdles bar further progress on fiscal decentralization. If this were true, then the intergovernmental assignment of the tax base would be an administrative matter, largely beyond the realm of politics and the methods of political science.

There are cases in which this caveat is highly relevant. Potential efficiency losses via local taxation at times preclude, or at least make very unwise, some forms of fiscal decentralization. For example, it would be wasteful for Australia to return to its highly decentralized regime of state and federal income taxes, which was in place until the federal state unilaterally took control of the income-tax field in 1942. Australian taxpayers in 1935 could, under certain circumstances, find themselves subject to as many as 14 different income taxes. This variety of levies brought with it an administrative Byzantium whose rebates and amended assessments could take up to three or four years before
they ran their frustrating course to a conclusion.\textsuperscript{7}

But such cases are rarities, and stand as cautionary tales in the folklore of fiscal studies. Modern tax regimes are instead marked by a strong emphasis on administrative and economic efficiency, with governments at all levels generally cooperating to maintain the legitimacy of the tax state.\textsuperscript{8} Such cooperation allows for a remarkable variation in the assignment of tax fields between the levels of government in developed states. Sweden, for example, permits local governments to collect the lion’s share of the personal income tax, a practice particularly uncommon among centralized industrial democracies. Other taxes along the income distribution stream -- i.e., taxes on production, distribution, and expenditure -- can be found assigned to the various levels of government with apparently no hard and fast restrictions.

There are, however, some fairly regular features of the management and assignment of tax bases. One is that agreements can generally be made to rationalize the overall tax base, as was noted above. This tendency applies especially where there are few subnational governments or they have been

\textsuperscript{7} On this see, Julie P. Smith, \textit{Taxing Popularity: The Story of Taxation in Australia}. Canberra: Federalism Research Centre, 1993, pp. 49.

\textsuperscript{8} For example, see the sections on various means of cooperation between Japan's central state and the local authorities in “Zeimu Gyousei Unei Jou no Kyouryoku Kankel” [Cooperation in Tax Administration] \textit{Jichitai Zaisei Kiso no Kakuritsu} [Enhancing the Fiscal Base of the Local Authorities], Mutai Shunsuke, \textit{et al}. Tokyo: Gyousei, 1995. Note that this kind of cooperation is also a common feature of tax relations among national entities, and is typified by tax treaties that allow credits for taxes paid on foreign-source income; see Richard A. Musgrave and Peggy B. Musgrave in “Tax Equity with Multiple Jurisdictions,” \textit{Taxation in a Sub-National Jurisdiction}. Edited by Allan M. Maslove. Toronto: University of Toronto Press, 1993, pp. 3-43, esp. pp. 19-20.
relatively constrained by a central authority, leaving an institutional legacy of more or less cooperative interaction. This latter point suggests that decentralization in Japan would not descend into a US-style fiscal free-for-all.

Second, the more visible types of taxes, especially property taxes, tend to be concentrated at the local level. The reasons for this distribution include history and social structure as well as the fact that the taxes are less buoyant and attract more political hostility. For example, “Eighteenth-century Americans preferred direct taxation - primarily the taxation of property -- in part because they wanted taxation to hurt and thus retard the growth of government.” Though mainstream public finance suggests the property tax is ideal for collecting revenues for local services, the decision to follow this logic is a political choice. The Swedish state has given ample confirmation of this point through its shift over the past few decades from heavy reliance on property taxes to more buoyant income taxes.

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9 This is not always the case, as the Canadian federal and provincial governments respectively impose a VAT (the Goods and Services Tax) and provincial sales taxes. Attempts to harmonize these taxes have been hampered by several provinces’ unwillingness to give up some measure of their fiscal autonomy; see Ikegami Taihiko, “Kanada ni okeru Renpou, Shu aida Zeigenhaibun Ronsou” [The Intergovernmental Debate over Revenue Distribution in Canada], Chuo Daigaku Keizaigakuronshuu, Vol. 36, No. 4, October, 1995. Moreover, in the US, it is seemingly impossible to get agreement on tax harmonization among the states, whose tax mixes are greatly divergent. In the absence of constitutional authority to secure any measure of uniformity, America largely relies on the marketplace to regulate tax rates and tax mixes among the fifty states; see Taryn A. Rounds, “Tax Harmonization and Tax Competition: Contrasting Views and Policy Issues in Three Federations,” Discussion Paper Number 15, Australian National University Federalism Research Centre, March 1992.

10 The quote is from Elliott Brownlee, “Tax regimes, national crisis, and state-building,” Funding the Modern American State, 1941-1995. Ed. by W. Elliott Brownlee. op. cit., p. 41. Also B. Guy Peters points out that the heavy reliance on the property tax in the Anglo-American democracies has at least as much to do with the historical rate of home ownership as it does the more theoretical rationale of assessing for locally provided services; see The Politics of Taxation: A Comparative Perspective. Oxford: Basil Blackwell, 1991, pp. 39-42. On public finance arguments and the property tax, see John F. Graham,
In other words, the relative assignment of direct and indirect taxes\(^{11}\) between governments often depends on bargaining power and what taxpaying publics will put up with rather than the theoretical constraints emphasized in most public finance arguments.\(^{12}\)

These brief notes are necessary, because there is a mountain of orthodoxy that would obscure the politics of inter-governmental tax assignments. For example, mainstream public finance approaches, including those used in Japan, rely heavily on the Tiebout model for drawing conclusions regarding the appropriate tax mix. Stated sufficiently simply for the purposes of this dissertation, Tiebout is said to operate when citizens of the local state can "vote with their feet" and thus leave tax jurisdictions they do not approve of.

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\(^{11}\) While there is not complete agreement on the division of all taxes under the rubric of "direct" and "indirect," the standard definition is that direct taxes are those "in which the rates of tax can be adjusted to reflect the circumstances of the taxpayer, such as his net income or total consumption, assets or net worth, and special needs related to age, dependants, or disability." Hence this definition includes income, wealth, and inheritance taxes, whereas indirect taxes are "levied at rates which are independant of the taxpayer's attributes." These taxes are most often imposed on products or acts, and include value-added taxes, customs duties, and admissions taxes. On this definition, see Jonathan R. Kesselman, "Role of the Tax Mix in Tax Reform," Changing the Tax Mix. Edited by John G. Head. Sydney: Australian Tax Research Foundation, 1986, pp. 49-94, esp. pp. 51-2.

The model thus advises the taxation of things at the local level and the taxation of persons at the national level; in other words, indirect taxes are recommended for subnational governments and direct taxes for the centre in order to prevent the option for exit from posing drastic limits on tax choices or producing excessive tax competition among local authorities.\(^{13}\)

However, there are serious problems with Tiebout and similar public finance analyses of intergovernmental fiscal relations. In particular, the models are hampered by their positivist methodology, which is far too abstract to deal adequately with the rich institutional history of a given intergovernmental fiscal regime.\(^{14}\) Though taxes per se do seem truly as certain a phenomenon as death, the precise mix of taxes cannot be infallibly predicted or prescribed by neoclassical models. This fact is evident in the above-noted variability of intergovernmental tax regimes.

Another constraint on local taxes is said to lie in the functions of the various levels of the state. The theory of public finance which underpins most thinking on the subject sees the role of local taxation as a means for extracting returns for the benefit derived from local services. This is the so-called "benefit

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principle," whose roots lie in the restricted activities and revenue base of the nightwatchman state. Benefit taxation contrasts with the principle of ability to pay, wherein taxes are levied in association with the state's redistributive function. Ideally then, taxes levied at the local level should not be very progressive, if at all, and should aim solely at recouping the cost of local services based on a rough evaluation of the benefit taxpayers accrue from them.\textsuperscript{15}

In practice, this kind of evaluation is very difficult to make, as taxpayers may live and work in different tax jurisdictions. Nor can tax for services -- as opposed to direct fees -- be levied with surgical precision on those who consume them, even if the taxpayers remain within the same jurisdiction. This is because the "tax price" paid is an inefficient mechanism for distributing costs. Such problems thus open up a wide scope for essentially political judgements in determining the intergovernmental tax mix.

The empirical record also shows, as we see in Table 2.1, that the intergovernmental allocation of major taxes in developed countries' tax regimes varies greatly. The Swedish example sees the heavy imposition of income taxes, albeit at flat rates, at the local level versus a rather light burden

\textsuperscript{15} A short description of the principle can be found in Richard Musgrave and Peggy Musgrave, "Tax Equity with Multiple Jurisdictions," \textit{Taxation in a Sub-National Jurisdiction}. Ed. by Allan M. Maslove. Toronto: Fair Tax Commission, 1993, pp. 5-7. A criticism of the principle of benefit taxation as a tax ideology can be found in Naohiko Jinno and Andrew DeWit, "Institutions, Ideology, and the Intergovernmental Allocation of Taxes," \textit{op. cit.}
at the national level. Canada, Germany, and Japan, as is also clear from the table, stand roughly between the example of Sweden and its diametrical opposites, Australia, France, Italy, the U.K. and the U.S., where income taxes play a minor role at the local level. Property taxes as well show considerable variation according to the particular country, with Australia, Canada, Japan, and the U.S. showing rather high levels of local funding from this source, whereas the Swedes levy no local property taxes since their reforms. Consumption taxes, meanwhile, are prominent local revenue sources in Germany and the U.S., but are levied almost wholly by the central states in Australia, France, Italy, Japan, Sweden and the U.K.

**Table 2.1: Tax Structures at National and Local Levels, 1994**

(Units: Percent of Gross Domestic Product)

<table>
<thead>
<tr>
<th>Country</th>
<th>Income Taxes</th>
<th>Property Taxes</th>
<th>Consumption Taxes</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>National</td>
<td>Local</td>
<td>National</td>
</tr>
<tr>
<td>Federal</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Australia</td>
<td>16.2</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Canada</td>
<td>9.8</td>
<td>6.2</td>
<td>0.0</td>
</tr>
<tr>
<td>Germany</td>
<td>4.6</td>
<td>6.9</td>
<td>0.0</td>
</tr>
<tr>
<td>U.S.</td>
<td>10.6</td>
<td>2.3</td>
<td>0.2</td>
</tr>
<tr>
<td>Unitary</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Japan</td>
<td>6.8</td>
<td>3.6</td>
<td>1.1</td>
</tr>
<tr>
<td>France</td>
<td>7.2</td>
<td>0.6</td>
<td>0.8</td>
</tr>
<tr>
<td>Italy</td>
<td>14.0</td>
<td>0.5</td>
<td>1.4</td>
</tr>
<tr>
<td>Sweden</td>
<td>4.5</td>
<td>17.2</td>
<td>1.6</td>
</tr>
<tr>
<td>U.K.</td>
<td>12.1</td>
<td>0.0</td>
<td>2.4</td>
</tr>
</tbody>
</table>


The table also indicates that the most productive taxes tend to be at the national level. This concentration of fiscal capacity is due to the redistributive
and economic management functions performed by the relatively centralized postwar fiscal regime. But as spending responsibilities grow and diversify at subnational levels of government, there are increasing calls for the transfer of tax room from the national authority.\textsuperscript{16}

The point, to reiterate, is that there are few demonstrably iron-clad rationales for depriving subnational levels of government of access to specific tax bases, and more generally, of enhanced fiscal autonomy. By extension, limited scope at best exists for denying that the assignment of taxes among the various levels of government is not strongly determined through politics. The argument that intergovernmental tax divisions are matters of politics, not principle, is strengthened by the fact of the globalization of the market economy. Many analysts have come to insist that the attendant massive movements of funds around the globe and around the clock, has seriously undermined orthodox assumptions about the appropriate distribution of powers in the fiscally centralized postwar industrial state. They conclude that as the national state loses its capacity to act as an interface between the global and domestic economies, the rationale for investing it with fiscal and administrative pre-eminence over the local authorities also erodes.\textsuperscript{17}


\textsuperscript{17} On this development, refer to Jinno Naohiko, "Reinforcing the Fiscal Resources of the Local Authorities: The Japanese Experience," Tokyo University, Faculty of Economics Discussion Paper Series, 95-F-20, August, 1995.
Degrees of Decentralization

I have argued in the above that political variables help shape intergovernmental taxation, but I have not offered a consistent explanation for variations in the kinds of institutions involved or the intensity of the associated politics. The tax regime concept cannot explain such differences, for example, due to its macro-level focus. This lack of a rigorous theoretical approach here would seem problematic, so far as there is a premium on comparative work with a consistent and restricted set of variables. But one thing that cannot be ignored is that analysts disagree on the very interpretation of fiscal and administrative centralization (or decentralization) in a particular country. The difficulty stems in large measure from the significant institutional diversity in countries' intergovernmental fiscal relations. This diversity not only includes -- as we have seen -- the character of the tax mix, but also historical influences on taxation, the rules and institutions that shape intergovernmental tax relations, and a host of other related features.

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18 Michael Loriaux notes this problem in his review article, "Comparative Political Economy as Comparative History," Comparative Politics, Vol. 21, No. 3, April 1989. Loriaux cites Alisdair MacIntyre in support of his contention that the search for laws of political behaviour should be abandoned in favour of a system-specific approach, using context and history to compare "the efforts of some element -- a political elite, government, or political party -- to assure its political survival." The concept of an organizational mission would appear to fit nicely into this style of comparative work.

19 A classic example here is the French tax regime, whose light burden of direct taxation arguably dates from the Revolution. The French nobility was legally entitled not to pay taxes, and the outrage this engendered appears to have influenced the subsequent character of the tax mix. Certainly this argument about path dependence also relies on the role of small business and other anti-income tax interests in modern French politics, but there is an interesting continuity. Unfortunately, there does not appear to be - at least in English or Japanese - a work that traces this legacy.
The division between unitary and federal states might seem the most obvious place to start in constructing a system of classification, but even it does not demarcate more and less centralized regimes. Rather, grounds exist for arguing that there are too few differences to warrant discussing centralized and federal states as truly distinct entities.\textsuperscript{20} Among the federal states, for example, Australia's strong vertical imbalance in the division of tax fields (see Table 2.1) gives the federal authority, or Commonwealth, a great deal of influence over the policies implemented by the states. Canada, by contrast, has greatly decentralized its access to fiscal resources over the postwar period, driven in large part by demands for greater autonomy from wealthy provinces (especially Alberta, British Columbia, and Ontario) and by nationalist aspirations in the province of Quebec.

Furthermore, the local authorities in centralized Britain became even more clearly dominated by the centre during the 1980s, when free-market Thatcherism's ironically aggressive agenda of centralization constrained Labour-dominated local councils and their already limited fiscal autonomy. The Thatcherites so disliked local councils that "in 1991 the cabinet considered abolishing local government altogether."\textsuperscript{21} To restrict the local authorities' capacity to spend, the Tories enacted controls on local taxation.


\textsuperscript{21} See "Never say die," The Economist, May 4, 1996, p. 64. The article further comments on the strong role of party politics in Britain's centre-local relations: "Labour...is all for local democracy -- provided that means Labour councils, controlled by moderates who can be relied upon to do the national leadership's bidding."
and then imposed the regressive and ill-fated poll tax. One effect of Conservative efforts to suffocate local autonomy saw local revenues in Britain plummet from 11 percent of total revenues in 1975 to 4.1 percent in 1993. Devolution of authority over taxes in the U.K. remains strongly opposed by the Conservatives and, reflecting a clear institutional interest in fiscal centralization, the British Treasury.²²

By contrast, many other unitary states have been devolving responsibilities -- and the resources to meet them -- onto their local governments. The Thai Government is one example, with its success in passing and implementing a raft of decentralization measures in 1994. Important prerequisites in this case were decentralization's salience on the agenda of party politics and elected politicians' ability to overcome the Ministry of the Interior's efforts to subvert the process. This case reflects yet again the significance of institutions: Thai local governments are dominated "by the central government through an administrative network of provincial governors, district officers and other officials belonging to or appointed by the Ministry of Interior (sic) in Bangkok. The power of the ministry to oversee the whole of the country outside the Bangkok Metropolitan Area has remained relatively unchanged and unchallenged for decades." In order to get around the obstacle of central

agency obstructionism, the ruling party made certain to include a number of
independent academics on the Local Revenue Improvement Committee that
studied and made recommendations on the issue of decentralization.23

Another notable case is China, where one might think the unabashedly anti-
democratic regime at the centre would be firmly in charge of the fiscal state.
However, China's 1980 reform of the intergovernmental fiscal system replaced
the highly centralized fiscal structure that had characterized the era of the
centrally planned economy. The reform implemented a "fiscal contract" system
in which a complex system of negotiations determines the level of fiscal
transfer and whether it will be from the centre to the local authority or, in the
event of a local surplus, vice-versa. Local governments thus have powerful
incentives and opportunities to cheat on their tax obligations. Enormous
problems have thus ensued for the Chinese central state, which finds itself in a
fiscal crisis due to a shrinking revenue base coupled with the need to prop up
large and inefficient corporations that perform a wide range of welfare state
functions for millions of citizens. Abandoning these firms to the marketplace

23 The quote is from Medhi Kronkaew, "The Political Economy of Decentralization in Thailand," Southeast
Asian Affairs, 1995, p. 345; see also the same author's "Fiscal Reform in Thailand," a paper presented
at the June 24-25, 1995 conference on Fiscal Regimes in the Asia-Pacific Region, Australian National
University, Canberra; note also the report on this conference and its discussions on local fiscal
autonomy by Andrew DeWit, "Ajia Taiheiyou Chiiki no Zei, Zaisei Seido ni Kansuru Kyanbera Kaigi
Houkoku," in Chihouzei, October 1995. It is interesting that the Thai Ministry of the Interior was
comparatively flexible concerning proposals for fiscal decentralization, but resolutely opposed to
reductions in its powers of administration and appointment. This could be because fiscal controls are
less certain and blunter instruments than are direct orders transmitted through appointees in local
administrations. If so, then this suggests that Japan's Interior Ministry bureaucrats found a fall-back
position through tax controls in the wake of the Occupation's dissolution of the ministry and its
extensive powers.
would create massive and politically unstable levels of unemployment, but convincing the rapidly growing local areas to go along with a scheme to redistribute revenues is proving surprisingly difficult for the ruling elite in Beijing.\textsuperscript{24}

In short, simply dichotomizing unitary and federal states obscures a great diversity in institutions and the degree of fiscal decentralization. Furthermore, the categories are not stable. A voluminous literature on federalism examines changes the concept has undergone through the wartime and postwar expansion of the federal state as well as more recent pressures for restraint and decentralization. There is also a large literature dealing with similar processes, as well as countetrends, in unitary states.\textsuperscript{25} The research indicates that a given national community will show, unless there is profound institutional ossification, some variance in its degree of fiscal decentralization as governments respond to the pressures of interest groups and socio-economic change.

It is, however, well beyond the scope of this thesis to review this literature in any detail. The main points to draw from such works and the preceding brief


\textsuperscript{25} See, for example, Percy Allen, "Subcentral Government and Centre-Local Relations," \textit{State and Society in Western Europe}. Cambridge: Polity, 1995, pp. 412-470 and Douglas E. Ashford, \textit{British Dogmatism}
discussion of recent changes in Thailand and elsewhere is that there is much institutional variability among states regarding their intergovernmental relations. Drastically polarized and constitutionally based definitions of federalism and centralized states describe, as Allen puts it, only “the visible face of power” and hence a more finely honed perspective on institutions is required. Moreover, these institutions themselves generally change over time in ways that indicate neither a linear path towards increased centralization nor to greater decentralization.

Decentralization as a Comparative Variable

Fiscal decentralization is clearly an inconstant category between types of states and even within a particular political community -- though as we saw above, the Japanese case is notable for its postwar stability. As a result of the general tendency towards change, there is no robust comparative theory to explain the degree of fiscal decentralization across countries, and constructing one seems a daunting challenge. After reviewing several analyses that focus on geography and other non-institutional variables, Gibson and Batley are led to conclude that “there is a large variation between countries unexplained by

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such variables." They argue somewhat vaguely that "the wider political background" is necessary to explain the variation.27

This dissertation examines closely the "wider political background" in the Japanese case. The goal here is not to construct a rigorous comparative theory, because the institutional context can affect the interpretation of even seemingly unambiguous indices of measurement. To take what should be a rather straightforward case, Dutch municipal and regional governments collect only about 10 percent of what they spend and hence would seem enmeshed in a centralized system. However, some analysts suggest the Dutch system of intergovernmental relations confers abundant local autonomy. Their arguments centre on the representative function played by the Vereniging van Nederlands Gemeenten (VNG), the Dutch association of local governments. Through this institution, local governments negotiate their levels of aid from the central state, which has "little direct leverage on policies in direct localities." Hence, what seems on a statistical basis to be a highly centralized intergovernmental regime of fiscal relations turns out instead to be much less so.28

Or is it? Jan Simonis, an expert on Dutch intergovernmental affairs, interprets the same institution in a completely different way. Simonis argues that the

Dutch national government has managed to take over the lion’s share of decisionmaking on local policies via a steady expansion of “co-governance.” This phenomenon sees the national authority able to use its control of finances to impose its preferences on the recipient local authorities. Moreover, the administrative style is supported by established institutional practices in the Netherlands, which tend to discourage the expansion of differences among the local authorities through “increased revenue from local taxes.” The author notes that many central government departments, concerned about increased taxation of their respective client interests, opposed higher local taxes. In fact, not all the local authorities were fully in support of the proposal: “On the one hand they are keen to obtain greater autonomy; on the other they are wary of the risks and consequences this kind of independence would create for them.”

This account, and others noted above and in the pages that follow, show that intergovernmental fiscal regimes are institutionally complex and cannot meaningfully be summarized by a restricted set of variables. I deliberately belabour this point because the desire to find simple explanations for, or measures of, complex phenomena is both the genius of good social science and the source of appalling reductionism by even brilliant social scientists.

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Arend Lijphardt, for example, constructs a comparative table that uses only the relative proportion of revenues collected locally to measure the level of decentralization across countries. Lijphardt concludes that because Japanese local authorities collect over 30 percent of their own revenues, they are highly autonomous actors. I will show below that Lijphardt’s approach is only the most glaring case that neglects the institutional context of MOHA’s tax controls.\(^{30}\)

Abandoning the quest for a readily quantifiable parsimony might seem to leave my account adrift, with no reasonably clear idea of the variables that are important in assessing centralization and the associated fiscal politics. But fiscal sociology wields a razor worthy of William of Ockham in its focus on control over finances. In this respect, the most fractious intergovernmental fiscal politics centre on subnational governments’ autonomous access to fiscal resources. Indeed, the fiscal history of many, if not most, states is notable for the centre’s efforts to restrict the local authorities’ range of independent action in the sphere of revenues and expenditures. What has varied is the institutional context in which these efforts occurred, permitting greater or lesser degrees of central control.\(^{31}\)

\(^{30}\) Note the discussion of “Decentralization” in Arend Liphadt, *Democracies: Patterns of Majoritarian and Consensus Government in Twenty-one Countries*. New Haven, Conn.: Yale University Press, 1984. Indeed, even where multiple variables are used to assess relative levels of centralization, the results tend to be quite ambiguous; see Michael Peillon, “Welfare and State Centralization,” *West European Politics*, Vol. 16, No. 2, April 1993.

Hence, it does to a large extent matter whether subnational governments collect their own revenues and set their own tax rates. Peters, for example, notes in his impressive comparative work on tax politics that "local governments with more independent revenue sources can, everything else being equal, do more of what they choose rather than what the central government wants them to do." The caveat, however, is that the larger institutional environment has to be assessed in tandem with the simple statistics on tax collection, as in Japan MOHA occupies the ambiguous role of both dominating the local tax base and defending it against the depredations of the centre, represented by MOF.

These points have not adequately been understood in analyses of Japan because many scholars, like Liphardt, rely on misleading statistical data without researching the institutional relationship behind the figures. Others have been keen to overturn the old orthodoxy by showing that specific subsidies do not afford close, top-down control, but they too have neglected to analyze the institutions and incentives of intergovernmental tax politics. By contrast, progressive Japanese public finance scholars often do better comparative work on intergovernmental relations than their counterparts in

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political science, who tend to ignore or dismiss their work.\textsuperscript{35}

\textit{Public Finance and Local Autonomy in Japan}

In Japanese, and especially among progressive public finance scholars, there is an extensive literature that calls for fiscal decentralization. This work is part of a critical tradition that stretches back at least to the Taisho (1912-1925) democracy period, when pressures for fiscal decentralization were frequently asserted.\textsuperscript{34} Nor is it surprising that Japan should have an indigenous tradition of insisting on the need for local autonomy, as the country was quite decentralized prior to the 1868 Meiji Restoration.\textsuperscript{35} The Meiji centralization of the state and the rapid modernization of feudal structures greatly altered, but did not eliminate, the sense of localism, which conservatives of the day often tried in fact to bolster. And in contemporary Japan, the local community and its needs are an increasingly potent source of decentralist pressures. Hence, Japanese debates on decentralization are based on a good deal more than the Occupation’s quintessentially American concern for local autonomy as the

\textsuperscript{33} This claim is based on the present author’s experience from discussions and from checking who cites whom.

\textsuperscript{34} Pre-war editions of journals such as \textit{Toshi Mondai} carry numerous articles showing how salient these pressures were, especially during discussions of major tax reforms in the 1920s and 1930s.

\textsuperscript{35} Kurt Steiner, \textit{Local Government in Japan}. Stanford: Stanford University Press, 1965, pp. 1-18, argues that one cannot persuasively argue there was local self-government in pre-Meiji Japan because there was no strong conception of rights. Hence largely autonomous, de jure as well as de facto, urban centres such as developed in the West were absent. However, his claim that the relations between the feudal state and local areas were “diffuse” and characterized by a “vacuum of government” rather than the “concept of the right to local self-government” does not logically preclude the existence of a large sphere of relatively autonomous local affairs, especially activities governed by custom rather than explicit law.
school of democracy.\textsuperscript{36}

In any case, the power of decentralization as a rhetorical device is undeniable. Certainly there are dissenting voices, from individuals who point to fiscal discipline and other presumed benefits of centralization, but they are clearly the minority. The rise of decentralization as a somewhat ambiguous new orthodoxy is reflected in other central state ministries' concern about MOHA's ability to use the concept as a slogan, in a campaign in which the prize is more likely to be a recirculation of power among the central ministries than its actual devolution to the local authorities.\textsuperscript{37}

But Japanese public finance scholars dwell less on the political-institutional roots of fiscal centralization than they do on its tax-transfer mechanisms. Few of their accounts examine the central state as the disaggregated entity it actually is, nor are they particularly concerned with the policymaking milieu that reproduces the centralized fiscal state. They focus instead on the means of fiscal control, and to this end many of them provide excellent accounts of the workings of the Japanese intergovernmental fiscal system. Many also examine the system in a comparative light, and this dissertation has benefited from having them to draw on.

\textsuperscript{36} Carol Gluck's work on political debates in the late Meiji era notes, for example, that "local autonomy" (chihou jichi) was long a focus of competing ideological agendas; see Japan's Modern Myths: Ideology in the Late Meiji Period. Princeton: Princeton University Press, 1985, pp. 189-205.

\textsuperscript{37} On this, see Kato Yoshiaki, "Chihou bunken chakuchi e no michi: Kengen iyou gutaisaku naku" [The road to decentralization: no concrete policies for transferring authority], Nihon Keizai Shinbun, October 22, 1994, p. 1.
The public finance work is thus not to be faulted for remaining largely within the confines of its own methodological concerns. What is needed, though, is to take the insights from such studies and invest them with the greater political understanding that can be achieved through an historical institutionalist analysis.

**Political Science and Local Autonomy in Japan**

Political science accounts of Japan’s intergovernmental relations have come largely to emphasize the autonomy of local governments, asserting that fiscal constraints are much exaggerated.\(^{38}\) Many of these studies are strongly informed by the 1960s trend towards viewing local government as an important arena of politics rather than, as was previously the case, merely an agent of central administration. This signal change in perceptions engendered major works that depicted a large scope for local activism and effectiveness.

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even in such highly centralized political communities as France.\textsuperscript{39}

While not wholly incorrect, claims that Japan is already quite decentralized have been too enthusiastic, and hence have generally overshot the mark. The pluralist approach favoured by the new orthodoxy causes it to neglect the larger institutional environment, or fiscal regime. Moreover, in asserting the importance of local activism against the centre, it has not paid adequate attention to the divergent and at times manipulable interests among the local authorities nor the emphasis in tax control on promoting uniformity as equity. This last item is especially important, I argue, because the crisis-ridden history of Japan's intergovernmental relations has left deep imprints on the shape of the fiscal regime and the purpose of its associated institutions.

The earlier work also centres for the most part on the fiscally expansive years before the oil shocks of the 1970s. The 1973 shock heralded the secular decline in the Japanese economy's rate of growth; and the shock in 1979, the rise of a protracted austerity campaign under the slogan of "administrative reform." The related fiscal weakness of the local authorities, from the mid-1970s on, did much to temper their late 1960s uprush of assertiveness. This was especially notable in the case of Tokyo Governor Minobe. The experience of Japan's largest subnational government surely has significance for the debate on the degree of decentralization and the relevance of the centre's

\textsuperscript{39} A notable example is Douglas Ashford, \textit{British Dogmatism and French Pragmatism: Centre-Local}
fiscal controls. Hence this aspect needs to be incorporated into discussions of local autonomy in Japan.

Financial Dependence and Local Autonomy

Ronald Aqua confronts head-on the question: "Does financial dependence limit local autonomy?" In his view, the fact that Japan's local authorities do not collect the bulk of their revenues is not in itself an impediment to local autonomy. This is because the local authorities do the majority of programme spending and receive a large transfer of general grants from the centre. Moreover, he emphasizes cases where the local authorities have mounted legal challenges to specific tax provisions and where they have ignored MOHA directives, such as on the need to reduce local salaries due to Japan's mounting fiscal problems in the wake of the 1973 oil shock.

But Aqua overlooks the fact that locally collected revenues are not based on autonomous taxes. My discussion of MOHA's tax controls in chapter 3 of this dissertation shows that local taxes are assessed standard and restricted rates by MOHA. There is some scope for choice at the local level, to be sure, but MOHA is able to enforce the rates through the operation of the transfers it manages, including the Local Allocation Tax and the Consumption Transfer Tax. Most local authorities that would seek to exceed the rates that MOHA


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advises for a particular tax, can be penalized through the transfer system because the amount of transfer is calculated on the basis of local tax effort. MOHA's calculations assume, unless the ministry has given explicit approval to an exception, that a given local authority is imposing a specific tax at the standard rate. If such is not the case, the local body will forfeit some portion of the transfers it would otherwise be entitled to.

Moreover, Aqua comments approvingly on the shift to general grants (mainly via the Allocation Tax) and away from the specific subsidies favoured by line ministries such as Construction, Education, and Health and Welfare. He sees this trend as indicative of a reduction in fiscal centralization, as local governments may use the general revenues "to meet any legal financial commitments."40

But higher levels of general transfers do not necessarily expand local fiscal autonomy. The context in which the level of grant increases has to be examined before such a verdict can be rendered, yet this was not done in Aqua's work nor in subsequent studies that cited his argument as evidence of fiscal decentralization. Many public finance analysts in Japan point out, by contrast, that the role of the Local Allocation Tax has shifted from one of simple fiscal equalization to one of paying down accumulations of debt. This new role

restricts the tax's utility to the local authorities. In addition, my case study of the politics of the Local Allocation Tax shows that the transfer and its institutional nexus are far more complex than Aqua and other political scientists tend to assume.

Debates in the comparative literature also recognize the need to inquire into the institutional circumstances of the particular country's intergovernmental relations before concluding whether increased general transfers actually mean greater local fiscal autonomy. One authoritative source notes, for example, that unrestricted grants do not necessarily mean that the recipient local governments are free to spend the money as they see fit. The reason is that the centre may impose "specified services at specified levels." The same work also argues that:

a gradual shift toward unrestricted grants usually means that communities are increasingly reliant on transfers to finance their traditional core services. Once this occurs, local governments become far more dependent on national transfers, not simply to support peripheral projects, but also to support the very heart of the local operating budget. In this sense the shift to unrestricted grants increases local dependency.

A further problem with Aqua's account is his suggestion that local debt is free from the intervention of the central state. That is, Aqua bolsters his claim of a

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relatively high degree of fiscal autonomy in Japan by, among other things, lumping local bonds in with local fees and charges and indicating that these are autonomous local revenues.\textsuperscript{43} But in fact the local authorities are compelled to secure the permission of MOHA before they float local bonds. This constraint can be quite a severe one at times, as former Tokyo Governor Minobe discovered in the mid-1970s.\textsuperscript{44}

*Lessons From Minobe's "Fiscal War"

Political scientists have largely failed to examine the implications for local autonomy of former Tokyo Governor Minobe's defeat in his "fiscal war" on the centre -- and especially MOHA -- in the wake of the first oil shock (i.e., from 1973 to 1977).\textsuperscript{45} This omission is quite puzzling. One would think the new wave of literature stressing the growing scope for local policymaking -- especially under the progressive leadership of Kyoto and Tokyo a generation ago -- would discuss the role MOHA's fiscal controls played in derailing the Minobe regime's plans for expanding Tokyo's expenditures and tax base. Kurt

\begin{itemize}
\item[44] Aqua, op. cit., p. 20.
\end{itemize}

\textsuperscript{45} See "Progressive Local Administrations: Local Public Policy and Local-National Relations, Political Opposition and Local Politics in Japan. op. cit., pp. 334-35.
Steiner, for example, appears satisfied in depicting Minobe's problems as the consequence of recession and reduced revenues. But this is only half the story: through its debt controls MOHA denied Minobe access to short-term substitute funding, and hence narrowed his policymaking options to deciding where to impose cuts in planned programmes.

Steven Reed also makes note of the case. But he does so only in passing and as an example of a renegade among the local authorities, most of whom "accept [MOHA's] definition of sound financial management."\textsuperscript{46} The problem here is, of course, that the comment fails to refute the argument that MOHA's ability to rein in Tokyo's metropolitan government showed that fiscal controls do constrain local policymaking.

A recent and well-documented work by Jinno Naohiko finds much more significance in Minobe's defeat in the fiscal war. Jinno notes that Minobe's strategy after 1973 was to fight for control over revenues at the local level and thereby expand authority over expenditures as well. This plan required that the central authorities back down in the face of his challenge, but the effort ended in humiliation for Minobe rather than the acquiescence of MOHA.

The fiscal bind for Tokyo's government in the early 1970s was that it ran out of ways to shift funds around in order to cover personnel expenses. These costs

\textsuperscript{46} Steven Reed, \textit{Japanese Prefectures and Policymaking, op. cit.}, pp. 31.
had rapidly increased as a result of expanded outlays on the metropolitan welfare state. Tokyo's 20 percent annual increases in spending were, prior to 1973, paid for through equivalent increases in revenues. But the economic effects of the oil shock slashed corporate tax receipts, upon which the city is highly dependent. Moreover, as an anti-inflation measure fees for public services were not to be raised. Though cuts were made in capital investment and the funds transferred to cover salaries, the limit had been reached with that strategy. Hence the Minobe Administration turned to MOHA for permission to float bonds; but MOHA declared that it would no longer extend such permission for revenue replacement. This move, and the refusal to yield to Tokyo's pressure for more tax room, shoved Minobe onto the path of fiscal reconstruction. In other words, the spur to austerity was the centre's control of the fiscal system through MOHA's administrative authority.47

With a more flexible tax base and autonomous access to the bond markets, it is quite possible that Minobe could have found the fiscal resources to ride out the economic downturn. Minobe's welfarist spending priorities had a significant base of popular support, but one inadequately organized for the task of bringing overwhelming pressure on the postwar fiscal regime. Many health and welfare measure adopted by the central government in the 1970s were in fact originated late in the previous decade by progressive local

leaders, especially the Minobe administration. So with greater fiscal autonomy, local authorities might well have had the fiscal stamina to maintain policy leadership and push harder against the boundaries of conservative policymaking. But the centralized fiscal regime and its tax and debt controls held against Minobe's challenge to the constraints on the local tax base.

This challenge can, in retrospect, be seen as effectively centring on whether progressives or conservatives would lead the expansion of Japan's welfare state. Certainly even had Minobe triumphed at this stage, he may in the end have failed to maintain Tokyo taxpayers' support with a programme of providing enhanced services for increased local levies. But on the other hand, the fiscal scale of Tokyo in the Japanese system is such that if the Minobe administration had triumphed against MOHA and the conservative hierarchy, he would have profoundly shifted the base of Japan's intergovernmental fiscal regime. This in turn might have helped erode in part the Japanese public's pronounced and institutionalized aversion to even moderate levels of taxation. The rout of Minobe in the fiscal war therefore opened the door to the "administrative reform" fiscal conservatism of the 1980s, which implemented cutbacks to an already small fiscal state.

*Refuting the "Vertical Control Model"*

Other political science work, as I mentioned above, tends to follow Aqua's lead
in downplaying the significance of financial controls from the central state. Muramatsu Michio, for example, rejects the "vertical control model," which he characterizes as one that centres on financial and administrative dominance of the local authorities by the central bureaucracy. The advocates of the model, Muramatsu notes, point to the early postwar proliferation of delegated functions that ministries had written into the Local Autonomy Law in order to maintain control over the authorities. The functions allow central ministries to compel local governments to undertake specific duties under the former's tutelage, and as noted in the introduction generally involve the extension of financing through specific subsidies. 48

Muramatsu critiques the vertical control model by pointing to instances where central direction has been deflected or modified by the local authorities. Local governments, depending on the issue at hand, can play central bureaucracies off one against the other in Japan's fragmented system of centralized government. 49 Hence one finds examples where local authorities have exceeded central ministries' recommended guidelines concerning day-care centres and medical care. Muramatsu thus correctly argues that the vertical control thesis has been content to assume that formal lines of authority are actual lines of authority, unmediated by the politics of local policymaking and


49 The phenomenon is called "vertical administration," or tatewari gyousei in Japanese. It refers to the fact that ministries and agencies of the central government have formal administrative authority over their functionally similar counterpart local agencies; e.g., the Ministry of Education can instruct local branches on issues pertaining to education, school facilities, and related matters.
uncomplicated by the intervention of other actors, such as politicians from the majority party.

In place of vertical control, Muramatsu advances a "lateral political competition model." In this model the local authorities compete through policy innovation and political entrepreneurialism so as to gain funding (via specific subsidies, in particular) for favoured programmes and projects. Muramatsu argues that "three-fourths of total government expenditures are made by local governments. Sensitive to people's needs and demands, local governments have created a series of new programs."

On the other hand, Muramatsu also notes that this "pluralization" of local policymaking came up against fiscal controls in the 1980s: "the pluralization which resulted in enormous expenditures causing central deficits has invited central government intervention once again, while its real impact remains to be seen." Fiscal deficits thus brought, in reaction, a strategy of recentralization in order to trim the cost of local government. Local expenditures, as a proportion of total government spending, declined from a peak of 76.9 percent in 1980 to 65.1 percent in 1989. But that only returned them to about the level
they had been in 1970, when they were 66.3 percent. If the policy can be viewed as a recentralization of control over expenditures, then the fact that the outcome was to return to the conditions of 1970 and earlier suggests there was considerable relevance in the vertical-control model's public finance arguments.

In fact, Japan's 1940 fiscal regime has always been marked by a great degree of deconcentration in expenditures versus concentration in revenues. Tracking statistical movements in the relative scale of local expenditures does not really "prove" much, except that the share of local government in overall spending has declined since the peak in 1980. Whether that means there was increased fiscal centralization is unclear. The type of expenditures and the influences on them need a deeper analysis before it can be concluded that a sea change occurred. What is clear from the 1970s, though, is that the central state used tax and debt controls to rein in the policymaking autonomy of the most powerful of the local authorities, Tokyo.

Here, then, is another case where MOHA's fiscal controls and its two-faced role vis-a-vis local governments are not adequately incorporated into the analyses. While it is correct to question the assumptions of the vertical control model, it is also important to recall that its adherents did not construct it out of thin air. Certainly those who depicted specific grants as unambiguous means

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50 The data are in Jinshichiro Yonehara, "Relations Between the National and Local Governments."
of central control were exaggerating the effectiveness of formal controls and underestimate political variables. But it is equally unwise to downplay the significance of MOHA's fiscal controls, for as Steven Reed concedes, "MOHA's administrative guidance concerning finances cannot be ignored." 51

But Reed, like Muramatsu, tends to sidestep the issue of MOHA's controls in his effort to depict a larger sphere for local policymaking autonomy than that advanced by the earlier orthodoxy. Reed notes that the 1970s saw a surprising spurt of policymaking at the local level in Japan. Though he also points out how dependent the activism was on ample local finances, he fails to note the effectiveness of MOHA's debt controls in curtailing local innovation (p. 58-9). The specific mechanisms of control in the Japanese or any other case is important. That is, it makes a significant institutional difference if the limits on local fiscal autonomy are, as in the United States, imposed through the bond markets and groups of electors or, as in Japan, a bureaucratic agency and the conservative political hierarchy in the central state.

Institutionalizing the Local System

A more recent contribution from Akizuki Kengo, part of a larger study of the role of Japan's bureaucracy in economic development, adopts a clearly meso-level institutionalist perspective on the intergovernmental system and the role

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Japan's Public Sector, op. cit., p. 168, Table 10.1.
of MOHA. Akizuki depicts MOHA as the pivotal agency in intergovernmental relations and stresses that it and the intergovernmental fiscal system present Japan's local authorities with a "financial safeguard" and provide "a set of stable rules for actors involved in intergovernmental processes, which enhance their willingness to participate." But he also points out that "a well-institutionalized system takes some goals (such as financial independence) and functions (such as rule-making) away from local government."52

Akizuki offers an interesting institutional sketch of MOHA. He points out that the ministry is very small and hence well able to inculcate its members with agency goals. Moreover, the unusually extensive practice of sending member bureaucrats for service in the local areas creates a strong network of contacts between MOHA and its clients, the local governments. Thus MOHA intercedes between the local authorities and the other central-state agencies both in order to protect local interests as well as its own organizational turf.

In effect, Akizuki takes a step back from the revisionist perspective that has come to shape most political science commentary on Japan's intergovernmental relations. Instead of downplaying the significance of fiscal controls, he concedes that the controls tend to hem in subnational governments even though they do enjoy more policymaking autonomy than


the old model of vertical control suggested.

Yet Akizuki neglects the historical dimension, a problem that is most notable when he sets out to explain MOHA's near-fetish for fiscal stability among local governments. Akizuki suggests the source of this policy orientation can be found in MOHA's structural position in the central state:

[MOHA] is situated in central bureaucratic politics. It must negotiate with MOF over financial matters and must compete with the line ministries for policy initiatives and jurisdiction. These central rivals will jump on [MOHA] as soon as local governments show any signs of disarray. In order to cope with the pressures from these ministries, [MOHA] must keep local governments in order.

[MOHA] is driven to tighten control of local governments by its institutional position at the centre, not necessarily by its perception of local governments. Ironically, [MOHA], which is perhaps the most liberal, understanding, and supportive agency for local governments, is also the most strictly institutionalized for central control over them.53

But there is in fact little irony in the matter, as MOHA and its predecessors were set up precisely to exercise central control over local taxes and transfers. MOHA's powers stem from fiscal history and deliberate choices by postwar bureaucrats to avoid the chaos of decentralization. In other words, it is necessary to examine history in order to understand institutional structure and how the latter helps shape choices in the present. MOHA and the tax structure it oversees (along with MOF) were quite consciously set in place to perform

53 Ibid., p. 365.
the role that Akizuki indicates derives from the current institutional order. Moreover, one of MOHA's major incentives to defend this fiscal system is the competition from MOF.

The next chapter turns to examine in detail the fiscal history and politics that gave rise to Japan's 1940 system.
Chapter 3

Institutions and Japan's 1940 Fiscal System

This tax system was given a revolutionary reform and in design is splendid. But in operation, it has revealed numerous major faults, especially the worsening inequities in local tax burdens...this tax system in fact has no substance (kakaretarumochi), and in my opinion is just a living corpse (ikeru shikabane).

Miyoshi Shigeo
Home Ministry Bureaucrat
(cited in 1931)

Here we have with the clarity of a textbook example what we mean by the crisis of a fiscal system: obvious, ineluctable, continuous failure due to unalterable social change.

Joseph Schumpeter,
“The Crisis of the Tax State”

The Prewar Tax System

Japan's prewar tax system, at the national level, was largely composed of the Business Tax (Eigyouzei), the Household Tax (Kaokuzei), the Income Tax (Shotokuzei), the land tax, and the Liquor Tax (Shuzei). The local authorities relied heavily on a myriad of local taxes and contributions as well as surtaxes imposed on the national taxes, at flat rates set according to central-state approval. Transfers from the central government, as was the case in most countries, were negligible in the prewar era. The period's fiscal system has in consequence been characterized as one that was "decentralized and

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deconcentrated” (bunkenteki bunsan shisutemu), because central-state authority over the local tax regime emphasized tax denial rather than outright control (hence, “decentralization”) and the public services that did exist were mostly provided at the local level (hence, “deconcentration”). Through tax denial the central authorities sought to keep their local counterparts from expanding and encroaching on tax fields that the central state was using to fund national defence and industrial development.¹

In other words, the prewar central state’s approach to local finances was generally one of benign neglect, so long as local spending and fiscal problems were kept within reasonable bounds. From the fiscal sociology perspective, subnational government was virtually a separate sphere of fiscal activity, one whose scale was restricted by the emphasis on benefit taxation and extremely limited redistribution. As was the case in many other countries, however, the growth of local needs and differences in local fiscal capacity began to pose a fundamental crisis for the prewar system. The crisis in Japan was essentially the same as elsewhere, though of course viewed from the meso-level of analysis it manifested itself and was resolved in a very different institutional context.

¹ On “deconcentration and decentralization” as well as “tax denial” and “tax control” in the Japanese intergovernmental fiscal system, refer to Jinno Naohiko, "Nihongata Zei, Zaisei Shisutemu," op. cit. Note also that prewar public services were quite rudimentary and local taxation often involved customary exactions, for local projects and facilities such as shrines, imposed roughly according to ability to pay.
Japanese central state agencies with a direct interest in local fiscal affairs, the Home Ministry and MOF, had thus rather an intermittent interest in local finance until the 1920s. This does not mean they completely ignored this area of administrative activity, because even in the prewar years there were grounds for fiscal competition between the two. In fact, the Home Ministry's founding in January of 1874 was soon accompanied by a struggle with MOF over local tax reform. MOF had been solely in control of local affairs prior to the institution of the Home Ministry, and was working on a tax reform at the time. Tax reform had become an issue because of unfairness in the tax system, but local bureaucrats used the opportunity to press for the separation of local from national taxes. Their goal was to secure a measure of autonomous local taxation. The effectiveness of this lobbying for local fiscal autonomy greatly increased with the institution of the Home Ministry, and in September of 1876 MOF was compelled to draw up a law that recognized taxation at the prefectural level as distinct from that of the national level. In the wake of that reform, though, the focus of bureaucratic activism turned to the business of building the state. Local public finance, and especially transfers from the central state, was too small-scale to excite much central bureaucratic attention and internecine conflict.

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Moreover, the Home Ministry's powers over subnational levels of government were pervasive and direct. The prefectural level was the fulcrum of the overall system, as the Home Ministry appointed the prefect and he oversaw administration at the lower levels. Certainly the ministry had to contend with other central agencies' efforts to use local government as a tool for implementing national policies. But the Home Ministry contained within itself an enormous range of functions; so many in fact that in postwar Japan they were parcelled out to the new ministries of Construction, Home Affairs, Labour, Health and Welfare, and Justice. Hence the Home Ministry fairly enveloped local government, and could impose its ends directly via ordinances and the power of appointment. MOHA's contemporary leverage through control of much of the local fiscal system is a poor substitute for its predecessor's far larger sphere of administrative preeminence.4

The intergovernmental tax regime came to the forefront of fiscal issues in the wake of the first world war, though, because Japanese capitalism's rapid but uneven development exacerbated discrepancies in fiscal capacity. The search for answers to the problem led to various studies, especially through the Special Fiscal Economy Advisory Commission (Rinji Zaisei Keizai Chousakai), a shingikai set up in 1919 in order to investigate Japan's political economy for areas in need of reform. Of particular concern was stagnation and decline in

the rural economy as well as disturbances, such as the 1919 Rice Riots, caused by the failure of urban incomes to keep pace with prices. Alleviating rural distress made the adoption of a redistributive system and comprehensive income taxation appear necessary to social-policy bureaucrats, especially those in MOF and the Home Ministry.\(^5\) The major tax issue, and the one most germane for this dissertation, was the heavy incidence of the land tax and other taxes, especially indirect taxes, on rural interests.\(^6\)

Fiscal imbalance became increasingly serious in the wake of the first world war, as the locus of economic activity shifted from farming to the highly productive new industries in urban areas. The decline of Japan's rural economy relative to the modernized, industrial sector therefore impelled large-scale reform of the tax system. The 1920s saw the bureaucracy mount an effort towards comprehensive tax reform; but strong opposition from business interests stymied this effort to adjust the structure of public finance to

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\(^5\) Sheldon Garon, *The State and Labor in Modern Japan*, Berkeley: University of California Press, 1987, pp. 76-98, discusses the specialization of functions in the Home Ministry from the early twentieth century and the emergence of specialist "social bureaucrats" in the area of labour legislation. The phenomenon was also evident in fiscal affairs.

\(^6\) Harry Oshima notes that the burden of the land tax played a major role in the sad plight of agriculturalists in late Meiji Japan. The problems the farmers suffered are evident in the frequency of uprisings and other disturbances, along with the rapid increase of tenant landholdings. He also observes that "[t]he fact that the percentage share of the consolidated tax receipts contributed by the land tax fell sharply from about 60 percent in 1880 to 15 percent in 1910 did not necessarily lessen the tax burden. In fact it might have increased the burden since a substantial portion of the indirect taxes fell on the peasants as purchasers of the taxed products." See "Meiji Fiscal Policy and Economic Progress," *The State and Economic Enterprise in Japan*. Ed. by William Lockwood. Princeton: Princeton University Press, 1965, pp. 353-390.
To a large extent, then, the pressure for tax reforms can be seen as intrinsic to the prewar fiscal system. According to comparative research done by H. Hinrichs, general fiscal evolution shows a movement from land taxes and poll taxes to "customs duties and modern forms of direct taxation such as income tax and corporation tax." Seen in this light, we can read fiscal choices in Japan in this era as stemming from the following: the land tax was relatively inelastic, and thus "could not meet the increasing demands of the treasury. Indirect taxes (e.g., on alcoholic beverages, sugar) were raised to supplement [it], but a more income-elastic tax was required -- income tax. It was introduced in 1887 and raised considerably in the 1920s and again in 1940." As we have seen, however, there was a good deal of politics within a process that public finance sees as a secular movement.  

Fiscal stress worsened with the Showa Panic of 1927. Economic development was heavily subsidized via the agricultural surplus, but development drew labour away from the rural areas and into the cities. This contradictory state of affairs naturally eroded the social stability and fiscal capacity of the

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7 A good discussion of fiscal politics in the 1920s is found in Ikegami Takehiko, "Daiichiji Taisen ato Nihon ni okeru Zeisei Seiri Mondai no Hassei" [Japan's Problem of Tax Reform after the First World War], *Tohoku Daigaku Kenkyu Nenpou*, Volume 48 Number 6, November 1986. See also Fujita Yasukazu, "Takahashi Zaisei Shita ni Okeru Chihou Zaisei no Saihensei (1 & 2)" [Reform of Local Finance under the Takahashi Fiscal System], *Keizai Ronso*, Volume 143, Number 2-3, 6, February-March, June 1989.

countryside, and further exacerbated discrepancies among local tax rates. In this milieu, the Showa Panic arrived like a typhoon to wreak even more havoc, and compelled the Home Ministry to undertake intensive research on a programme for fiscal redistribution. In August of 1932, The Home Ministry in fact wrote up a bill, the "Chihou Zaisei Chousei Seido Youkouan" [Outline for a System of Local Fiscal Adjustment], which sought to redistribute according to population and the fiscal resources of local authorities.

MOF's Tax Bureau, too, was driven to examine the means available for a system of fiscal redistribution, as organized rural protest manifested itself in politics. However, differences emerged in the two bureaucracies' plans for funding the structure of redistribution. The Home Ministry programme for fiscal redistribution was aimed solely at funding reductions in local tax burdens, through increases in national income, capital-interest, and inheritance taxes as well as the institution of a luxury tax. By contrast, the MOF proposal was for the transfer of the local Household Tax to the national level, after which the funds would be used for fiscal equalization. In other words, MOF was seeking to centralize taxation -- a programme that would have eroded local fiscal autonomy.

Nor were these the only proposals on the agenda, as in the wake of the Showa Panic, the Seiyukai's Tanaka Cabinet came to power and instituted a Tax Advisory Commission (Zeisei Chousakai). The Commission reported in
December of 1928, and advocated that the land tax be shifted to the local authorities. This recommendation constituted a reversal from the previous reliance on surtaxes, the hallmark of the Kenseikai governments’ approach to local fiscal reform. Reflecting local pressures for devolution of major national taxes, the proposal was drawn up in a bill that included a transfer of the Business Tax to the local authorities, and was then presented to the Imperial Diet in 1929. However, the bill came to naught in the legislative proceedings because of opposition from the aristocratic clique. Afterwards, simply delegating taxes to the local level was not to re-emerge as a serious policy option.

The highest political hurdle confronting the reallocation of taxes was the concern that such would undermine the fiscal resources of the central state. Opposition in the Imperial Diet focused on the possible need for greater central revenues in order to fund industrial development and equip the country’s military. In addition, however, some actors recognized that the uneven growth of the local economies made such a tax shift unwise. The reason was that the fiscal imbalance among the local authorities would have worsened in the absence of a redistributive mechanism. That is, the wealthier local entities would have benefited from the expanded powers of taxation because of their stronger fiscal capacity; but the poorer areas would

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not have been able to exploit the expanded tax room due to their weak local economies and consequently restricted fiscal capacity. Gradually, the policy options narrowed in the direction of fiscal redistribution based on centralized taxation, and especially the lucrative income tax.

Table 3.1: Ratio of Local to National Direct Taxes, Selected Prefectures, 1934
(Units: Thousand Yen)

<table>
<thead>
<tr>
<th>Prefecture</th>
<th>Direct National Tax (A)</th>
<th>Local Tax (B)</th>
<th>B/A</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tokyo</td>
<td>83,708</td>
<td>70,642</td>
<td>0.844</td>
</tr>
<tr>
<td>Osaka</td>
<td>45,676</td>
<td>42,981</td>
<td>0.941</td>
</tr>
<tr>
<td>Hyogo</td>
<td>20,607</td>
<td>35,720</td>
<td>1.733</td>
</tr>
<tr>
<td>Aichi</td>
<td>14,415</td>
<td>27,111</td>
<td>1.881</td>
</tr>
<tr>
<td>Aomori</td>
<td>1,538</td>
<td>7,044</td>
<td>4.567</td>
</tr>
<tr>
<td>Kagoshima</td>
<td>2,531</td>
<td>11,830</td>
<td>4.674</td>
</tr>
<tr>
<td>Tokushima</td>
<td>1,255</td>
<td>7,063</td>
<td>5.643</td>
</tr>
<tr>
<td>Okinawa</td>
<td>237</td>
<td>2,139</td>
<td>9.014</td>
</tr>
</tbody>
</table>


The scale of the fiscal problem in the prewar period is indicated in table 3.1. This table presents the ratios of the amount of local taxes to national direct taxes\(^{11}\) for selected prefectures and major cities. As the data show, the spread of relative tax burdens was very great in prewar Japan, due to uneven economic development and the attendant wide variations in fiscal capacity.

\(^{11}\) Note that the direct taxes consist of the Income, Business Profit, Land, Business Transaction, Mining Business, Mining Asset, Capital Interest, and Inheritance Taxes.
The crisis of the prewar system is also reflected in the rates for the surtax on the land tax and the rates for the Household Tax. Table 3.2 shows clearly that in 1935 the urbanized and richer prefectures were able to keep their tax rates far lower than those found in their weaker rural counterparts. Hence the plans for fiscal redistribution.

<table>
<thead>
<tr>
<th>Prefecture</th>
<th>Rate of Surtax on the Land Tax</th>
<th>Household Tax Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tokyo</td>
<td>0.560</td>
<td>0.65</td>
</tr>
<tr>
<td>Aomori</td>
<td>1.467</td>
<td>4.15</td>
</tr>
<tr>
<td>Iwate</td>
<td>1.490</td>
<td>2.70</td>
</tr>
<tr>
<td>Okinawa</td>
<td>1.695</td>
<td>9.75</td>
</tr>
<tr>
<td>National Average</td>
<td>1.325</td>
<td>4.23</td>
</tr>
</tbody>
</table>


The Home Ministry had a particularly strong interest in these fiscal problems, and not only because of its extensive networks of personnel in local governments. An even more powerful motivating force was the ministry’s de facto loss of authority to dictate local tax rates.

That the Home Ministry was not able to enforce its jurisdiction over local tax rates (ie, the surtaxes on national taxes) is an important and, for some perhaps, a surprising point. The ministry is the archetype of Japan's prewar bureaucratic authoritarianism, and dominated local governments through the appointment of key personnel and a vast array of directives. But the prewar
depression caused such a divergence in local fiscal capacities that the ministry could not credibly demand that tax rates be balanced among the local authorities. Uniform tax rates on grossly unequal tax bases produce commensurately disproportionate streams of revenue per capita. This simple fact made it necessary to increase tax rates in fiscally weaker areas, with the ministry's resigned acknowledgement of the unavoidable. Restoration of effective control over, and balance among, local taxes required redistribution to bolster the fiscal position of weaker administrative entities. But a sufficiently redistributive scheme would require increased taxes to fund it; and increasing taxes, under the prewar fiscal system, meant essentially to impose an even greater burden on the rural interests who were already being heavily taxed relative to urban interests. Shifting more of the tax burden, via income taxes, onto urban business interests had not been accomplished in the 1920s, due to the political coalitions of the Taisho Democracy era (1912-1925). The need for income-tax reform thus presented itself again as a prerequisite to the modernization of the prewar fiscal regime.\(^\text{12}\)

The early 1930s saw an additional powerful actor arrive on the stage of Japanese politics: the military. Pressures mounted for increased spending on armaments and other expenses for more aggressive colonial policies and militarism. This was especially the case in the wake of the assassination of the

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\(^{12}\) The late 1920s and early 1930s saw heavy but futile pressure from the central state for the local authorities to cut their expenditures, which proved too difficult due to fixed patterns of spending. The only alternative for the locals was to increase the local tax burden. See Suzuki Takeo, \textit{Zaiseishi} [Fiscal History]. Tokyo: Toyo Keizai Shinposha, 1962, pp. 155-56.
Finance Minister Takahashi in February of 1936, after which the state budget rose dramatically, as is evident in Table 3.3.

**Table 3.3: National Government Expenditures and National Income in Japan.**

1936-1945

(Units: Million Yen)

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>National Government Expenditures</th>
<th>Estimated National Income</th>
<th>National Expenditures, % of National Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>1936-37</td>
<td>2,282</td>
<td>16,320</td>
<td>14</td>
</tr>
<tr>
<td>1937-38</td>
<td>4,461</td>
<td>20,476</td>
<td>23</td>
</tr>
<tr>
<td>1938-39</td>
<td>7,705</td>
<td>23,200</td>
<td>33</td>
</tr>
<tr>
<td>1939-40</td>
<td>8,418</td>
<td>28,300</td>
<td>30</td>
</tr>
<tr>
<td>1940-41</td>
<td>10,534</td>
<td>32,000</td>
<td>33</td>
</tr>
<tr>
<td>1941-42</td>
<td>18,728</td>
<td>36,800</td>
<td>51</td>
</tr>
<tr>
<td>1942-43</td>
<td>24,695</td>
<td>45,000</td>
<td>55</td>
</tr>
<tr>
<td>1943-44</td>
<td>36,036</td>
<td>50,000</td>
<td>72</td>
</tr>
<tr>
<td>1944-45</td>
<td>49,652</td>
<td>60,000</td>
<td>83</td>
</tr>
</tbody>
</table>


Tax policy also shows the mark of the new and militarist regime, though in a rather contrary form than cartoons of the absolutist Japanese state suggest. There were efforts to expand revenues to fund the increasing expenditures on armaments. However, the tax policy bureaucrats continued to encounter effective opposition from business interests -- to the extent that a thoroughgoing overhaul of the tax system, proposed in the 1936 "Baba Tax Reform," was blocked.
The Baba reform, which took its name from the minister of Finance, included what were -- even by the standards of the time -- rather drastic remedies for the local finances. In the mid-1930s, subnational governments were receiving 53.1 percent of their revenues from taxes and contributions over which they exercised great discretion, while 35.5 percent came from surtaxes, and 11.4 percent from specific subsidies that had in the interwar period been instituted to cover the cost of primary education and other responsibilities. Indeed, there was an effort to use these transfers to reinforce control over local rates of surtax, but the scale of transfer was insufficient to secure this end. The Baba programme thus sought to restructure the local fiscal regime so that independent local taxes would provide no more than 17.2 percent of local revenues, with 32.4 percent coming from surtaxes, 39.0 percent from general subsidies and 11.4 from specific subsidies. In the words of Kikuchi Shinzo, a contemporary observer, the Baba reform was “an effort to suffocate local autonomy and impose, in place of a deliberately withered local administration, a uniform, centralized bureaucratism.”

But the effective opposition to the Baba measures was not focused on the plans for local finances, and instead centred on the proposal to introduce a comprehensive form of the income tax. This plan was, like previous initiatives, stymied because it would have led to much higher taxes being placed on urban business interests. In the wake of the failure of the Baba Reforms, the

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13 The details and commentary are in Murayama Takamitsu, *Nihon Chihou Zaiseishi* [A History of Japan's...
North China War Emergency Taxes and others were levied from 1937 to 1939, but their actual fiscal significance was not very great; certainly they produced nowhere near the volume of revenues needed to match Japan's escalating expenditures. The low productivity of the tax system plus the continued instability in the rural areas hence forced a major tax reform in 1940, one that drew heavily on the Baba programme.\textsuperscript{14}

The 1940 Tax Reform

The argument that there were at least two major policy objectives in the 1940 reform is still somewhat controversial in Japanese public finance circles. Mainstream opinion -- to the extent that it pays attention to the war years -- views the reform as motivated solely by the need for revenues for warfighting, an empirically untenable argument that perhaps reflects an understandable revulsion for the wartime fascist state rather than an objective appraisal of fiscal history.\textsuperscript{15} Recent empirical research shows the moralistic position to be clearly misinformed, as there is indisputable evidence that a powerful system


of intergovernmental redistribution was constructed, one aimed both at maintaining social stability in the rural areas as well as reinforcing them for their role in the war effort.

Table 3.4: Changes in the Structure of Local Finance

(Units: Percentage of Revenues)

<table>
<thead>
<tr>
<th>Year</th>
<th>Local Taxes (A)</th>
<th>LAT (B)</th>
<th>Fees/Charges (D)</th>
<th>Subsidies (E)</th>
<th>Transfers from Centre (B+C+E)</th>
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<td>0.011</td>
<td>0.154</td>
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Note: LTT=Local Transfer Tax, LAT=Local Allocation Tax.
Source: Table in Noguchi Yukio, 1940-Nen Taisei [The 1940 System], op.cit., pp. 124.
This new redistributive role of the central state is evident in table 3.4, which shows the prewar, wartime, and postwar levels of redistribution to the local authorities. The table depicts very well the fact that the level of transfers from the centre underwent a sea change during the Pacific War. From 1940, the Local Allocation Tax (LAT)\(^{16}\) and subsidies from the national treasury provide an increasingly significant portion of local revenues. These transfers were based on the centre’s assumption of control over local resources, which gave it potent fiscal tools that will be discussed in detail below.

Japanese politico-economic studies are constantly under siege from culturalist claims and other superficial assertions of the country’s uniqueness.\(^{17}\) Hence, it is important to repeat that wartime centralization of the tax system -- and especially the income tax -- was the norm among belligerent nations. All countries faced the need to raise funds efficiently, with as little harm to price levels as possible. The war years saw, in consequence, the institution of income-tax collection systems that took regular deductions from the working class, which previously had been exempt from such taxation. Japan’s 1940

\(^{16}\) In fact, during the war it was -- as we have seen -- referred to as the Distribution Tax, but as the principle of redistribution remains the same, it is more convenient to assign the most recent name to the tax.

\(^{17}\) For example, Mochida Nobuki, a public finance economist at the University of Tokyo, writes that “Japan’s system of equitable tax allocations, which has no equivalent in the West, drastically reduces residents’ Tieboutian voting with their feet between regions. At the same time, Japanese society also places great value on long-term relationships and \textit{ex post facto} equity, and this shared idea of fairness prevents the American idea that bankruptcies are an integral part of decentralization from gaining ground in Japan”; see “Balancing Equity and Decentralization,” \textit{Social Science Japan}, November 1995. In fact, not only is fiscal equalization common elsewhere, but Sven Steinmo’s work handily shows that

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institution of regular income tax deductions, wherein the employer acts as the collection agent for the state, preceded that of its adversaries by a few years and was in fact a policy "re-import" from the Japanese colony of Manchukuo (Manchuria). But in overall fiscal terms, Japan did not deviate much from the rough norm of tax policymaking among the warring nations.

Moreover, it was common elsewhere for fiscal centralization to meet other objectives in addition to the goal of raising revenues for warfighting. In Canada, for example, the fiscal pressures of the war provided an opportunity to overcome the opposition of the larger provinces and implement a landmark set of recommendations to centralize taxation and create a system for redistributing resources to the poorer provinces. Some of these areas had been so ravaged by the Great Depression and the protracted drought of the 1930s that large numbers of their young male residents were unfit for wartime service due to chronic malnourishment. Against a national average of 48 percent, the prairie provinces of Saskatchewan and Alberta saw respective declines in provincial per capita income between 1928-29 and 1933 of 72

American public policy choices are due more to institutions rather than vague and generally conflicting culturalist variables (especially "values").

Jinno Naohiko, 1993, op. cit., p. 234 notes that at-source collection of the income tax was instituted in Manchukuo in 1911. The UK and the UK, on the other hand, adopted the same measure in 1943 and 1944, respectively.

The Nazi leadership in Germany also centralized the tax system, extended the redistributive system set up to cope with local fiscal crises during the Weimar Republic, and shifted the burden of income taxation downward onto middle and lower-income earners. A useful review of the tax changes in Germany, including comparisons with those implemented by the wartime Allied powers, is presented in Mabel Newcomer, "War and Postwar Developments in the German Tax System," National Tax Journal, Volume 1 Number 1, March 1948, pp. 1-11.
percent and 61 percent.\textsuperscript{20}

Japan's highly centralized "1940 fiscal system" saw local governments lose, via redistribution, the capacity to determine rates of local surtaxes. As seen in tables 3.1 and 3.2, the Home Ministry had previously been forced to allow enormous deviations in local tax rates because it lacked the fiscal tools to enforce its own area of jurisdiction. But the 1940 tax reform modernized the income tax and thus shifted the burden of taxation away from the fiscally strapped countryside. Moreover, the more equitable tax structure underpinned a new system for redistributing taxes, one that gave the Home Ministry the means to enforce standard rates, as it could withhold transfers in the event of deviations for which it had not given explicit approval. As one analyst notes:

The Home Ministry initiated the local tax reform of 1940, which established a Local Distribution Tax system to ensure adequate local revenues and adjust financial inequalities among the local governments...This system increased the local tax revenues as a whole, but it also made the local governments increasingly dependent on these tax allotments.\textsuperscript{21}

The new local tax regime had two major facets. One was the centralization of local land, Business, and House taxes through collection by the national authority; these revenues were subsequently returned to the prefectures from which they had been taken. The measure was hence called the system of

"Refund Taxes" (Kanpuzei) and helped bring local taxes, and decisions concerning them, firmly within the grasp of the central state.

The second element of the new intergovernmental tax regime was the system of Distributive Taxes (Haifuzei). This structure saw set percentages of selected national taxes transferred to the Distribution Tax account and thence redistributed to local authorities on the basis of calculated revenue capacity and overall fiscal need. The former assessment was made by totalling revenues from the respective locality's surtaxes on the land tax, House Tax, and Business Tax, with the distribution of central funds being done in inverse proportion to this sum. The latter item, fiscal need, was based on the local authority's population, with disbursements being made in direct proportion to this figure. The tax base funding the structure included 16.55 percent of the classified income tax, the aggregate income tax, and the corporate income tax; and added to this, 50 percent of the Amusement Tax and the Admission Tax.22

Thus the hallmarks of the new intergovernmental tax structure were centralized collection and redistribution. The system emphasized extensive intervention towards promoting uniformity, and both the fiscal means and the end they served marked a sharp contrast to the previous separation of local


and national taxation and the large gaps in tax rates among the local authorities. In one analysts words, "the 1940 reform was in formal terms the final reform of the old local tax system, but in truth it marks the point of departure to the contemporary local tax structure."\(^{23}\)

**Enhanced Tax Control**

One of the most important points to emphasize here concerns the framework for decisionmaking on two types of local taxation. The prewar regime of tax control was rather loose, or "deconcentrated." On the one hand this meant that the Home Ministry lacked the fiscal means to enforce its directives on rates of surtax. But it was also the case that much local taxation was highly informal, consisting often of contributions for local services such as shrines and their maintenance. These contributions were not mandated by law, but rather by community norms, and were generally levied on the basis of externally assessed ability to pay.

The centralization of the tax state during the war put de facto decisionmaking authority over official local taxation -- i.e., surtaxes on national taxes -- into the hands of the Home Ministry's Local Affairs Bureau. This change thus brought nominal and effective control over local taxation into the same hands, for as noted earlier de jure authority had always resided in the Local Affairs Bureau.

\(^{23}\) Murayama Takamitsu, *Nihon Chihou Zaiseishi* [A History of Japan's Local Finance], Tokyo: Gyousei,
But the transformation of the rural socio-economic landscape also greatly eroded the place of the customary local levies, and therefore fiscal redistribution and the modern tax state had to replace more informal mechanisms of funding local services. This process reinforced tax centralization and deepened the local authorities' dependence on the central state. Both of these changes contributed to the emergence of the contemporary “centralized-deconcentrated system” (shuukenteki, bunsan shisutemu), which couples centralized fiscal controls with the decentralized delivery of services.24

The Postwar Reforms

After Japan's surrender in 1945, a series of fundamental tax reforms was implemented under the American Occupation. The reforms generally centred on raising revenue, both to introduce a greater degree of fiscal equity via income taxation and to control inflation through the absorption of mass spending power. In addition, there was the pressing need to finance the postwar state and the burden of the Occupation, as well as the perceived need to expropriate large fortunes. These policies, implemented in the midst of a defeated economy that had lost nearly a quarter of its physical stock, took a heavy toll and helped produce a robust anti-tax sentiment. Indeed, popular opposition to tax assessments at times erupted into “mass demonstrations,
attacks on tax offices, burning of tax records, and beating of tax officials.”

This chaotic environment was exacerbated by great fiscal instability among the local authorities and consequently a heavy dependence on central-state transfers. This is evident in Table 3.4, which shows that subsidies skyrocketed to comprise nearly half of local revenues in 1946.

Fiscal Decentralization Under SCAP

In this very early postwar period, SCAP’s desire to foster “the spirit of local autonomy among the people” was the motive force behind Japanese tax policymaking, and the initial response to local fiscal crisis was to decentralize the tax system. Revisions were made to the Local Tax Law and Local Apportionment Tax Law to allow higher levels of local surtax on the Land, House, and Business taxes. But these were relatively minor changes. SCAP’s decentralist reforms included far more aggressive measures, such as extending an Inhabitants Tax (Juuminzei) to the prefectures and allowing both levels of subnational government to levy extra-legal independent taxes in order to secure a larger measure of flexibility in local taxation.

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26 Shiomi Seisaburo, Japan’s Finance and Taxation, 1940-56, op. cit., p. 67. Note that “extra-legal” (houteigai) refers to taxes not written into the local tax law. A cornerstone of MOHA’s contemporary fiscal control is its ability to permit these taxes, of which there are very few.
Later, in the spring of 1947, revisions to local taxation included a wholesale downward reallocation of decisionmaking authority and the right to autonomous occupancy of important tax fields. The new constitution, promulgated in the same year, guaranteed local autonomy; and as one means to this end, major elements of the Local Apportionment Tax regime were placed in the hands of the prefectural governments, with municipalities permitted to levy surtaxes on the new prefectural taxes. Standard rates still applied to the independent prefectural taxes, but to avoid rigidity in the local tax base there was again a generous recognition of excess taxation. In addition, several narrow-based consumption taxes were transferred to the local level as well, including the Admissions Tax.

The next major development came in July of 1948. Shiomi Seisaburo expresses the character of the changes and the rationales for them quite succinctly:

As local autonomy progressed, the necessity for local independence was stressed and the Local Finance Law was enacted to implement the Local Autonomy Law. Accordingly, this latest revision was so framed as to make local taxes independent of national taxes and to minimize supervision of the central government over local finance. The Ministry of Home Affairs [i.e., Naimushou], which had been handling the local administration for many years, was dissolved at the end of 1947 and the Local Finance Commission was created to take over these duties.27

27Ibid. p. 75.
Shiomi goes on to note that SCAP was hardly through with its reforms. The same package of measures included the elimination of central controls over several local taxes as well as the institution and revision of extra-legal independent taxes. In Shiomi's words, "[t]hese were entirely novel ideas and particularly noteworthy as a turning point in the history of the local taxation system in view of the fact that local finance had been at the mercy of the central government ever since the institution of the taxation system in Japan far back in the Meiji Era (1868-1968)." 28

Of course, the diametrical opposite of the rapidly decentralizing postwar tax system was the 1940 system. Prior to the war, the national and local tax systems were, as Shiomi himself notes, quite separate entities, and the absence of a redistributive system posed a strong hindrance to effective centralized tax controls. However, Shiomi's comments suggest how profound a departure from past Japanese practice the reforms were, because they sought to enshrine local fiscal autonomy in the law. Shiomi's ready appreciation of the extent to which the reforms posed a challenge to central authority hints at how strongly opposed many former Home Ministry bureaucrats were to such an explicit and codified erosion of central authority. But these bureaucrats could only, for the duration of the Occupation, attempt to subvert decentralization through linguistic obfuscation and legislative

28 Ibid. p. 76.
obstruction behind the scenes.

Indeed, in the middle of the apparent dominance of policymaking by the Occupation authorities, the bureaucrats were often busily crafting means to maintain or enhance their powers vis-a-vis one another and in relation to civil society. Kurt Steiner and others have, for example, handily documented the efforts made by the Home Ministry bureaucrats to manage the process of decentralization the Occupation was committed to imposing on Japan. Of particular concern to the Home Ministry leadership was the Occupation's insistence on democratizing local administration through direct election of the prefectural governor. The prefecture was the linchpin of the Home Ministry's administrative rule over the local authorities, a hierarchy of centralized control that was borrowed from the Napoleonic French model. In both regimes, the prefecture -- in France, the prefect -- was a middle level of government set up specifically to oversee local affairs and was headed by an appointee from the Interior Ministry. Losing the power to select this official was thus perceived in the Home Ministry as a serious detraction from the bureaucracy's authority, and the reform was therefore obstructed as diligently as was possible under the Occupation.

Nevertheless, the Home Ministry was stripped of the power to appoint prefectural leaders, even as its control of the local tax base was being undermined. And then it lost its integrity as a ministry per se when the
Occupation dismantled it in 1947 as part of its reorganization of local government and the Local Autonomy Law. From the remains of the Home Ministry's dismemberment, the Occupation spun off an array of agencies concerned with construction, labour, elections, and local finance. Subsequent Occupation reforms sought to bolster the autonomous role of the latter of these new agencies. But having lost direct authority over local government personnel, the former Home Ministry bureaucrats fell back and regrouped at the line of control over local finance, there to make their stand against fiscal decentralization. Indeed, though Occupation-inspired purges hit the Home Ministry particularly hard, its displaced bureaucrats were prominent in the subsequent rollback of the Occupation's reforms to the taxes, laws, and institutions that comprise Japan's intergovernmental fiscal relations.

The Dodge Line Shock and the Shoup Report

In fact, the Occupation's shifting priorities appear to have encouraged the reassertion of centralized fiscal controls. Most notably, the 1949 imposition of the Dodge Line included a massive cut in local taxation, which caused havoc in local finances. Joseph Dodge was an American banker brought to Japan by SCAP and given wide-ranging powers to impose drastic solutions to the country's prolonged bout of inflation. As part of his programme to crush

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29 Kent Calder notes that 1300 officials from the Home Ministry were purged, "representing 70 percent of those purged in the entire civilian sector of the government"; see Crisis and Compensation: Public Policy and Political Stability in Japan. Princeton: Princeton University Press, 1988, pp. 150-1.
inflation and "over-balance" the Japanese central government budget, the proportion of the national personal and corporate income taxes transferred to subnational governments went from the 1948 setting of 33.14 percent to 16.29 percent.

The redistributive tax system was thus abruptly axed in half to accomodate Dodge's demand for drastically reduced expenditures. Moreover, Dodge's nostrum of economic dogma, through starving Japan's corporate sector of funds, nearly achieved the economic collapse that General Curtis LeMay's wartime bombing had not. However, the bureaucracy wisely found the means to supply alternative sources of finance and thus check the ominous spread of bankruptcies and unemployment. But for the local authorities, especially the weaker ones, the Dodge Line's insensate fiscal austerity hit like a shock-wave.30

Several months prior to the appointment of Dodge, the public's anti-tax sentiments and the confusion in intergovernmental affairs saw Japanese authorities and elements of the Occupation's Internal Revenue Division request the appointment of a blue-ribbon Tax Mission. The mission came to be headed by Carl S. Shoup, a highly respected public finance scholar, who hand-picked a small team of America's best and brightest in the field. The

30 Note Steiner, Local Government in Japan, op. cit., p. 106.
Japanese were hoping for recommendations of recentralized taxation, but what they got instead was effectively a plan to federalize the fiscal state, through a strict division of tax fields and functions among its component levels of government. Shoup's report can, as Shiomi suggests from an historical perspective, be seen as a strong distillation of Anglo-American tax ideologies applied liberally to Japan. Up to that point, Japan had been governed on the tax front largely according to indigenously selected Continental European examples.

The first *Shoup Report* was delivered in 1949, with a less significant second installment coming in 1950. The analysis of intergovernmental fiscal relations in Japan dwelt much on the need for local fiscal autonomy, defined largely as a clear separation of tax bases, tax collection authority, and programmatic responsibilities among the three main levels of government. The philosophical core of this approach was the characteristically American conviction that democratic behaviour was fostered by strong local governments and the ability of electors to perceive which level of administration bore responsibility for specific taxes and programmes. In order to bolster local fiscal autonomy, Shoup also recommended that the Distribution Tax (known as the *Haifuzei* from 1948) be replaced by a system of equalization grants (*Heikou Koufukin*), whose methods of calculation and transfer to recipient governments were to

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be transparent and based solely on local fiscal requirements.

A further recommendation in the *Shoup Report* was that a Local Finance Commission be set in place and take an independent role in coordinating fiscal relations between the central state and the local authorities. Such a commission was, in essence, to be a greatly altered and far more autonomous version of the agency that had already been created through the dissolution of the previous Home Ministry. The membership of the new Local Finance Commission, in an effort to ensure strong local representation, was to be drawn heavily (3 out of a proposed 5 members) from among the six national associations of governors and other local administrators (*Jichi Roku Dantai*). Moreover, the powers exercised by the Commission were to include the allocation of shares of maximum allowable local debt, determination of the basis for distributing equalization grants, and temporary suspension of restrictions on the maximum rates of local taxes when it deemed appropriate.\(^{32}\)

While not America's radically decentralized federalism, where only the financial markets and local electors hold the local authorities accountable, Shoup's intergovernmental tax regime sought to amalgamate the previous Occupation reforms and create a coherent system of decentralized authority over taxation and spending. It was thus an enormous red flag waved right in the faces of many of the Japanese fiscal authorities.

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This last round of the Occupation’s tax reforms is of great significance, but not because -- as many still hold -- the current Japanese tax system is based on Shoup. On the contrary, the reforms are important because the tax and institutional changes based on Shoup and other SCAP measures were so quickly and consistently deconstructed in favour of the wartime fiscal system. With the advantage of hindsight and the literature on transwar phenomena, we can see that the Shoup episode and its aftermath do not bespeak the failure to recommend “realistic” tax policies that fit with Japan’s fiscal traditions. In fact, many of Shoup’s reforms to modernize Japanese tax administration were retained. Revisions to the Shoup system centred on fostering capital accumulation and gutting local fiscal autonomy, core elements of postwar Japan’s centralized developmental state. These particular foci of rollback give evidence of wartime learning, expressed in the revanche of the 1940 system and its institutions.

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34 One of the best accounts of the political background to the Shoup Report and its deconstruction is Martin Bronfenbrenner and Kichiro Kogiku, “The Aftermath of the Shoup Reforms” (Parts 1 and 2), National Tax Journal, Vol. 10, Nos. 3 and 4, September and December, 1957. Their work suggests that Shoup was in large measure a failure, due to a lack of realism in some cases as well as an unfavourable political context. See also Kozo Yamamura, Economic Policy in Postwar Japan: Growth Versus Economic Democracy. Berkeley: University of California Press, 1967.
Fiscal Control for Equity as Uniformity

To repeat an earlier point, the existence of a centralized fiscal regime is not, in itself, remarkable. The postwar expansion of the welfare state in the advanced industrial countries was often accompanied by the central or federal level's dominance of major tax fields, and especially the income tax. What stands out in the Japanese case is the return to much of the pattern of 1940 in the wake of large-scale fiscal decentralization under Shoup and earlier Occupation reforms.

Understanding the process of recentralization involves grasping the range of motives of the actors involved. It is important, of course, to point to the role of naked self-interest; but not to the extent that illustrating the politics of recentralization becomes merely a caricature, wherein sworn enemies of fiscal democracy callously put SCAP's system to the sword. Emphasizing malign intentions focuses the analysis too much on control for its own sake and thus highlights only one aspect of a larger story. For as I have alluded to earlier, a defining experience of MOF and Home Ministry bureaucrats was the prewar fiscal crises of the local authorities. The political salience of dire local circumstances is evident in repeated prewar efforts to secure tax reform and the institution of a redistributive system. The Home Ministry, institutionally exposed to the crises through direct contact with subnational governments, and having de facto lost its control over local taxes, was certainly far more
cognizant of and concerned about the problems than MOF (a fact, we shall see, that is even more apparent in the postwar era). But the scale of the problem was such that MOF as well was drawn into the search for solutions.

The postwar re-emergence of fiscal stress at the local level thus helps account for the return of the 1940 fiscal system. Japan was thoroughly vanquished in the war and gripped by chaos on multiple fronts. Economic output in the wake of the surrender plummeted, and the central state tried desperately to pump liquidity into the economy via subsidies, thus igniting a furious inflation. Table 3.5, it will be recalled, shows that subsidies also flowed copiously to the local authorities in the years 1946 to 1948, when aggregate transfers constituted half or more of the local authorities' revenues. Then the sudden imposition of fiscal austerity via the Dodge Line saw local governments thrown into very dire straits indeed. With massive wartime destruction, raging inflation, and severe housing and employment shortages, the fiscal problems of local governments were one emergent catastrophe among many that demanded solution by the state and the Occupation. The Shoup reforms offered one answer, but one inconsistent with past practice and with no popular social base. The reforms were also a deliberate repudiation of the fiscal controls that MOF and Home Ministry bureaucrats had crafted to deal with similar difficulties in the pre-Pacific War period. The return of an old problem, especially in such an environment of great uncertainty, simply begs to be resolved by indigenous methods that are not only believed to have worked in the past, but also
enhance the authority of the actors in a position to advise or engineer their adoption.

This is not to say, however, that fiscal recentralization was wholeheartedly supported by all the bureaucrats within the Home Ministry and its successors. Many of the bureaucrats within the old ministry and the local finance agencies that were created with its dissolution were, on the contrary, favourably disposed to decentralizing the fiscal state. There is, as was discussed earlier, an indigenous Japanese history of effective local autonomy from the central feudal state as well as movements against the centralization of the later Meiji state. Local fiscal autonomy was for some a progressive move in reaction to a national state whose policies had for long years emphasized militarization and the regimentation of daily life.

However, conditions in the early postwar era were not particularly amenable to this goal of decentralization. The centralists held the upper hand, in large measure because of the extreme fiscal crisis that Dodge exacerbated and that continued into the late 1950s. Debt climbed among the local authorities, with the worst year being 1954's 64.8 billion yen of local debt versus the budgeted forecast of 14.0 billion yen. This brought about, on November 25 of 1955, the opening of an Emergency Diet on countermeasures for the local fiscal crisis --
an "unprecedented measure" (zenko mizou no sochi). Under such conditions, the centralists were able -- in drafting reforms to the local finance laws and deliberations of relevant shingikai committees -- to insist that the choice was the risky path of bolstering local fiscal autonomy or the old policy of centralization in order to reinforce local finances.

The records of the shingikai and other agencies clearly show the concern of the bureaucrats and their consistent post-Shoup emphasis on fiscal recentralization. The Local Finance Commission Report of 1951, for example, calls attention to the local fiscal crisis and the problem of taxation beyond the legally fixed rates (which was allowed through SCAP and Shoup reforms). By 1953, both the Local Autonomy Agency and MOF, via the GTAC, were expressing serious concerns about increasing divergence in taxation among the local authorities. And in 1954, the Local Autonomy Agency report argued explicitly that, in order to avoid fiscal imbalance, local autonomy had to be curtailed through the recentralization of taxes and other measures. The report portrayed two choices: Shoup's independent taxes (dokuritsuzeishugi) or the tradition of surtaxes (fukazeishugi), and strongly suggested that reversion to the latter was most appropriate for a "small country like Japan" (semai Nihon no kuni).


36 These reports are "Chihouzaisei no Jokyouhokoku" by Chihouzaisei linkai, 1951; "Zeiseichousakai Toushin" by Zeiseichousakai, November, 1953, pp. 4-6; "Chihouzaisei no Jokyouhokoku " by Jichichou, March, 1953, pp. 46-52; and "Chihouzaisei no Jokyouhokoku" by Jichichou, March 1954, pp. 27-33. A
Pressures for recentralizing local finance did not only emanate from fiscal bureaucrats. One of the major revisions of Shoup was the rejection of the innovative Value Added Tax, which Shoup had envisioned as an independent tax base for municipalities. The measure failed to make it through the implementation stage to a large extent because of opposition from local businesses and many residents. These interest groups were adamantly against what they perceived as increased taxation and hence opposed the new local property taxes as well. Local politicians and administrators, too, generally felt uncertain that their governments possessed the fiscal and managerial capacity to perform the new tasks they had been assigned. This opposition of local interests and governments helped reinforce the position of the central bureaucrats who stood against Shoup’s programme for local fiscal autonomy.37

But interest groups mobilize on specific tax policy issues, the ones that affect them most, and hence cannot be the authors of an entire fiscal regime.

37 Martin Bronfenbrenner, “The Japanese Value-Added Sales Tax,” National Tax Journal, Volume 3, 1950, pp 298-313, discusses popular resistance to the VAT. One example of bureaucratic efforts to stymie Shoup’s plan for a VAT is seen in MOF Tax Bureau Chief Hiraita Keiichirou’s call for further study -- the administrative kiss of death in Japan -- of the tax because of large-scale opposition and the question of whether the prefectural officials had sufficient skill to manage the tax’s collection. Indeed, Hiraita goes on to reject the whole premise of Shoup, that there should be separate taxes assigned to the central, prefectural, and municipal levels of government, on the grounds of Japan’s being a “poor and small country” (binbou de semai kuni); see “Zeisei Kaikaku no Mondaiten” [Problems in Tax Reform], Kinyuu Zaisei Jijou, Volume 1, Number 1, 1952, pp. 42-47, especially pp. 45-6.
Certainly their piecemeal efforts in postwar Japan did not add up to an overall programme of reform of the intergovernmental tax system. Hence, in terms of agency, the large-scale restructuring of this system in postwar Japan was not due to pressures from private lobbies, but rather the contest between the decentralist path opened by Shoup and the Occupation and the mainstream, centralist tendency of the postwar bureaucracy.

The Redistributive System

One of the most salient areas of the wartime system's revanche was seen in redistribution. Shoup's system of equalization grants, supervised by an autonomous Commission, was to a great extent implemented in June of 1950. But as part of a general recentralization of the state, in the "reverse course," the Local Autonomy Agency (Chiho Jichichou) was reorganized in August 1952, and renamed simply the Autonomy Agency (Jichichou). The new agency also absorbed the Local Finance Commission (Chiho Zaisei linkai), which caused some administrators in the latter agency much consternation concerning the fate of the recently implemented reforms in local finance. Worry centred on the issue of whether the proposed reorganization would undermine the autonomous management of the redistributive system.36

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36 The chair of the Local Finance Commission went so far as to publicly express his concern that the administrative changes would detract significantly from local autonomy. See Maruyama Takamitsu, *Nihon Chiho Zeiseishi* [A History of Japan's Local Tax System], Tokyo: Gyousei, 1985, p. 452.
However, the position taken by the new Autonomy Agency was to avoid as much as possible any outside interference in its jurisdiction. Hence, during preparation of the Diet bill for amalgamating the Local Autonomy Agency and the Local Finance Commission, the new Agency’s leadership strongly opposed proposals to have the Local Finance Advisory Council (*Chihou Zaisei Chousakai*), one of the Agency’s affiliated organizations, become anything more than simply an institution for submitting questions to (i.e., *shimon kikan*).  

In addition, changes were made to the redistributive system, effectively pulling it back in the direction of the wartime fiscal state. Shoup had sought to implement a system that eliminated the centre’s control through specific subsidies and the absence of local involvement in determining the levels and means of redistribution. But the pressure of central-state actors saw the equalization grant system eliminated in May of 1954, and replaced by the Local Allocation Tax.

The amount of funds to be redistributed was the focus of much friction between

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39 On this, see “Chihou Zaisei Shingikai no Seikaku ni Iken Chousei: Chizaiin, Haishigo no Koufukin Santei, Haifu ni Kuryo” [Ideas Concerning the Character of the Local Finance Advisory Council], *Kinyuu Zaisei Jijou*, Volume 3, Number 16, April 14, 1952, pp. 11-12.

40 Shoup sought to clarify national-level and local-level functions as well as those which are shared. The *Shoup Report* then recommended that the costs for such programmes be covered by the relevant level of government, in order to avoid the recurrent problem of centralized control through the manipulation of subsidies and the imposition of excessive costs on the local authorities. But the system was not put into place, and instead the current order allows the national ministries to impose burdens on the local authorities using the latters’ resources. See, e.g., Kurt Steiner, *Local Government in Japan*. Stanford: 1965, pp. 283-91.
MOF and the Local Autonomy Agency in the annual budgetary process. MOF, especially the Budget Bureau, constantly sought to cut the level of transfers to the local authorities whereas the Local Autonomy Agency pressed to have them increased. The scope for conflict was narrowed a good deal when the two compromised, in 1954, on including fixed percentages of the national corporate and personal income taxes and the liquor tax in the new Allocation Tax. The latter tax was then effectively transferred to the Autonomy Agency and distributed to the local authorities according to a complex formula. This arrangement continues, with the current Ministry of Home Affairs having been set up in 1960 to replace the Autonomy Agency.41

At first glance, the above redistributive structure appears quite depoliticized. There are, as noted, regular and legally sanctioned procedures for determining the approximate volume of Allocation Tax revenues to be distributed as well as a formula governing that distribution. However, as I examine in more detail in chapter 5, the local authorities are not represented in an autonomous and disinterested commission -- Shoup's proposal -- when decisions are made on such matters as the percentage of national taxes to be included in the Allocation Tax, the subsequent redistribution of revenues, and allowable levels of local debt. Moreover, 6 percent of the total funds for the

Allocation Tax are deposited into the Special Allocation Fund, which allows for explicit ministerial discretion in transfers.\textsuperscript{42}

The point here is that the wartime system's centralized fiscal control has in large measure been reintroduced. Shoup was not revised willy-nilly, as one would expect from short-term political calculations, but rather with a fairly clear aim of returning to what had been in place prior to the Occupation. Controlled local tax rates and direct management of local debt have been reestablished, in place of institutions with mandatory direct local input into decisions concerning these matters. The strong resemblance between the fiscal chaos of the prewar and the early postwar periods apparently made the 1940 fiscal system seem, for the actors most familiar with Japan's fiscal order, the only realistic choice.

\textit{MOHA's Tax Controls}

MOHA's controls over local taxes are comparatively strict, a fact that is clear to most observers. Steven Reed, in his probing effort to bring a more comparative perspective to the politics of Japan's intergovernmental relations, is forced to concede that "[w]hile regulation of local taxes is common in unitary

\textsuperscript{42}Kurt Steiner, \textit{Local Government in Japan}. \textit{ibid.} pp. 287-8, points out that this measure dates from the Shoup reform package of 1950, when a 10 percent special grant was created at the behest of Japanese officials, who "argued with great tenacity" for this division of special and general grants. The concession was finally made by SCAP, but only for the years from 1950 to 1952. However, the special grant was afterwards made a permanent measure. Purnendra Jain's interviews at MOHA indicate that local
states, the Japanese system seems particularly restrictive. Indeed, MOHA's formal powers over local taxation were a focus of criticism in the Second Ad Hoc Administrative Reform Commission's call for greater fiscal flexibility at the local level. But the powers remain in place, meaning local taxes are set by recommendation of the MOHA Local Tax Bureau. The recommendations are then ratified in the Diet, and there is no record of them having been changed. While this hardly means that MOHA steadfastly ignores opinion from politicians, other central agencies, and the local authorities themselves, it does indicate that MOHA is in a position to aggregate such information and then define the point of compromise among potentially conflicting aims.

MOHA's fiscal controls are of several types, depending on the particular tax. One type is the Standard Rate (Hyoujun Zeiritsu), which applies to personal and corporate income taxes and property taxes at both the prefectural and municipal levels. MOHA sets a standard rate for these taxes. When a local authority makes a convincing case for the need to exceed this rate temporarily, MOHA can recognize the appeal, allow the extra tax burden, and use the standard rate in calculating the local authority's share of the Allocation Tax. The latter measure both prevents an inadvertent tax penalty being visited on the local authority and obviously serves as a means of encouraging general


44 This information is according to a communication from the MOHA Minister's office, in November of 1995.

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compliance with the standard rates.

Another control is the Restricted Rate (Seigen Zeiritsu), which applies to most of the aforementioned taxes and represents an upper limit that may not be exceeded. For example, the standard rates for the prefectural and municipal taxes on corporate income (Houjin Juuminzei) are 5 percent and 12.3 percent respectively, and the restricted rates are 6 percent and 14.7 percent.

Of less importance, in terms of the number of taxes affected, is the Fixed Tax Rate (Ittei Zeiritsu). As the name implies, it is a single rate that has to be adhered to. This rate applies to the prefectural and municipal taxes on tobacco, for example.45

MOHA controls debt via an ostensibly temporary addendum to the Local Autonomy Law, Article 250, which states that the permission of the MOHA minister or the prefectural governor is required "before floating a loan or changing the manner of floatation, interest rate, or the manner of liquidation of the existing loan (sic)."46 The control over local debt is an important constraint on the local authorities, especially when troughs in the business cycle cause their revenues to decline.

45 Current rates for local taxes are presented in tabular form along with detailed information on local finance law, on pp. 37-49 in "Chihouzei Kankei Shiryou Handobukku, Heisei 8-nen, 10-gatsu" [Handbook of Materials on Local Taxation, October 1996], op. cit.

This weakness is especially pronounced in the case of the wealthier prefectures and the metropolises such as Tokyo and Osaka, as is evident in the Table 3.5, which shows Tokyo’s declining revenues and rising debt from 1989 and the onset of recession, to 1993. Japan’s metropolises collect well over half of their own revenues, in contrast to most other subnational governments. But they are especially dependent on direct income-tax revenues and generally receive no Allocation Tax to substitute for lost revenues in recessions. In Japan, corporate income tax revenues readily contract in economic downturns, forcing the worst affected local authorities to float bonds to cover the shortfall. By law, MOHA has to give its approval before

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47 The average contraction of revenues, due to economic cycles, among the prefectures is 30 percent. See, Igarashi Fumihiko, Ookurashou Kaitairon [The Argument for Breaking up the Ministry of Finance], Tokyo: Toyo Keizai, 1995, pp. 178.
these bond flotations can occur.\textsuperscript{48}

The 1940 tax reform sought to secure stability and a rough measure of equity in fiscal outcomes among the local authorities, and hence transfers from the central state doubled, as was seen in Table 3.4. But this figure was only twice an already low base of transfers in a relatively small economy, meaning that the aggregate level of expenditures was not great. By contrast, the rapid growth of the Japanese economy in the 1950s and 1960s generated an enormous volume of tax resources for collection and redistribution. Thus, compared to the prewar and wartime years, MOF and MOHA now have powerful motivations for maintaining their trenches on Japan's tax fields.

The next chapter examines in more detail the constellation of interests, including MOF and MOHA, that is concerned with Japan's intergovernmental fiscal relations.

\textsuperscript{48} Information on the above tax and debt controls can be found in Mutai Shunsuke, et al., Jichitai Zaisei Kiban no Kakuritsu, op. cit., especially on pp. 34-44. The book is produced by MOHA staff and presents an interesting defence of fiscal control from the standpoint of preserving equity among the local authorities and intergenerational tax burdens.
Chapter 4

Interests in Japan’s Contemporary Fiscal Politics

The power structure in Japan has four parts. There’s the central government, the Home Affairs Ministry -- which represents the regions -- the prefectures, and the municipalities. And each part has its own philosophical bent. Thus when I hear people advocating decentralization, I’m quick to ask where they want power to devolve.

Kato Hiroshi
Chairman, Government Tax Advisory Council

MOHA’s Organizational Mission

This study of the reconstitution and reproduction of the 1940 fiscal system thus centres on MOHA’s “organizational mission.”¹ One of the smallest agencies in Japan’s central state, MOHA is a distillation of the dismantled Home Ministry’s local finance functions, as the ministry at present contains a Minister’s Secretariat and three bureaux: Local Administration, Local Finance, and Local Tax.² Other areas under the old Home Ministry’s vast purview, such as public

¹ John C. Campbell refers to the Japanese Ministry of Labour’s "organizational mission," or "continuity of bureaucratic motives, style, and actual policy." The ministry’s organizational mission is rooted in its autonomy and strong motives for policy sponsorship, even though it is not one of the powerful economic ministries, such as MITI and MOF, that are generally cited in studies of bureaucratic power in Japan. See Campbell, How Policies Change: The Japanese Government and the Aging Society. Princeton: Princeton University Press, 1992, 277-81 and fn. 53. My thanks to John Campbell for much-appreciated hints that MOHA’s role might profitably be viewed as an organizational mission.

² According to Kengo Akizuki, MOHA’s personnel number 569 bureaucrats in a ministry that “is recognized as one of the most important bureaucracies.” MOHA also includes the Fire Defence Agency, but that is an external bureau whose business is not central to MOHA’s work. See “Institutionalizing the Local System,” op. cit. p. 342.
works and labour relations, were transferred to newly created central agencies when the Home Ministry per se was dissolved in 1947. Shorn of intraministerial cross-pressures from spending bureaux, MOHA found the administrative space to develop a clearly defined agenda that centres on equity and uniformity in local finance. In other words, MOHA's organizational mission is in part possible because its structure does not incorporate the contradictory interest, characteristic of the postwar era’s highly politicized spending ministries, of offloading a large share of the burden for public works onto the local authorities.

This downward shift of burdens is a major problem for MOHA. Particularly troublesome are specific subsidies (*tokutei hojokin*), which line ministries direct to their counterpart agencies at the local level. The subsidies often leave much of the cost of a given project to be borne by the recipient local authority, and hence ostensibly local funds are effectively used as the respective central agency desires. The structure within which such phenomena occur is referred to as “vertical administration” (*tatewari gyousei*), because intergovernmental relations are fragmented into discrete channels of authority between the

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3 As Kent Calder notes, the postwar break-up of the Home Ministry weakened component functions such as land-use planning. This weakness, in the new constitutional regime of electoral politics, led to a high degree of politicization as postwar politicians sought to secure their electoral bases through distributional politics. See *Crisis and Compensation*. Princeton: Princeton University Press, 1988, especially the sections on “Regional Policy” and “Land Use Policy.” Note that Calder’s work (e.g., pp. 289–98) does not investigate the details of the reassertion of fiscal controls through MOHA and its early postwar predecessors, and hence he overlooks the role of bureaucrats in the redistributive system that funds the “crisis and compensation” dynamic from the centre to the periphery.

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individual ministry and its counterpart bureaux in the local administrations.⁴

Vertical administration, like competition with MOF over tax fields, is one aspect of MOHA's often contentious relationship with other ministries in the central state.⁵ Both of these phenomena condition MOHA's role as an intermediary between agencies of the central government and the local authorities, whose interests MOHA represents.

MOHA thus opposes MOF and other central agencies' interventions in local administrative and fiscal affairs. To accomplish its objective, indeed duty, of protecting the fiscal health of the local authorities, MOHA requires considerable authority. The reassertion of the wartime system secured this authority to a fair degree. Therefore, seen through the lens of MOHA's organizational mission the maintenance of the 1940 system's fiscal controls is not for MOHA's power, per se, but rather to restrict one potential source of renewed fiscal chaos.⁶

In many developed countries, subnational governments are directly


⁶ Expressions of the need to maintain equity among the local authorities are a constant thread in MOHA statements and publications. See, for example, Mutai Shunsuke et al., *Jichitai Zaisei Kiso no Kakuritsu*, [Enhancing the Fiscal Base of the Local Authorities]. Tokyo: Gyousei, 1995., pp. 2-6.
represented at the national level. Japanese local authorities do not enjoy the same institutionalized access, and require a representative in the central state. This is because the scale of Japan's intergovernmental fiscal transfers and their focus on public works spending create enormous incentives for intervention in subnational affairs. Moreover, the country's political institutions are highly fragmented. Not only does vertical administration produce strong divisions at the level of intergovernmental relations, but Japan's central political leadership is comparatively weak. This is seen especially in the passivity of the Prime Minister's Office and the role of the electoral system in encouraging relative indiscipline within the ruling party. These features make it difficult to achieve the level of supra-ministerial coordination and party discipline that is elsewhere characteristic of parliamentary systems of government.

Japan's fragmented political institutions have given Diet politicians comparatively much room to engage in distributive politics. This is manifested


8 A good account is in Robert C. Angel, "Japan's Premiership and Cabinet: A Study in Democratic Institutions and Processes," a paper prepared for the Washington and Southeast Region Japan Seminar, February 25, 1995. Note also that the 1994 introduction of single-member and proportional representation districts appears to be having "the perverse effect of exacerbating intra-party rather than inter-party policy differences"; see Gerald Curtis, "Reform requires deregulation of political activities," *Asahi Evening News,* May 26, 1996, p. 3.

especially through so-called "policy tribes" (zoku giin) of legislators, which wield considerable influence in many distributive and symbolic areas of policymaking.\textsuperscript{10} Not only are these politicians in search of votes for reelection, but when their politicking focuses on public works, they have the added incentive of bribes and kickbacks that can be used to finance their campaigns (and presumably other, more frivolous purposes as well).\textsuperscript{11} The various zoku and their often allied spending ministries tend to come into conflict with MOHA's efforts to maintain order in local fiscal affairs.

Hence MOHA cannot entirely manage the fiscal environment of the local authorities, notably because of countervailing power wielded by shifting coalitions of politicians, bureaucrats, and private interests. Indeed, in many instances of local policymaking, MOHA's authority is limited by the developmentalist agenda that still heavily defines the Japanese state.\textsuperscript{12}

\textsuperscript{10}On zoku giin and their relationship to policymaking, see Inoguchi Takashi, "Shin, Zokugiin Taibouron" [Aims for the New Policy Tribes], in Chuo Koron, March 1994, pp. 104-12. Also, the role of the zoku giin and the PARC in tax policymaking is discussed in Takashi Inoguchi and Tomoaki Iwai, "Zeisei Zoku no Seijiryokugaku" [Study of the Political Power of the Tax Policy Tribes], Chuo Koron, March 1987, pp. 96-106.

\textsuperscript{11}A detailed discussion of such "structural corruption" can be found in Gavan McCormack's chapter on "The Construction State," The Emptiness of Japanese Affluence, op. cit.; see especially, pp. 32-44.

\textsuperscript{12}For example, a recent study of urban redevelopment in the Japanese city of Omuta shows that MITI and the Construction Ministry were both decisive actors in this case of local policymaking, along with the Japan Development Bank. MOHA's role certainly restricted the scope within which redevelopment could be undertaken, indeed envisioned, but the ministry in turn made concessions on financing through debt allocation and tax changes. These comments are based on communications during December 1995 with Ted Gilman concerning his Ph.D. dissertation, "No Miracles Here: Urban Redevelopment Efforts in Japan and the United States," University of Michigan, 1995. For an interesting account of developmentalism in Japan, see Gavan McCormack's chapter on "The Construction State," The Emptiness of Japanese Affluence, op. cit., 25-77.
MOHA is therefore on the one hand a hegemon at the local level, willing to pursue its own interests; but on the other hand, MOHA is a crucial buffer between the local authorities and the politicized designs of the spending ministries as well as MOF's fiscal austerity concerning local finance. Without MOHA, the local authorities' capacity and resources to place their own stamp on policymaking would almost certainly decline. The weak representation of local governments in the central state in fact led them to support the administrative changes that saw MOHA become a full-fledged ministry in 1960.\textsuperscript{13}

Yet the bulk of the intergovernmental fiscal regime has been outside the rather narrow sphere of interest and influence of \textit{zoku} politicians. This ostensibly depoliticized fiscal terrain is the site of MOHA's struggles against MOF's persistent efforts to appropriate sections of the local tax base as well as offload fiscal burdens through cuts in transfers from the budget of the central state. The two ministries see local finance from virtually opposite points of view, and thus devise their policies accordingly.\textsuperscript{14} The fiscal conflicts between the ministries will be examined in much greater detail in the ensuing chapters, so

\textsuperscript{13} See Takatsuji Masami, \textit{Chihoujichi} [Local Autonomy], Tokyo: Gendai Gyousei, 1983, pp. 70-1. In describing MOHA as a "hegemon," then, I am emphasizing the aspect of consent at least as much as that of coercion. MOHA at times is forced to resort to the latter, as in the case of Tokyo Governor Minobe; but the ministry also has to respond to local needs and demands in order to remain an effective representative. An unresponsive MOHA would likely see local authorities turn more determinedly to other means, such as Diet politicians, to lobby the central state.

\textsuperscript{14} A sampling of opinion among bureaucrats on the issue of local revenues showed 100 percent of the MOHA respondents argued the revenues were insufficient, whereas 37 and 46 percent, respectively, of MOF bureaucrats thought the revenue levels were either too great or satisfactory. See Table 6.3,
at this point I will only note that MOHA's main hurdles vis-a-vis MOF is that it does not have independent authority over much of the general government tax base, especially income taxes, nor can it decide on its own the mix that will fund the Local Allocation Tax. In addition, what shapes Japan's intergovernmental distribution of taxes is power, taxpayer tolerance and convention, rather than constitutional rules. MOF and MOHA's shared jurisdiction on major tax fields has thus engendered intermittent turf wars and collaborative truces between them, with both the conflicts and the truces generally impeding efforts toward enhanced local fiscal autonomy.

Recent years have seen conflict between the two ministries escalate. The reasons for the upsurge are several, and will be dealt with in detail in the individual case studies. However, noteworthy is the reemergence of fiscal stress due to slowing economic growth and globalization of the economy coupled with increasing demands on the state. Another related source is the long-range programme to "rebalance" the tax system in order to promote economic vitality and perceived fairness in distributing the tax burden. This is evident in Table 4.1, which shows the overall changes in the revenue structure since 1955.


15 Note that some federal states have more or less explicit rules for allocating intergovernmental tax bases. The interpretation of the rules often varies over time, as it certainly has in Canada, but there is at least a legal basis for one level of government to file suit in protecting its tax base.
As the table shows, the weight of taxation incident on the income field peaked in the mid-1980s, and has thereafter declined relative to taxes on consumption and assets (e.g., property taxes). The government policy to shift the burden of taxes over time away from income derives from a belief that the tax system overall is too dependent on the income base. Table 4.1 shows there has been some success with this strategy, though of course the 1990s recession had a dampening influence on income-tax revenues as well.\(^\text{16}\)

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<td>Income</td>
<td>48.4</td>
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<td>59.1</td>
<td>54.3</td>
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<tr>
<td>Consumption</td>
<td>39.0</td>
<td>33.6</td>
<td>24.4</td>
<td>19.0</td>
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<td>Assets</td>
<td>12.6</td>
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There is, of course, a good deal of politics behind the choice to rebalance the tax fields. The shift away from income taxation is strongly linked to a problem explored in one of the case studies below: perceptions of unfairness in the personal income tax have convinced ranking fiscal bureaucrats and ruling party politicians that permanent cuts are necessary. But the point to be made here concerns the effect that the changing tax base has on intergovernmental traffic.

\(^\text{16}\) One ranking MOF interviewee in fact suggested that the ministry's long-term aim is to raise the Consumption Tax to near-European levels while reducing dependence on income taxes.
tax politics. For as the balance of taxation changes, MOF and MOHA are encouraged to compete to expand their tax room in new fields as well as protect their absolute shares in areas slated for cuts or gradual attrition.

Cooperation is also sometimes evident. A recent example of cooperation between the two ministries, in a reform that cost a degree of local fiscal autonomy, is seen in MOHA's acquiescence to the elimination of the Electricity and Gas taxes (denkizei and gasuzei) when the Consumption Tax (shouhizei) was adopted. Competition is, by contrast, visible in the Land Value Tax (chikazei) episode, the struggle over the Local Consumption Tax (chihoushouhizei), and the current sparring concerning corporate income taxes and cuts in the Local Allocation Tax (chiho koufuzei).

*Politicians and Tax Politics*

 Returning briefly to the wartime fiscal centralization and the roots of MOHA's organizational mission, we have seen that the former is not unique. Nor is the simultaneous construction of a system of intergovernmental redistribution. But other redistributive fiscal systems, such as those established in Australia and Canada, either included or soon came to include explicit mechanisms for intergovernmental political and bureaucratic negotiation. These mechanisms
were, in other words, aimed at alleviating centralized fiscal controls.\textsuperscript{17}

By contrast, Japanese central-state bureaucrats devised their reforms in reaction to the legacy of American military occupation, which had sought to tear apart the intergovernmental fiscal system that the bureaucrats had long laboured to build. Once the Occupation had ended -- indeed, to some extent even before -- Japan's MOF and the predecessors of MOHA worked to reconstruct the 1940 system, thereby giving themselves great latitude to impose fiscal discipline and maintain a virtually uniform regime of local finances. In other words, bureaucratic preferences generally set the agenda for the postwar reconstitution of the 1940 intergovernmental fiscal system.

Political scientists will naturally ask where the Diet politicians were during this concerted bureaucratic agenda-setting on intergovernmental tax relations. The answer to this question fits into the argument made earlier; that is, the national-level politicians' attentions were devoted mainly to the distributive end of intergovernmental fiscal relations. Driven by the electorally based need to show results to supporters,\textsuperscript{18} such politicians for the most part sought

\textsuperscript{17} In Australia, for instance, the Commonwealth Grants Commission and its fiscal equalization formula are sites of contest and negotiation among the federal and state governments; see Christine Fletcher, "Competition Between Regional Governments and the Federal Culture of Fiscal Equalization, Australian Journal of Political Science, Vol. 28, 1993, pp. 58-9.

\textsuperscript{18} Note that postwar Japan's Single Non Transferable Vote electoral system tended to place a premium on politicians' being seen to "deliver the goods" to the local constituency. Securing a shift of fiscal resources to a lower level of government would thus not appear to be in the interests of a Diet politician, unless voters were organized to reward such policies. On the importance of local service for Dietmembers, see Samuel Kernel, "The Primacy of Politics in Economic Policy," Parallel Politics:
influence at the expenditure rather than the taxation end of the fiscal process.

Japanese politicians' role in tax politics per se centers on highly visible and politicized forms of taxation, especially in the realm of intergovernmental fiscal relations. This was also the case in the decades between the two world wars, when attempts by the bureaucracy to rationalize intergovernmental fiscal relations and the overall structure of taxation foundered on the political power of urban capitalist interests. Earlier, through the late 1800s era of state-building, politicians' attentions had focused on the tand tax (chiso) and whether it should be raised to fund armaments production and other strategies aimed at bolstering Japan's military-industrial base. The political parties' positions on such industrial development differed only marginally, and they gradually abandoned their pressure for reductions in the land tax; then, at the turn of the century, they ceased their opposition to increases in the tax.

Party tax platforms in this period were largely patterned on the fiscal structure and the incidence of the tax burden. For even as the land tax burden increased in absolute terms, it declined as a percentage of total revenues and thus elicited a commensurately shrinking degree of interest. The land tax supplied over forty million yen, or 60.6 percent of total national tax revenues of just over sixty-eight million yen in 1890. By 1920 the land tax yielded seventy-four million yen, but that was only 7.9 percent of total revenues of 938 million yen.

yen. Most of the burden of revenues was shifted instead to indirect taxes, which amounted to 543 million yen in 1920, of which the liquor tax (Shuzei) provided the largest share at 164 million yen, or 17.5 percent of total national revenues. The period’s burning tax issue had as a result become one of lifting the tax burden somewhat off the lower classes, especially rural inhabitants, and transferring it to wealthy urban residents and capitalists. But the parties were by then effective spokesmen for the modern sector’s opposition to bureaucratically led efforts to make the obsolete tax system more productive and fair.\(^\text{19}\)

In the postwar era, the focus of party politics turned in particular to the personal income tax. Distress concerning Japan’s great wave of anti-tax sentiment in the early postwar period was transferred from the front-line offices of the tax-collection branch to MOF’s career bureaucrats in Tokyo. These officials, in turn, inculcated in the conservative parties of the 1950s a strong appreciation for the political utility of personal income tax cuts. This helped institutionalize anti-income tax sentiments as a strong influence on Japanese party politics and tax policymaking.\(^\text{20}\)


\(^{20}\) On this period, see Ohtake Hideo, “Hatoyama, Kishi Jidai no Chisai Seifuron” [The Small-State Debate of the Hatoyama and Kishi Era], in *Seijigaku Nenpo 1991*. Note that other factors provide the background to anti-income tax politics in Japan. One of the major items of comparative significance is the fact that
Tax politics in recent years continue to exhibit this focus on more visible taxes, as reductions in income tax are always attractive options for party political manouevring. The long years of the Heisei Recession in the early 1990s saw the former Socialist Party (now the Social Democratic Party of Japan) press for income-tax cuts, which became a dominant theme in the public debate on tax policymaking. Competition over tax cuts indeed became so intense that the LDP hierarchy felt threatened by the prospect of rank- and-file defections.21

Also, the October 20, 1996 general election centred very much on the tax platform of the New Frontier Party, led by Japan’s foremost Machiavellian Ozawa Ichirou. The party sought to exploit public opposition to the ruling coalition’s commitment to raise the Consumption Tax rate to 5 percent, and so offered a “freeze” (touketsu) of the 3 percent rate until 2001 plus a continuation of income-tax cuts aimed at stimulating the sluggish economy. Though Ozawa failed to win the election with this basket of populist tax measures, that would appear due more to voter distrust of him and his Soka Gakkai religious supporters in general. Certainly polling date show the tax cuts themselves

there was almost no support from labour and the Left for income taxation, in sharp contrast to the case in North America. In Japan, the Socialist Party was resolutely opposed, for example, to the Shoup plans to centre the tax system on the personal income tax and the ideology of “ability to pay,” as Japanese socialists saw income taxation -- in Marxian terms -- as a tax on labour rather than surplus value. By contrast, the US and Canada have fiscal histories wherein the role of labour and progressive political forces were crucial for the institution of the income tax and the maintenance of its political legitimacy until recent years. These issues are discussed in greater detail in Chapter 6.

21 See, for example, “Shushou: shintai, taisei ni shitagau, ‘shotokuzeigenzei no jisshi hitsuyou’” [The PM says to follow the general trend, “implementing an income tax cut is necessary”], Nihon Keizai Shinbun, July 11, 1993, p. 1.
garnered strong voter support.\textsuperscript{22}

\textit{Intergovernmental Tax Politics}

Intergovernmental tax politics are a less attractive issue area, however. Diet politicians tend to exert little deliberate influence at this level, compared to politicians in many other centralized and federal states,\textsuperscript{23} save when personal income tax cuts they have engineered restrict local finances. This latter effect is indirect -- not the result of a policy concerning local resources themselves -- and stems from the fact that local income taxes are calculated in terms of their national-level counterparts. The political dimensions of the intergovernmental tax structure per se are outside the calculus of the majority of Diet politicians, who are far more interested in the specific subsidies of the line ministries.\textsuperscript{24}

There are, as we will see, occasions when national politicians express interest in intergovernmental fiscal relations, but these are generally responses to the agenda set by the competition or cooperation of the two strongest ministries, MOF and MOHA, in this policy area.

\textsuperscript{22} Polls in the October 1 \textit{Asahi} and the October 5 \textit{Yomiuri} newspapers in 1996 both showed that prospective voters ranked the tax issues highest or among the highest priorities when deciding how to vote.

\textsuperscript{23} Examples discussed earlier showed, for instance, that British, Dutch, French, and Thai politicians are more involved in intergovernmental fiscal reforms than are their Japanese counterparts.

\textsuperscript{24} Kengo Akizuki makes the very interesting point that MOHA's formula for redistributing the proceeds of the Allocation Tax have removed those funds from the sphere of explicit political contention, and that the alternative of specific subsidies helps perpetuate this condition; see "Institutionalizing the Local System," \textit{op. cit.}, 359-60.
To be sure, MOHA has a sizable cadre of supporters in the Diet whose votes can be mobilized on issues related to intergovernmental finance. Yet this is according to the ministry's agenda rather than the politicians' independent activism.

There is at least one significant case where a politician, as policy entrepreneur, took a strong role in intergovernmental fiscal politics. But the politician, former Prime Minister Kakuei Tanaka, predictably used the rhetoric of decentralization to advance a clearly self-interested agenda. The incident occurred in the early 1950s, when Tanaka was a rising Diet politician. Tanaka became involved in the issue of how to manage the revenues from the Gasoline Tax (Kihatsuyuuzei), which had been implemented in 1937 and was producing an increasingly heavy yield as the economy recovered from its wartime damage and early postwar turmoil. For example, the Gasoline Tax drew 20.5 billion yen, or just under 5 percent of total national indirect tax revenues of 435 billion yen in 1953. By 1960, this percentage share of total national indirect taxation had increased to 12.5 percent; and by 1970, it had climbed to 18.9 percent.

Tanaka could not have known the scale of road-building that was to occur in Japan as the 1950s wore on; but, being from Niigata with its long and

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snowbound winters, he was certainly aware of the importance of roads to economic activity. Hence Tanaka stressed the importance of road-building to the recovery and future growth of the Japanese economy. However, for him and his Diet supporters, a major problem was the centralization of decisionmaking on road-building and its finances within, respectively, the ministries of Transport and Finance. This administrative structure was a legacy of the prewar order, wherein decisions on road construction and maintenance were removed from the pork-barrel concerns of party politics and based instead on transport's contribution to Japan's military power.

The need to decentralize highway planning and construction decisions, by moving them into the Construction Ministry, quickly became a pet issue for Tanaka. In fact he repeatedly invoked the idea that the postwar era was a break from the past and the associated dominance of the excessively centralized and bureaucratic state. Moreover, he insisted that funding for road-building be earmarked in order to get around potential obstacles posed by MOF's control of the budget.

Though MOF strongly opposed the loss of its discretion through the institution of an earmarked tax, Tanaka's coalition of private-sector and political allies carried the day. The result saw a quarter of the revenues from the Gasoline

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Tax deposited directly into a special account for the highly politicized Construction Ministry. In short, this postwar example of politically driven "decentralization" was more a deflection of revenues to one of the most politicized arms of the central state rather than an actual devolution of fiscal resources to the local authorities.

The above outcome indicates that Diet politicians, notably the more powerful ones, certainly can overcome bureaucratic opposition to their tax initiatives. But it also suggests there is a relatively limited sphere in which such politicians are motivated to act.

Local Politicians and Fiscal Decentralization

On the other hand, local government politicians have an obvious and direct interest in intergovernmental fiscal relations. This is because the local authorities suffer most from the vagaries of national policymaking, the uncertainty that stems from a high dependence on direct-tax revenues, and especially MOF's frequent efforts to restrict local budgets.

Local politicians are organized into the Six National Associations of Local

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Governments (*Chihou Roku Dantai*, hereafter CRD), which were seen by the U.S. Occupation as a means for encouraging local autonomy. The former Home Ministry bureaucrats at the time proved themselves to be major impediments to the Occupation's decentralist goals. In order to bypass the Home Ministry, the heads of the CRD were, as Richard Samuels puts it, used "quite aggressively." Samuels also reveals that the CRD were given standing on:

important national administration committees such as the Local Systems Investigation Council and the Town and Village Amalgamation Promotion Committee. In addition, each of the six CRD chairmen sat as members of the Local Administration Committee (*Chihou Gyousei linkai*), which was created in the wake of the dismantling of the Home Ministry. The CRD emerged in the immediate postwar period from its semi-governmental torpor at SCAP’s direction, and its leaders became some of the most influential executives of MacArthur's local policy. All six were formally reinaugurated after the war as part of the SCAP effort to nurture interest groups and to introduce local autonomy to Japan.

But Samuels goes on to note that the CRD have been the targets of extensive criticism for their complacency in the face of the post-Occupation recentralization of state functions. Japanese and foreign observers, he writes, have often seen the CRD's as a transmission belt for central directives and the

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28 These six organizations comprise the National Association of Prefectural Assembly Chairmen (*Zenkoku Todoufuken Gikai Gichoukai*), the National Association of City Assembly Chiefs (*Zenkoku Shigikai Gichoukai*), the National Association of Town and Village Assembly Chairmen (*Zenkoku Chousongikai Gichoukai*), the National Association of Governors (*Zenkoku Chijikai*), the National Association of Mayors (*Zenkoku Shichoukai*), the National Association of Towns and Villages (*Zenkoku Chouson Choukai*); see *Jichi Yougoshu* [Japanese-English Glossary on Local Government]. Tokyo: Jichi Sougou Sentaa, 1994, p. 130.

implementation of national policymaking. Samuels seeks to leaven this characterization somewhat by depicting the CRD as an important collective actor in lobbying for funds from the centre’s budgetary process.

Most prominent for our purposes here is the fact, which Samuels concedes, that there is often considerable division among the constituent organizations of the CRD on tax policies. In particular, the views of the associations representing municipalities and smaller administrative units often diverge from those of the representatives of prefectures concerning the distribution of tax revenues and the advisability of fiscal decentralization.\(^30\) My case studies show there are not always large splits over fiscal issues, but there is a strong tendency toward this and it has clear structural roots. It is, in fact, a potential that MOF has in the past tried to exploit in its contests with MOHA.

One of the most limiting features for the CRD’s effectiveness as an agent for fiscal decentralization is this division of interest. The division arises because large and wealthy prefectures and metropolises, with Tokyo on top, receive no Allocation Tax whereas the rest of the local authorities generally do. Tokyo collects upwards of 70 percent of its own revenues, and effectively pays large amounts, especially through its residents’ personal and corporate income tax

\(^{30}\) Recent commentary on this phenomenon recognizes the dependence of the poorer local authorities on the Allocation Tax and their consequent unwillingness to work with larger governments for fiscal autonomy. Local Allocation Tax revenues create, for governments with restricted fiscal capacity, a disincentive to increasing their own tax effort. The position of such weaker local authorities in supporting the tax makes, of course, perfect fiscal sense; but it also helps MOHA legitimate its role in
payments, into the coffers of fiscally weaker local authorities. Of the latter, those who cannot manage to raise more than 30 percent of their total revenues from the local tax base include 66 percent of prefectures, 31 percent of municipalities, and 83.6 percent of towns and villages. MOHA itself often calls attention to these fiscal divisions in its efforts to set the agenda of policymaking on the issue of decentralizing control over tax revenues.31

Moreover, as is evident in my case studies, the CRD generally rely on MOHA to plead their cause -- so far as tax policymaking is concerned -- in the main fora at the centre of the state. In particular, the local interest is represented by MOHA in the Government Tax Advisory Council, or GTAC (Seifū Zeisei Chousakai), wherein virtually all policy proposals relating to the intergovernmental tax system are argued before representatives of major interest groups and among expert members of specialized subcommittees.32

The GTAC is one of a large number of institutions known generically as deliberation councils (shingikai). Many are fairly inconsequential in policymaking, but some -- such as the GTAC -- are important sites where

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31 A typical example of this approach is seen in the fact that the data cited in the above come from a MOHA publication that argues the need for fiscal decentralization while also asserting the need for uniformity. The only way to reconcile those two contradictory ends is to define decentralization as the control of tax rates and redistribution through MOHA. See, Mutai Shunsuke et al., Jichitai Zaisei Kiso no Kakuritsu, op. cit., pp. 2-6.

32 The Local System Advisory Commission (Chihō Seido Chousakai) was an important site of policymaking influence in the period when Shoup was being revised; but afterwards it dwindled into relative insignificance in tax policymaking, to the point where one rarely sees mention of it in the press.
representatives of major interest groups are brought together to debate appropriate turns in public policy. Though MOHA bureaucrats have some jurisdiction in the selection of members and related functions, MOF personnel play the central role. It is MOF Tax Bureau staff who select the bulk of the representatives for the GTAC, determine the information they will discuss, and even write up their final report. In spite of this obvious scope for manipulation, the product of the discussions is not regarded as a sham. A more subtle process is at work, one in which bureaucrats learn about positions and perceptions among major interest groups in their areas of authority, while the represented interests are brought into policymaking and thus encouraged to compromise with one another. Such features give a fairly high degree of credibility to the institution, as an adjunct to more effective policy design and implementation. MOF is thus usually able to manipulate the debate along desired lines without grossly eroding the GTAC report's legitimacy. A strong report can give a considerable degree of momentum to a policy initiative.33

It has of course become a commonplace to note that the GTAC's influence relative to that of the LDP's Tax Advisory Council, or LDPTAC (Jimintou Zeisei

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Chousakai), has declined since about the late 1960s. But the GTAC remains the pre-eminent site for agenda-setting on intergovernmental tax issues, if not most tax policymaking.

Other Interests

Other major interests involved in intergovernmental tax politics include big business lobbies such as Keidanren, though their salience and the character of their participation vary depending on the specific issue. For example, business organizations were opposed to the Gas and Electricity taxes that were eliminated in the rationalization of the indirect tax regime as part of the 1989 institution of the Consumption Tax (Shouhizei). Business groups were also against the prefectural-level collection of the Local Consumption Tax, sought by MOHA from the fall of 1993. Hence, on tax matters, the corporate sector is generally a fiscally conservative force, focused on seeking tax reductions that apply to business as a class (e.g., cuts in corporate income taxes) or to sectoral interests.

This does not mean business opposes fiscal decentralization. Indeed, when the cream of corporate Japan assessed intergovernmental fiscal relations during the famous Second Ad Hoc Commission on Administrative Reform in the early 1980s, they called for a relaxation of MOHA’s controls over local tax

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34 The representative study of this phenomenon is Kishiro Yasuyuki, Jimintou Zeiseichousakai (The
rates and the institution of new local taxes. The purpose was to introduce a stronger form of self-government among local residents, with an apparent public choice assumption being that such would result in fiscal conservatism.\(^{35}\)

The corporate consensus would appear to be that decentralization can be a good thing, so long as it means smaller government or at least no increase in tax burdens.

In other words, when it comes to taxes the business community acts largely according to the general fiscal principles sketched in the introduction to this dissertation: it does its best to reduce its tax burden. On the other hand, there is a pronounced split when it comes to the expenditure end of fiscal politics. Businesses that do not rely heavily on public spending, especially Japan's internationally competitive firms, encourage reform of the public sector. But the recipients of largesse are not at all keen on spending cuts, at least in the programme areas from which they benefit. This is true, for example, of construction firms, which employ 10.6 percent of the Japanese workforce -- about twice the average of other industrialized states\(^{36}\) -- and greatly depend on Japan's high level of public works spending, as was displayed in table 1.1.

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\(^{35}\) The report is cited and described briefly in "Sentaku to Futan: Kazei Jishuken no Kakudairon" [Choice and Burden: The Argument Concerning Expanding Autonomous Tax Authority], in Mutai Shunsuke, et al., Jichitai Zaisei Kiso no Kakuritsu, op. cit., pp. 41-4.

\(^{36}\) OECD figures show 10.6 percent of Japan's working population in construction in 1994, whereas the percentage in Canada was 4.8, the US 4.3 (1993), Australia 5.4, France 6.4, Germany 7.0, Italy 6.8, Sweden 4.7, and the UK 3.8. The data are from OECD: National Accounts, Detailed Tables, Volume 2, 1982-1994. Paris: 1996.
Another interest whose role varies according to the particular tax and its calculation of political advantage is the Local Employees' Union, *Jichirou*. The union is the most powerful interest group in the Socialist Party and a resolute opponent of MOHA as an institution. However, as a union it is generally keen on seeking to maintain or expand its membership -- through local tax collection, for example. Hence, at times *Jichirou* assesses its interests as coincident with those of MOHA. As was described at length in the previous chapter, this has frequently been the case under the coalition governments of the 1990s.

*Other Central Agencies*

The tax aspect of intergovernmental relations is of little interest to most other central-state ministries, because they have no jurisdiction in the area. Of course, the ministries of Agriculture, Forests and Fisheries, International Trade and Industry, Transport, and Health often lobby for client groups' interests with respect to specific taxes. However, there is little evidence that such ministries are concerned with which level of the state levies a particular tax.\(^{37}\)

By contrast, the ministries are very keen on expanding the role of specific

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\(^{37}\) An example of the lobbying is seen in the various ministries' "wish list" for tax reductions for the 1997 fiscal year; see "Futan keigen youbo, aitsugu" [Demands for lower burdens come one after another], in *Nihon Keizai Shinbun*, August 31, 1996, p. 5.
subsidies, often working in tandem with LDP and politicians and such client interests as construction firms. From MOHA's point of view, then, other ministries can, by transferring fiscal burdens onto local governments, bedevil efforts to maintain local fiscal stability. This often antagonistic role, to MOHA's, of the spending ministries is particularly evident in the delegated functions (*inin jimu*) that are a commonplace in Japan's centre-local administrative relations.

According to a recent account, "[t]he number of agency-delegated functions has increased significantly. At present, more than half of the functions performed by prefectural governments are agency-delegated."\(^38\) Delegated functions stem in part from the local government codes of Japan's Meiji era (1868-1912), when duties that the local authorities were expected to carry out were assigned by the central government. Under SCAP\(^39\) the codes were revised in order to break from the old regime's dominance of local governments. However, the Local Autonomy Law instituted in the early postwar reforms was itself considerably amended during the Occupation's "reverse course" and afterwards, thus expanding the scope for intervention in local affairs. Pressure for amendments to the law arose, not surprisingly, in


\(^{39}\) This is the acronym for Supreme Commander Allied Pacific, or the commander of the forces -- overwhelmingly American -- that occupied Japan after the surrender and until April 28 of 1952. The acronym actually designates Generals MacArthur and later Ridgway, but in practice it refers to the occupation as a whole. See Kurt Steiner, *Local Government in Japan*. Stanford: Stanford University Press, 1965, p. 64 fn.
large part from central government agencies' efforts to recover control over their respective corners of local affairs.

Delegated functions allow central ministries to foist administrative responsibilities and fiscal burdens onto local authorities. But these functions are not, strictly speaking, an element of the intergovernmental tax system. They are, moreover, declining in their direct fiscal significance because of the gradual reduction of specific subsidies.\(^{40}\)

The above shows that the policymaking regime for intergovernmental taxation is largely dominated by MOF and MOHA. Other agencies and organizations are important, and often require some degree of attention in the effort to explain policy outcomes. But these other interests lack the authority, cohesion, and clarity of purpose that MOF and MOHA possess when it comes to intergovernmental tax politics. The following case studies therefore centre on MOF's interest in cutting transfers from the centre without ceding tax room to the local authorities or MOHA; and MOHA's interest in wresting tax room from MOF without ceding its own controls to the local authorities.

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Chapter 5

Controlling Redistribution: The Local Allocation Tax

The rules for distributing the Allocation Tax are a black box -- only the MOHA people know what goes on inside.

MOF Tax Bureau Interviewee

Simply substituting specific subsidies with the Allocation Tax raises questions about the current structure that is strengthening MOHA's intervention in local affairs.

Mayor of Takeo City, Chiba Prefecture

Recentralizing Redistribution

The current Local Allocation Tax (LAT) and its predecessors were described in some detail in chapter 3. The object in that exposition was to depict the central fiscal devices of the prewar, wartime, and postwar periods; in other words, to relate the institution, reform, and re-institution of the 1940 system. This section will retrace some of that ground, but along rather a different path. The focus here will be on the interministerial politics of the LAT as well as the tax's role in inhibiting local fiscal autonomy and impeding reforms in that direction. In particular, I stress that determining the rules for allocation is not the apolitical process many political scientists believe it to be.
One of the first items to clarify concerning the LAT is that it is not actually a tax. It is, rather, a transfer mechanism whose funding is derived from fixed percentages of selected national taxes.\(^1\) The designation of the LAT as a “tax” stems from the 1940 reform, which the previous section noted saw the institution of the Local Apportionment Tax (Chihou Bunyozei) on the basis of set percentages of income and other taxes. The funds were accumulated in a special account for the transfer, and the accumulated revenues were then distributed equally to the prefectural and municipal levels, according to several measures aimed at calculating relative fiscal need. The significance of the transfer increased, as we saw in Table 3.4, because as a proportion of the local authorities’ aggregate revenues it rises from 9.2 percent in 1940 to 15.8 percent in 1945.

Japan’s 1945 surrender brought chaos to the militarized economy and administration. Tax revenues in 1946 plunged to 7.2 percent of national income from the previous year’s 11.2 percent. Moreover, the source of revenues shifted from the wartime average of 58.6 percent direct and 33.7 percent indirect taxes to 43.6 percent and 46.9 percent respectively in 1946. This decline in revenues from the major direct taxes reflected not only Japan’s woeful economic circumstances, but also a host of administrative problems that allowed income taxation to be evaded or paid in the next or even the

\(^1\) Specifically, the Local Allocation Tax in 1995 drew its revenues from a 32 percent share of the national personal and corporate income taxes as well as the liquor tax; a 25 percent share of the national tobacco tax; and a 24 percent share of the national consumption tax.
second fiscal year in greatly depreciated currency.²

Of course, in this period SCAP's ideology of local fiscal autonomy was the strongest influence on Japanese tax policymaking. This ideology went in tandem with, it is important to note, the Occupation's efforts to decentralize policing, education, and other centralized state functions. In consequence, the responses to the early postwar local fiscal crisis show a decentralist trend in both finances and administrative burdens. Unprecedented fiscal reforms began with the earliest tax revisions in the wake of the surrender and continued through the legislation based on the Shoup Report.

The Shoup reform sought, as part of fiscal decentralization, to put the Distribution Tax on firmer and more favourable ground for the local authorities. Hence, Shoup recommended the rules governing the tax's distribution be modernized through an increase in the range of local circumstances taken into account in calculating financial need. Shoup also recognized that the central state's sole jurisdiction in deciding the level of and rules for fiscal redistribution greatly circumscribed local autonomy. The Shoup Report therefore sought to revise the structure of the Local Autonomy Agency, the descendant of the

² On these figures and the administrative problems, see Henry Shavell, "Postwar Taxation in Japan," in the Journal of Political Economy, Volume 56, 1948, pp. 126-30. A curious aspect of Japan's fiscal history, when seen against the rather authoritarian prewar state and its heavy expenditures on national defence, is that tax enforcement was remarkably lax. Taxpayers incurred no penalty for not reporting particulars about their income, though they were legally obliged to do so. Shavell notes that there was not so much as one case of conviction or punishment for tax evasion up to 1948, and that Japanese tax officials regarded criminal punishment for tax evasion as "contrary to the Japanese philosophy of
Home Ministry's Local Affairs Bureau, so as to secure direct representation from the local authorities. In this respect, Shoup was evidently taking a lesson from SCAP's inclusion of the six CRD chairmen on the Local Finance Commission, which was one means through which SCAP sought to bypass the uncooperative former Home Ministry bureaucracy in the early postwar period. The new institution recommended by Shoup was to have been called the Local Finance Commission and, ideally, would mediate between the local and central authorities on the Allocation Tax, the apportionment of debt, and other fiscal issues. But this plan did not come to fruition due to the reconstitution of the Home Ministry's Local Affairs Bureau through its absorption of the Commission.

Conflicts with MOF

Recentralization of the fiscal regime in the 1950s virtually eliminated institutionalized local input in the management of the system, but did not depoliticize the process of decisionmaking on redistribution. Maintenance of the old role of the Distribution Tax entailed the redistribution of centrally controlled tax revenues; as in the 1940 tax reform, two central agencies (MOF and the Local Autonomy Agency [Jichichou]), were in charge of general subsidies. But in the postwar order, these institutions lacked the exigency of stabilizing the local areas in the midst of a global war.
The initial post-Occupation structure for determining the amount of the LAT involved annual negotiations between MOF and the Local Autonomy Agency, whose fiscal interests were much at odds. MOF approached budgeting issues in the wake of the Dodge Line with an austere cast of mind and a commitment to keeping the burden of the state below twenty percent of gross national product. This policy orientation led MOF, during annual budgeting sessions, to overestimate the level of anticipated local revenues. On the other hand, the Local Autonomy Agency challenged MOF's figures with its own underestimates, as it sought to enlarge its jurisdiction and secure funds to cope with local fiscal crises. The absence of a fixed framework for deciding the level of redistribution left the matter to interministerial political maneouvring. A former official from the Local Autonomy Agency describes the negotiations between MOF and the Agency as having been particularly tough because of this problem.3

One solution to the difficulty was offered through the Local System Advisory Commission's (Chihou Seido Chousakai; herafter, LSAC) report of October 1953, which recommended that the structure of redistribution be revised. This report, produced very much as a reflection of the Local Autonomy Agency's

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aggressive tax collection caused riots and other disturbances.

aims, advocating a major reversal of the Shoup reforms. Against the backdrop of continuing fiscal crisis at the local level and the concern about politicization of the intergovernmental tax-transfer system, the report called for stable and centrally directed redistribution. Specifically, the report recommended the recentralization of several important taxes, including the Admissions Tax (Nyuujouzei) and the Amusement Tax (Yukyouinshokuzei), as well as the transfer of a share of the Fixed Assets Tax base (Koteishisanzei) from the municipal to the prefectural level. Other proposals for centralization included terminating Shoup's local Value Added Tax (Fukakachizei) and reinforcing the Enterprise Tax (Jigyousei) instead; adjusting tax controls; and introducing a system of debt management that monitored the tax effort of indebted local authorities and placed them under the authority of the Local Autonomy Agency.

On August 7, 1953, the cabinet created the GTAC and thus formalized MOF's earlier ad hoc tax system of deliberation councils. The GTAC also went on to study the problem of fiscal transfers, as its mandate permitted this sharing of administrative purview with the pre-existing LSAC. The creation of the GTAC at this point, and its grant of administrative purview over local governments' tax matters, clearly displeased the head of the Local Autonomy Agency's Finance Department. This reaction is indicative of the friction between the two

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4 See supranote 33, chapter 3.

5 The Finance Department head indicated that he felt the new deliberation group was redundant (dasokuteki), but added that he welcomed as many views as possible on the question of local taxation.
central agencies.

However, the annual fights over the LAT needed resolution in order to avoid politicization of the system. The GTAC's November 11, 1953 report on the local tax problem was thus virtually identical, on the major points, with that of the LSAC. The MOF-dominated GTAC report differed, for the most part, only in advocating a more restricted scale for local finance and in making minor adjustments to some intergovernmental tax arrangements.\(^6\)

Both reports were taken up by the political process in February, 1954, and resulted in a series of legislative changes that 1) implemented the compromise on the LAT; 2) centralized the taxes identified in the reports and set up the redistributive structures called for; 3) installed the system of debt control; 4) and enacted several of the other measures desired by the two deliberation councils.

The outcome most germane to this section was the 1954 institution of the LAT, with the rates of its component personal income, corporate income, and liquor taxes set at twenty percent. These rates were raised through the high-growth period with little friction between the two ministries, until revenue constraints

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reemerged in the late 1960s. An additional reason for the relative quiescence was that both MOF and MOHA benefited from cooperating on increases in the rate of contributions to the LAT during this period. The ministries enhanced their jurisdiction through the negotiations concerning the tax and, by extension, the superintendence of local fiscal affairs. However, it also meant that their cooperation became more crucial to the fiscal process. By 1965, the two ministries had found enough common ground, in a regime of rapid economic growth, to increase the rates of personal income, corporate income, and liquor taxes in the LAT to thirty-two percent. The rates have remained unchanged since then, however, because the era of relatively easy financing came to an end and the MOF-MOHA conflicts resumed.

Allocating the Rules of Distribution

The rules governing the distribution of the LAT come under considerable suspicion from many local governments, public finance specialists, and not surprisingly, bureaucrats within MOF. In fact, the 1954 compromise implemented an extremely detailed method of computation for determining if a local authority is entitled to LAT revenues, and if so how much. The computation involves adding up the relevant local government’s tax effort, or Basic Financial Revenue (Kijun Zaisei Shuunyuu), exclusive of non-statutory

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taxes and other specified items. Also calculated is the local authority’s Basic Financial Need (Kijun Zaisei Juyou). This figure expresses the local authorities’ demand for expenditures according to a complex formula that includes the particular jurisdiction’s total area, population, number of students and classrooms, length of roads and rivers, degree of coldness and amount of snowfall, and other variables. These variables are meant to ensure that all local authorities are treated in a manner that takes adequate note of possible special circumstances, such as a large number of retirees in the community. Akizuki argues that the calculations are removed from the arena of zoku politics and other distorting influences. In other words, the distribution of LAT revenues, once they are calculated, is not politicized by MOHA or other agencies, and this helps explain why Diet politicians do not try to intervene in the process.\(^8\)

There is, however, considerable room for discretionary control over LAT funds, because MOHA’s Finance Bureau makes adjustments to the formula for redistribution. This may seem a trivial matter; and, as was noted earlier, virtually all political science accounts of Japan’s general transfer regime regard the LAT as an unproblematic shift of funds from the centre to the fiscally weaker local authorities. But in fact, redistribution is not that simple if one looks at the phenomenon from a comparative standpoint.

\(^8\) "Institutionalizing the Local System: The Ministry of Local Affairs and Intergovernmental Relations in Japan," in The Japanese Civil Service and Economic Development, op. cit.
The issue here is not merely, as noted in chapter 1, that the LAT revenues are often effectively earmarked for paying down debt. Nor is it that 6 percent of the LAT is distributed according to discretionary criteria. A further problem is the question of who chooses the elements that compose the formula for redistribution. Though the process may be properly bureaucratic in the wake of the selection, the items deemed appropriate to include “are largely the result of political decisions.” The truth of this assertion is seen, for instance, in the enormous variation in the criteria for redistribution throughout Europe and even among the German states. Redistribution to local authorities is predicated on conceptions of spending needs, and “it must be recognized that overall assessments of spending needs inevitably involve many value judgements as to the relative importance of different local services and the
Because of the inherently political nature of these choices, the selection of redistributive criteria is generally debated in open fora that include not only bureaucrats but local and national politicians as well. In Australia, for example, the high degree of centralization in the tax system (i.e., the federal government monopolizes the income tax field) has brought about compensating institutions for intergovernmental bargaining and ratification of the criteria for distributing grants. In Canada, in fact, successive rounds of "executive federalism" have seen provincial leaders dismantle piece by piece the federal government's powers to attach conditions to its fiscal transfers. Similar mechanisms for intergovernmental negotiation are evident in most other federal and unitary states, especially those where the scale of transferred resources approaches that seen in Japan.

But Japan does not have institutionalized consultation. There are ad hoc consultations with prefectural governments, but these are not routinized and do not confer explicit bargaining rights on local authorities. Certainly it is more efficient to have MOHA act in this area on behalf of Japan's 47 prefectures and other subnational governments, due to the difficulties of achieving consensus among such a large number of actors. Yet the choice of institutions to cope with this collective action problem is not so constrained that centralization in

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9 Philip Blair, "Financing Equalization Between Local and Regional Authorities in European Countries,"
MOHA's Finance Bureau is the only viable alternative. Indeed, the degree of centralization is so great that only ten members of the Finance Bureau actually do the work of adjusting the rules. This may be an efficient and unproblematic solution, if viewed in rational choice terms as an agency relationship in which politicians ultimately control the delegated responsibilities. But one can also argue that the trade-off of centralization in order to enhance efficiency gives MOHA an indisputably large scope in which to impress its own institutional agenda on the rules of distribution.

These points were confirmed by a recent nationwide survey of Japanese mayors, wherein 67 percent of the respondents complained that MOHA's method of calculating the LAT was opaque, 44 percent argued that the distribution does not reflect the wishes of the local authorities, and a further 22 percent felt it was improper (okashii) that MOHA changed the rules for distribution every year. As the mayor of Sagamihara City in Kanagawa Prefecture argued, "authority for determining the distribution of the LAT should be transferred from MOHA to the CRD and other local organizations."10

Further evidence that the LAT affords discretionary powers to MOHA is seen in the pressures from other spending ministries and their allied zoku politicians.

10 The comprehensive survey was undertaken in order to highlight problems in the current trend towards shifting specific subsidies into the general subsidies account (i.e., the Allocation Tax). See "Kuni tanomi no kouzu kawarazu" (The structure of dependence on the central government remains unchanged), Nihon Keizai Shinbun, January 6, 1997, pp. 28-9.
to have the LAT rules altered to favour particular distributive ends. This intra-state lobbying includes, for instance, the Construction Ministry and affiliated politicians' efforts to have more fiscal room granted for the support of road-building and road maintenance. Such line ministries also gave tacit support to the Local Autonomy Agency's early postwar pressures for higher rates of the LAT's component taxes. The Education Ministry was supportive because the LAT funds, which are general revenues once disbursed from MOHA's Finance Bureau, could be used as funds for compulsory education expenses. In other words, the role of the Local Autonomy Agency itself expanded because it could decide whether assigned responsibilities for the local authorities should be paid for via subsidies or be included in the calculations of a specific local authority's basic fiscal demand. If the latter, the cost of the delegated work would become an element in the determination of the amount of LAT to be disbursed to the particular local authority. This utility of the LAT to MOHA is often unappreciated in studies that view it as merely a general fiscal transfer.

The bargaining that takes place with other central agencies concerning the rules of distribution is neither institutionalized nor in any manner of speaking open. It is in thus understandable that many academics and public officials

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12 Kengo Akizuki makes this argument, for example, one which is common to conventional and revisionist accounts of MOHA's tax controls; see "Institutionalizing the Local System," op. cit., pp. 360-61.
regard this backroom dealing and MOHA's dominance of the rules over distributing the LAT as a "black box."\textsuperscript{13}

Therefore, rather than a simple fiscal transfer, the LAT must be viewed as part of a complex of institutions that restrict broader input into decisionmaking. The LAT is both a "no strings attached" transfer and an important element of MOHA's structure of influence and fiscal control. Below I sketch the means through which the latter phenomenon is said to operate.

\textit{The Politics of Allocation Tax Increases}

The 1954 compromise between MOF and MOHA on the LAT turf depended on larger fiscal trends, as I alluded to above. Even during the rapid average annual growth of the Japanese economy, there were troughs in the wake of the biggest crests of the economic boom. These slowdowns in growth showed up quickly in reduced natural revenue increases from the highly elastic income tax, and brought pressure for fiscal readjustment from MOF's Budget and Tax Bureaux. Moreover, the scale of the state expanded through public works projects and the mounting, albeit modest, outlays on welfare programmes and services.

\textsuperscript{13} The phrase was used in interviews at MOF's Tax Bureau, and it is not uncommon in newspaper and academic sources.
Conflict between MOF and MOHA over redistribution reemerged in the mid-1960s. From MOF's perspective, a major problem was excessive local spending, especially on salaries, which was gradually pushing the central state toward the much-loathed step of deficit spending. The dislike MOF had of this circumstance can be gauged from the fact that the ministry had scrupulously avoided deficits after the imposition of the Dodge Line in 1949-50. As a result, in 1965 MOF sought to offload more of the burden of local projects onto local debt even as it conceded to the final increase (from 29.5 to 32 percent) in the rates of component taxes for the LAT. This policy line was enunciated in the November 1 mid-term report of MOF's Fiscal System Advisory Council (Zaisei Seido Shingikai).

MOHA's Local System Advisory Council (Chihou Seidi Chousakai) answered the challenge in a March 8, 1966 report on local taxation and transfers. MOHA clearly prefers general transfers to local debt or specific subsidies. Debt was a major aspect of fiscal crisis in the prewar and early postwar eras, and hence is anathema to MOHA's organizational mission of stability and uniformity. The latter source of funds, specific subsidies, is also disliked because it involves generally having to share administrative turf with the spending ministry in charge of the subsidy. The MOHA advisory council, not surprisingly, came

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14 Akizuki Kengo, "Institutionalizing the Local System," op. cit., pp. 354-55, confirms that there is considerable friction between MOHA and line ministries on the issue of specific subsidies. Also, note that both MOF's General Affairs section in charge of the budget for MOHA, and MOHA's Fiscal Affairs Bureau share interests here. The MOF agency would be in charge of a larger budget were all subsidies made general and thus transferred via the Allocation Tax. The agencies' discussions of this are well-
down clearly in favour of general transfers versus the position put forward by MOF.

These reports were official expressions of the new fiscal reality in intergovernmental affairs. Long in advance of Diet politicians' turn to fiscal austerity in the 1980s, MOF had announced its concern about spending pressures and its resolve to do something about them. By contrast, MOHA signalled its readiness to stand in opposition to MOF's plan to offload fiscal burdens onto local governments.

The conflict between the two ministries escalated the next year, when MOF was compelled to float bonds to cover a revenue shortfall. Being driven toward deficit spending -- albeit the ostensibly productive outlay of construction bonds -- was bad enough. But in addition, MOF was losing its capacity to make adjustments in the budget because expenditures were effectively becoming earmarked. In November of 1967, MOF came out strongly against "fiscal rigidification" (zaisei kouchokuka) and pointed to four major sources of this problem. These sources included such politicized transfers of tax dollars as the rice-price guarantee, the cost-inefficiency of the railways, and the mounting deficits of the health insurance system. The fourth contributing factor, though, was the LAT, which MOF declared that it wanted to cut from the 32 percent level (of component taxes) that had been set only two years before.
MOF and MOHA's squabbles over funding the LAT continue, their intensity varying inversely with the rate of increase in tax collection. During the steep decline in revenue collection in the early 1990s, for example, MOF's Budget Bureau again pressed hard for outright cuts in the component taxes. The argument was that local budgets were robust relative to that of the central state. But these recent efforts to cut the component tax rates have so far been strongly and successfully resisted by MOHA.

**MOF-MOHA Compromise on the Special Account**

Possibly contributing to the stability on the rates of the LAT is the MOF-MOHA compromise on using it as a tool of financial administration. This unusual compromise on the transfer was reached in 1987, with the institution of the Special Account for Loans from the LAT (*Koufuzei Tokubetsukaikei Kariirekin*). This and subsequent measures allow for temporary reductions to be made in LAT transfers from MOF in the event of serious fiscal stress. The unpaid balance of the LAT is treated as a loan from the special account to the central state, and is to be repaid in the next year or afterwards. This system might, at first glance, appear to be a harmless bureaucratic expedient. However, it has come under heavy criticism in public finance circles because the movement of the funds in and out of the account is unclear and not under the authority of

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the institutional roots of a major policy change.
local governments. Moreover, shifting funds around across years -- rather than within the same fiscal year -- is an irregular procedure and beckons further study.\(^{15}\)

MOF's reasons for entering into the compromise instead of simply pushing for cuts in the LAT can only be speculated at. According to Japanese public finance scholars, MOF wanted to keep politicians from interfering in this aspect of the fiscal system and perhaps turning it into a massive and expanding porkbarrel. A full-scale bureaucratic fight on this issue would almost certainly invite political attention, as alterations to the basic framework of the LAT require the approval of the Diet.

On the other hand, MOHA's reasons for participating in the scheme seem obvious. Cuts in the transfer would reduce MOHA's means with which to fulfill its organizational mission of smoothing out fiscal gaps among the local authorities. This feature, in tandem with ministerial discretion concerning the rules for allocation, is likely incentive enough for compromise. Yet here again, the outcome of the compromise is a structure outside of the direct influence of the local authorities.

\(^{15}\) A short description of the problem is in "Zaisei kenzenka ni 'gyaku kouka'" [An outcome contrary to the pursuit of fiscal soundness], number 8 in the *Nihon Keizai Shinbun* series on decentralization, May 1, 1996, p. 25. My thanks to John C. Campbell, an expert on Japanese budget politics, for confirming that the transfer of funds across the years is highly unorthodox.
General Subsidies and Fiscal Dependence

A related reason for MOHA to strike such bargains with MOF is that, in spite of the complaints from many mayors and other local officials, the LAT does serve MOHA well in maintaining a large bloc of satisfied local governments. This phenomenon has long been evident in Japanese intergovernmental fiscal politics, and is likely a property of any system of redistribution between -- to use the Canadian parlance -- "have" and "have not" subnational entities. Moreover, as is perhaps also the case in all such systems, the entities that pay more than they receive in transfers generally support fiscal decentralization while the net beneficiaries are considerably less enthusiastic about such policies. Hence the unwillingness of many smaller prefectures and municipalities to follow the lead of Tokyo and other large constituencies, which favour a more liberal fiscal regime. A large number of these less fiscally robust local governments have become dependent on LAT transfers. Indeed, some administrations opt to take the easiest path by reducing their tax effort to the standard rates, thus gaining their specified share of LAT revenues and avoiding the political pain of taxing up to the maximum permitted by MOHA.

There are, in this case as well, at least two ways of looking at the phenomenon. One perspective, implicit in the revisionist literature, suggests that a large bloc of satisfied local governments means the LAT is fairly distributed among local governments. Were the system of general transfers grossly inadequate,
capricious, or coercive, there would be less willingness to rely on it. Hence, if one views the LAT in isolation from its institutional environment, it is easy to argue that it satisfies local fiscal needs at a marginal perceived cost in local autonomy.

On the other hand, a more critical point of view would note that MOHA certainly has to ground its fiscal hegemony on a large measure of consent. Japan is a centralized state, but it is also indisputably democratic, with other opportunities for local governments to air grievances if they choose to bypass MOHA. If my argument concerning MOHA's organizational mission of perpetuating fiscal control is true, it follows that it is in MOHA's interest to create a bloc of dependent and supportive, or at least compliant, local governments.

A corollary of this condition, however, is much dissatisfaction among the larger administrations, which pay into the LAT base but receive little or nothing in return. This phenomenon is, as I noted earlier, common for wealthier constituencies in systems that redistribute revenues among subnational governments. Rich provinces in highly decentralized Canada have long felt, for example, that they are unfairly burdened in order to pay for fiscal federalism. In Japan, Tokyo contains 9.4 percent of the population and

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16 Some of the politics of Canada's intergovernmental finance are reviewed in Ikegami Taihiko, “Kanada ni okeru Renpou, Shu aida Zeigenhaibun Ronsou” [The Intergovernmental Debate over Revenue Distribution in Canada], in Chuo Daigaku Keizaigakuronshuu, Vol. 36, No. 4, October, 1995.
represents 18 percent of gross national product, but supplies fully 29 percent of personal income tax, 37 percent of corporate tax, and 35 percent of consumption tax revenues. These revenues are the main elements of the LAT, from which Tokyo receives no transfers. Since some smaller local governments are not taxing to the extent that they could be, revenues gleaned from Tokyo and other areas are effectively being misallocated. Such monies, the argument goes, could be spent on the notoriously poor infrastructure of Japan’s larger metropolises.

That is, many local authorities do not challenge MOHA’s dominance and scope for discretion concerning the LAT (including the 6 percent portion), because the only perceived alternative is a fiscal autonomy that would compel them to place heavier burdens on local taxpayers or rationalize their expenditures. The political implications of arguing that the local authorities should be “weaned” from subsidies, both specific and general, will seem

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17 The figures are from, “Zaiseichousei ni kyoudouzei kousou” [Fiscal adjustment and cooperative taxation], item number 9 in the series “Chihoubunken no riron” [The debate on decentalization] in Nihon Keizai Shinbun, May 2, 1996, p. 29.

18 Note that the calculation of basic financial revenue for prefectures and municipalities is based on 80 and 75 percent, respectively, of total revenues. This is to provide incentives to enlarge the local tax base, by avoiding the situation wherein “any increase in local tax revenue would reduce the local allocation tax by the same amount”; see Junschihiro Yonehara, “Relations Between National and Local Governments,” Japan’s Public Sector: How the Government is Financed. Ed. by Tokue Shibata. Tokyo: University of Tokyo Press, 1993, p. 174. Estimating the efficiency loss through transfers managed by MOHA is beyond the scope of the present work. Some comparative light can be shed on the matter through the example of Australia, however. Australia’s fiscal equalization mechanisms are “often described as the most comprehensive and explicit in the world,” include far more variables than Japan’s, and are also ratified through intergovernmental bargaining at the Premiers’ Conference. Even so, the net welfare loss of the distortions on allocation has been estimated at “around twenty per cent of the aggregate cost equalization transfers.” See Peter Groenewegen, “The political economy of federalism since 1970,” State, Economy and Public Policy in Australia. Ed. by Stephen Bell and Brian Head. Oxford: Oxford University Press, 1994.
familiar to anyone who has followed the trajectory of fiscal decentralization debates elsewhere. In many other countries with large-scale redistribution, those arguing decentralization are often hoping for, so to speak, a leaner and meaner local state. The not-so-hidden agenda of devolutionist Republicans in the United States, for example, has with good reason been characterized as a mean-spirited (and likely ineffective) fiscal “stimulus” to the poor. Moreover, most work on fiscal decentralization is aimed at the question of whether devolution can shrink the state, with rather a technocratic disregard for what the expenditure cuts might cost in human terms.

But in Japan support for decentralization has long been the preserve of the Left, and only in recent years has it gained a strong following among the conservative establishment. Rationalizing expenditures at the local level can be viewed as a progressive policy option in Japan because of the scale of waste and political corruption associated with the public works that constitute a large share of local spending. Attempting to secure fiscal discipline at the local level, via the reduction of transfers and a shift towards greater reliance on local resources (with a concomitant transfer of tax controls), is therefore not a neo-liberal strategy to remove the so-called “undeserving poor” from the welfare rolls. Instead, the aim is to enhance reliance on local fiscal resources.

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and thus reduce wasteful public works through breaking the existing pattern of corrupt fiscal politics.  

Proposals for Reform

The Japanese public debate recognizes some of the problems posed by excessively centralized control of the LAT. In fact, the final report of the Decentralization subcommittee (Chihoubunken bukai) of the Administrative Reform Promotion Group (Seifu no Gyousei Kaikaku Suishin Honbu), submitted on October 4, 1994, advocated major changes to the LAT law. The subcommittee reasoned that the constituent taxes should be earmarked for direct deposit into the LAT fund rather than flow, as they do at present, into general revenues and then be transferred to the special account by MOF. This measure would not in itself be a major decentralist reform; rather, it is seen as the first step in that direction.

Moreover, the current debate on fiscal decentralization centres on, as was noted in the introduction to this dissertation, the reduction of specific subsidies and their replacement by general subsidies. The process is referred to, in direct translation, as "general finance-ization" (ippan zaigenka), and is

21 An example of the progressive argument is seen in Jinno Naohiko, "Zeigen utsuseba, zaigenryoku no jichitai kakusa heru" [Transfering taxes can reduce local fiscal gaps], Asahi Shinbun, December 13, 1996, p. 4.

22 Refer to "Chihoubunken no saishuu houkokuan katamaru" [The final report on decentralization is determined], in Nihon Keizai Shinbun, November 1, 1994, p. 2.
hindered by the uncertain political situation in Japanese party and bureaucratic circles. Yet were the policy line to meet with unanticipated success, it does not follow that fiscal decentralization would be the result. For one thing, the 1980s record of cuts to specific subsidies not being compensated by commensurate increases in general subsidies gives pause for doubt. Experience in other countries, too, suggests that general subsidies are more visible targets for restraint, as “national governments can place a limit on the total allocation to local governments by deciding first what the total funding pool will be and then distributing the pool according to an entitlement formula.”23 But even if fiscal restraint did not complicate the issue, the absence of formal avenues for local input into the system would not change.

Prospects For Politicization

Other actual and potential problems with the tax came to light in the protracted negotiations over the 1997 budget. One of the major sticking points in the negotiations between the ruling coalition and the bureaucracy concerned funding for the construction of new high-speed shinkansen (“bullet train”) lines. A proposal for five new lines has long been left languishing on the drawing boards for lack of finances, especially because the projects are truly massive pork barrel public works.

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23 On this, see Heidenheimer, et al., pp. 308.
The funding hurdle confronting negotiators seemed insurmountable, for two major reasons. The first is Japan's debt-strewn fiscal landscape of the 1990s. The legacy of pump-priming via public works and income-tax cuts is that Japan has, in the mid-1990s, become the industrialized world's most debt-ridden nation. The combined debt of the government sector in Japan in 1996 stood at 440 trillion yen, which has created a consensus among the public finance community that great prudence in spending is imperative. Thus large-scale projects such as the shinkansen lines are viewed as not only wasteful but a dangerous anachronism, the "dregs" (zanshi) of the high-growth era's porkbarrel politics.24

The more immediate barrier arose because Japan Rail was unwilling to take on 50 percent of the construction costs, which is the funding arrangement in place for previous shinkansen projects. But attention eventually turned to whether LAT revenues could be used to cover part of the costs. MOHA has long been in principle against this use of general subsidies, and had thought the matter a dead issue after it came up on the agenda in the summer of 1996. Moreover, when it reemerged later in the year, MOHA requested a postponement of any decision to August of 1997. MOF also opposed a deal on funding, citing the country's massive debt load. However, a deal was concluded just before the end of the year, one that will see MOHA transfer LAT

24 The comments are from Ishi Hiromitsu, a major figure in Japan's public finance community; see the interview with Ishi in "Zaisei saiken honenuki no shouchou" [A symbol of the mutilation of fiscal reconsruction], Yomiuri Shinbun, December 26, 1996, p. 7.
In fact, MOHA is ambivalent on the issue. It stands to gain much prestige through its gatekeeper role with the LAT, because of the bullet-train funding scheme and other such “economic development” (keizai kaihatu) projects. These latter envision Japan as a series of separate regions of technopolises and other public-works bonanzas. Big schemes involving so much concrete and steel cost a lot of money, especially in Japan, but the targeted subsidies that are largely the purview of the Construction Ministry are on a slow decline. Hence politicians’ recent interest in the LAT. But MOHA’s opportunity also confronts the ministry with the risk of creeping politicization of the LAT, through the activities of the zoku giin. Moreover, as MOHA’s influence increases there are almost certainly to be challenges from other ministries, which already resent its authority to vet proposals where the use specific subsidies entails a corresponding financial contribution for the local authorities.

In other words, the LAT, is certainly not a simple transfer of fiscal resources, and is apparently about to become even less so. Lacking in open and

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25 “Hashiru seiji, kasumu zaisei saiken” [Fast politics leaves fiscal reconstruction in the dust], Nihon Keizai Shinbun, December 18, 1996, p. 5.

26 These points were confirmed via a January 7, 1997, telephone interview with a public finance scholar who works closely with MOHA and therefore must remain anonymous here. On other ministries’ worries that MOHA authority will increase through decentralization, see Yoshiaki Kato, “Chihou Bunken Chakuchi e no Michi: Kengen Ijou Gutaisaku naku” [The Road to Decentralization: No Concrete Policies for Transferring Authority], in Nihon Keizai Shinbun, October 22, 1994, p. 1.
institutionalized intergovernmental consultation, the transfer system is part of the regime of fiscal centralization. Moreover, because it is already a point of friction between MOF and MOHA, the likelihood of the latter's voluntarily relinquishing its discretionary authority seems minimal. This is likely to be even more true if the recent trend continues and more fiscal resources are shifted to the general versus specific subsidy account, thus inviting further attention from zoku giin in search of finances for vote-oriented expenditures.
Chapter 6

The Income Tax Field and Corporate Taxes

Dr. Carl Shoup...once said that governments are prone to create a corporate tax system that is based not so much on economic theory or economic rationale but on one simple criterion: That tax is easy to collect and can be collected in large amounts.

Nakamura Yoshio,
Managing Director, Keidanren

Japan’s corporate income tax structure bears strong evidence of bureaucratic intervention and the revanche of the 1940 fiscal system. Of special note here is the division of the tax field between MOF and MOHA. This structure gives them strong incentives -- in the context of the party competition for personal income tax cuts -- to oppose fiscal decentralization as well as corporate pressures for tax cuts. In consequence, Japan is notable for high corporate tax rates and overall burdens relative to other advanced industrialized countries.

1940 and the Modern Income Tax

The 1940 reform set the stage by modernizing the income tax through clearly distinguishing the personal and corporate income tax fields. As was noted earlier, this reform realized in large measure the prewar bureaucracy’s aim of shifting the tax burden onto Japan’s modern sector of salaried urban workers and capitalists.
Table 6.1: National Taxes By Principal Items, 1940-1945.

(Units: Thousands of Yen)

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Taxes</th>
<th>Total Direct</th>
<th>PIT</th>
<th>CIT</th>
<th>Total Indirect</th>
</tr>
</thead>
<tbody>
<tr>
<td>1940</td>
<td>4,140,843</td>
<td>2,616,123</td>
<td>1,488,679</td>
<td>182,873</td>
<td>1,524,720</td>
</tr>
<tr>
<td>1941</td>
<td>4,817,942</td>
<td>3,048,246</td>
<td>1,401,363</td>
<td>534,907</td>
<td>1,769,696</td>
</tr>
<tr>
<td>1942</td>
<td>7,350,520</td>
<td>4,611,232</td>
<td>2,236,191</td>
<td>775,946</td>
<td>2,739,288</td>
</tr>
<tr>
<td>1943</td>
<td>9,731,154</td>
<td>5,442,242</td>
<td>2,604,097</td>
<td>993,618</td>
<td>4,288,912</td>
</tr>
<tr>
<td>1944</td>
<td>12,715,146</td>
<td>8,375,566</td>
<td>2,040,581</td>
<td>1,326,514</td>
<td>4,330,591</td>
</tr>
</tbody>
</table>

Note: Year= Fiscal Year; PIT=Personal Income Tax; CIT=Corporate Income Tax.

The 1940 reform was not, however, the ideal of comprehensive income taxation sought in the 1920s. Rather, the bureaucrats learned from earlier policy failures and thus carefully tailored the wartime tax reform so as to gain as much acquiescence as possible while still securing the essential goal of shifting the burden. The outcome centred the tax system on schedular types of income taxes, a regime the Japanese bureaucrats modelled on contemporary British and French examples. Put simply, the schedular taxes did not treat all forms of income equally as is the case with a comprehensive tax system (a characteristically North American tax style). The new system instead taxed different forms of income, such as income from interest and dividends, at different rates, though once aggregate income exceeded 5,000 yen (in 1940),

Income taxation thus became the base of the Japanese state's revenues in the 1940 reform. The national-level Corporate Income Tax (hereafter, CIT), in particular, rapidly emerged as a salient source of revenues for warfighting and redistribution, as Table 6.1 indicates.

Table 6.1 shows that the CIT's 641 percent increase from 1940 to 1945 greatly outpaced the other sources of revenue listed, including the rates of increase of direct, indirect, and total taxes. This situation is reversed in the chaos of the early postwar period, as Table 6.2 notes. In this period, corporate profits were extremely low and often hidden from zealous tax assessors whose Occupation overseers sought to maximize revenues. Consequently, revenues from corporate income taxation were quite low relative to other taxes, and especially the Personal Income Tax (hereafter, PIT), through the remainder of the 1940s.

However, shortly before the 1950-51 passage of the Shoup tax reforms, the revenues from the CIT recovered and then began to match those of the PIT. After the implementation of Shoup consolidated the Occupation's PIT reforms of 1947, the CIT resumed its movement relative to the PIT and in fact came to
exceed the latter as a source of revenues in 1960.

Table 6.2: National Taxes By Principal Items, Selected Years 1946-90.

(Units: Millions of Yen)

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Taxes</th>
<th>Total Direct</th>
<th>PIT</th>
<th>CIT</th>
<th>Total Indirect</th>
</tr>
</thead>
<tbody>
<tr>
<td>1946</td>
<td>37,438</td>
<td>21,332</td>
<td>12,241</td>
<td>1,316</td>
<td>16,106</td>
</tr>
<tr>
<td>1947</td>
<td>189,600</td>
<td>99,409</td>
<td>79,273</td>
<td>7,290</td>
<td>90,191</td>
</tr>
<tr>
<td>1948</td>
<td>447,745</td>
<td>222,669</td>
<td>190,832</td>
<td>28,107</td>
<td>225,976</td>
</tr>
<tr>
<td>1949</td>
<td>636,405</td>
<td>344,351</td>
<td>276,754</td>
<td>61,264</td>
<td>292,055</td>
</tr>
<tr>
<td>1950</td>
<td>570,849</td>
<td>313,620</td>
<td>220,134</td>
<td>83,790</td>
<td>257,230</td>
</tr>
<tr>
<td>1951</td>
<td>723,144</td>
<td>424,995</td>
<td>225,672</td>
<td>183,881</td>
<td>238,149</td>
</tr>
<tr>
<td>1955</td>
<td>936,882</td>
<td>481,120</td>
<td>276,675</td>
<td>192,121</td>
<td>455,772</td>
</tr>
<tr>
<td>1960</td>
<td>1,801,464</td>
<td>975,336</td>
<td>390,660</td>
<td>573,353</td>
<td>823,128</td>
</tr>
<tr>
<td>1965</td>
<td>3,279,653</td>
<td>1,941,565</td>
<td>970,329</td>
<td>927,120</td>
<td>1,338,088</td>
</tr>
<tr>
<td>1970</td>
<td>7,775,386</td>
<td>5,134,413</td>
<td>2,428,170</td>
<td>2,567,168</td>
<td>2,640,973</td>
</tr>
<tr>
<td>1975</td>
<td>14,505,758</td>
<td>10,058,267</td>
<td>5,482,283</td>
<td>4,127,908</td>
<td>4,448,919</td>
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<tr>
<td>1980</td>
<td>28,373,115</td>
<td>20,182,840</td>
<td>10,792,224</td>
<td>8,922,666</td>
<td>8,210,275</td>
</tr>
<tr>
<td>1985</td>
<td>39,150,200</td>
<td>28,517,000</td>
<td>15,438,000</td>
<td>12,207,000</td>
<td>12,207,000</td>
</tr>
<tr>
<td>1990</td>
<td>62,779,800</td>
<td>46,297,100</td>
<td>25,995,500</td>
<td>18,383,600</td>
<td>16,482,700</td>
</tr>
</tbody>
</table>

Note: Year= Fiscal Year; PIT=Personal Income Tax; CIT=Corporate Income Tax.

The very strong position of the CIT relative to the PIT in early postwar Japan is not, in fact, anomalous. The Canadian case, for example, shows a generally equally heavy reliance on both corporate and personal income taxes at the federal level from the end of the war through to 1953. From 1953 on, though, the PIT's place in the Canadian federal revenue structure increased from 4.6
percent of GNP to 6.1 percent in 1989, whereas the tax take from the CIT more than halved, in dropping from 4.7 percent of GNP to 2.0 percent in 1989.²

Table 6.3: Taxes on Corporate Income as Percentage of GDP.

<table>
<thead>
<tr>
<th></th>
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<td>3.5</td>
<td>2.8</td>
<td>4.4</td>
<td>4.2</td>
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<tr>
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<td>3.9</td>
<td>3.5</td>
<td>4.4</td>
<td>3.7</td>
<td>2.7</td>
<td>2.6</td>
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<tr>
<td>France</td>
<td>1.8</td>
<td>2.2</td>
<td>1.9</td>
<td>2.1</td>
<td>2.0</td>
<td>2.3</td>
<td>1.6</td>
</tr>
<tr>
<td>Germany</td>
<td>2.5</td>
<td>1.9</td>
<td>1.6</td>
<td>2.1</td>
<td>2.3</td>
<td>1.8</td>
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</tr>
<tr>
<td>Japan</td>
<td>4.1</td>
<td>5.2</td>
<td>4.3</td>
<td>5.5</td>
<td>5.8</td>
<td>6.8</td>
<td>4.1</td>
</tr>
<tr>
<td>Sweden</td>
<td>2.1</td>
<td>1.8</td>
<td>1.9</td>
<td>1.2</td>
<td>1.7</td>
<td>1.7</td>
<td>2.8</td>
</tr>
<tr>
<td>U.K.</td>
<td>2.2</td>
<td>3.3</td>
<td>2.4</td>
<td>2.9</td>
<td>4.7</td>
<td>3.9</td>
<td>2.7</td>
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<tr>
<td>U.S.</td>
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<td>3.6</td>
<td>3.0</td>
<td>2.9</td>
<td>2.0</td>
<td>2.1</td>
<td>2.5</td>
</tr>
</tbody>
</table>

Source: The source for the table is Table 12 in Revenue Statistics of OECD Member Countries, 1965-95. Paris: 1996. The corporate tax revenue figures are from table 52 of the same publication.

What is unusual about the Japanese case, therefore, is not the mere fact of the CIT's current salience in the country's revenue structure. Rather, Table 6.3 shows that Japan stands out because it increased its heavy reliance on corporate taxation at a time when most other developed countries (save the

notable example of the U.K. after its 1984 tax reform)\textsuperscript{3} were reducing theirs. Indeed, even though Japan's corporate tax revenues dropped from 29.3 trillion yen in 1990 to 19.8 trillion yen in 1994 (due to the effects of the Heisei recession), the table shows that as a percentage of GDP Japan's burden was second only to that of Australia.

Public finance work often argues that the salience of the CIT in Japan's revenue structure reflects the high rate of corporate income in the national income accounts. Yet between 1950 to 1960, America, Canada, New Zealand, and the U.K. were all taxing corporations -- as a percentage of GDP -- at higher levels than Japan, whereas France, Sweden, and West Germany were imposing lower burdens. The Anglo-American countries' high levels of corporate income taxation was the legacy of political mobilization for fiscal democracy coupled with the ratcheting effect of the second world war. By contrast, the Europeans and Scandinavians taxed corporate income rather lightly, providing very broad-based tax breaks for investment that allowed the state to shape economic development.

Hence the standard argument that Japan has a high level of corporate-derived revenues in its mix because of the relative importance of corporate activities in

\textsuperscript{3} Sven Steinmo suggests, in his account of Britain's 1984 corporate tax reform, that the majority of Tory politicians, including the Chancellor of the Exchequer, expected the burden on capital would be rationalized and reduced. The latter was not realized in large part because the reform was drawn up under conditions of budget secrecy, with virtually no consultation outside Treasury circles. In other words, the government "miscalculated" and then held fast to its reform. See Steinmo, \textit{Taxation and Democracy}, op. cit., pp. 174-7.
the national economy appears rather problematic if offered as the sole explanation for the tax burden.\textsuperscript{4} Much of the variation among countries' corporate tax burdens in the early postwar period appears instead to depend on the scale of tax expenditures and the degree of targeting in them. Also, the public finance argument neglects Japan's postwar fiscal politics, when virtually annual PIT cuts created pressure to turn to the CIT.

\textit{Japan's Postwar Income Tax Cuts}

Until the Tanaka administration made an explicit commitment to welfarism in 1971, postwar Japanese governments followed a policy of keeping the overall tax burden as a proportion of GNP to below twenty per cent of national income. Achieving this aim in a rapidly growing economy, as Japan's was for close to two decades, required large and virtually annual income-tax cuts, due to the sharp progressivity of the tax system.\textsuperscript{5} In the absence of such reductions, the volume of revenues would quickly have become a flood as taxpayers' accelerating incomes moved them up through the progressive rate structure of


the PIT.

But the straight technical explanation for virtually annual tax cuts belies the tax politics of the early postwar era. The goal of the Occupation, prior to the arrival of Shoup and his tax reform mission, was to maximize revenues in order to pay for the costs of reconstruction and the burden of the occupying forces. The emphasis on the American side was to limit as much as possible the burden to be borne by American taxpayers, and this led to comparatively heavy exactions on the Japanese public. This problem was compounded by Japan's poorly developed tax administration, which afforded few impartial means of assessment to the tax collectors. Hence, the collectors, with little training but lots of pressure to fulfill individual tax collection quotas, at times levied assessments that exceeded taxpayers' net worth.

The result of this was public furor, to the extent that tax collectors were at times physically assaulted. Front-line personnel in the revenue-collection offices, under siege by enraged taxpayers, thus became a major source of institutional pressure on MOF for leniency concerning the PIT. This pressure from the front-office personnel was further passed along as MOF inculcated the conservative parties with the political utility of cuts in the PIT rates and increases in exemptions. Indeed, the early postwar political environment was such that the lesson was obvious to conservative politicians save those who sought a large state, remilitarization, or tax cuts to be centred on their small-business
Moreover, the Socialists too emphasized the need for PIT reductions. This position reflected their reliance on company unions and the general lack of an association between income taxation and democracy in postwar Japan. In addition, the Left worried -- not without reason -- that a highly elastic tax base would encourage Japan's unrepentant conservatives to rearm.

Party politics in postwar Japan therefore centred quite early on income tax cuts. Of course, few people anywhere actually enjoy paying the income tax, so the mere fact of opposition to it in Japan does not explain outcomes in policymaking. What is important, in a comparative sense, is that no major interest in Japan stood in defence of the PIT. This outcome was not evident, by comparison, in the Anglo-American democracies, as Canadian and American social democrats looked to income taxation to play a central role in redistributing the burden of the state. Japan's strongly negative politicization of the PIT hence confounded the U.S. Occupation's efforts to impose the Anglo-American version of fiscal democracy on an institutionally quite dissimilar polity.⁶

In addition, differences in corporate and personal income tax burdens stem at

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least in part from differences in political institutions. Sven Steinmo’s work, reveals that the US relies heavily on progressive forms of income taxation which over the postwar period were hollowed out by a myriad of highly specific loopholes. Steinmo explains this fact through reference to America’s highly porous and fragmented set of political institutions: these create a context in which it is both possible and rational to pursue and extend very selective corporate income tax expenditures.\(^7\) Ronald King also remarks that the early postwar equation of income taxation with democracy, an ideology given political force by the Democrats, labour, and other progressive interests, saw business and the Republicans eventually respond with an insistence on incentives. King notes, for example, the Ways and Means Chairman’s hyperbolic comment in 1947 upon introducing a 20 percent across-the-board stimulative income tax cut, that “we Republicans have been warning that the short-haired women and long-haired men of alien minds in the administrative branch of the Government were trying to wreck the American way of life and install a hybrid oligarchy at Washington through confiscatory taxation.” But this aggressive and overtly ideological tax agenda was not appropriate to the new postwar politics of the income tax. Efforts to make wholesale cuts to the tax gave way to less politically charged, and hence more effective, means of securing selective tax reductions for the Republicans’ client interests. The 1954 Revenue Act then codified the selective incentives approach, such that “official rate schedules would be kept sharply progressive as a matter of

conscious policy yet would be combined with a number of categorical exemptions and dispensations.\textsuperscript{8}

\textit{Postwar Japan's Special Tax Measures}

Japan, too, made considerable use of incentives in the field of corporate income taxation, but with the important difference that the exemptions and deductions were constructed in the classic across-the-board bureaucratic pattern. The process of tax policymaking in fact strongly resembled Germany's. The end of direct Allied administration saw Germany's MOF regain control over tax policymaking and then use the Allies' confiscatory levels of taxation to craft broad-based incentives for business. Corporate income-tax policy gave business investors the choice of either using their capital in ways the state preferred, or paying high rates of tax. Because bureaucrats generally enjoy a greater degree of autonomy than politicians from the lobbying of specific interests and firms, in both Germany and Japan they were generally able to craft more broadly based tax measures than was characteristic of, say, Anglo-America.\textsuperscript{9}

Further evidence of this point is provided by Daniel Okimoto's comparison of industry-oriented tax policymaking in the US and Japan. Okimoto notes that

studies show a greater variation of tax expenditures in the US as well as most European countries. The reason is the political might of “old-line industries,” whose lobbying wins them tax breaks that effectively put the tax burden “onto the shoulders of the most efficient and promising sectors, a perverse reward for efficiency and growth.” By contrast, Japan’s relatively weak legislature and powerful bureaucracy shape a tax policymaking process that limits the potential for economically irrational business taxation.\(^9\)

**MOF’s Initiation of Special Measures**

According to Chalmers Johnson, postwar Japan’s tax expenditure process began when Minister of Finance Ikeda Hayato persuaded the MOF bureaucracy to accept preferences as a replacement for the direct subsidies that the Japanese Government had been dispensing to business since the end of the war.\(^1^1\) In other words, Johnson (who is generally labelled a statist) suggests MOF was reluctant to use tax expenditures, and that they instead emerged as a result of pressure from politicians. But another, more persuasive account is found in interviews with former Japanese bureaucrats who worked in the MOF Tax Bureau at the time. The interviews reveal that in 1951 Ikeda was obsessed with increasing the CIT rate from 35 percent to 42 percent in

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order to tax some of the profits from the Korean War boom and thus overcome Japan's chronic postwar revenue shortages.

These revenue shortages were causing serious problems during the annual budget-setting process, especially because a lack of funds imposes difficult trade-offs on politicians' natural inclination to disburse benefits to client groups. MOF Tax Bureau chief Hirata sought to counter Ikeda's tax hike with the introduction of special tax measures aimed at keeping the corporate burden from increasing. This sequence of events "cleared the road" for tax expenditures, especially the reintroduction of special tax measures enacted during the war but eliminated by Shoup and previous US-inspired reforms. Ikeda found himself unable to oppose the tax expenditures, which of course reduced corporate tax revenues, because the influential business community strongly supported them.


12 This fact is evident, for instance, in the struggles between LDP politicians and the MOF Tax Bureau group in GTAC. From the mid-1950s and well into the 1960s, there were frequent disputes between these groups over how much of the natural revenue increase from the Personal Income Tax to devote to increased expenditures (the politicians' choice) and how much to use for increasing tax exemptions and other forms of tax reduction (the bureaucrats' preference). On some occasions, the squabbling became public, as in 1957 due to the enormous surge in tax revenues; see Takeda Takao and Hayashi Takehisa, "Zaisei Seisaku no Keisei Katei" [The Evolution of Fiscal Policy], in Gendai Nihon no Zaisei Kinyuu: Showa 30-Nendai [Finance in Modern Japan: 1955-1965]. Tokyo: Tokyo Daigaku Shuppankai, 1978, pp. 244-46.

Indeed, the precedent set, tax expenditures were enacted in a virtual flood. Major corporate lobby groups, beginning with the well-known Keidanren, pressed the LDP, the MOF Tax Bureau (especially via the GTAC), and MITI for tax expenditures. The process of allocating tax breaks involved annual negotiations between MOF and MITI, in which a global limit was placed on the yen amounts of measures to be awarded for a given year. Then MITI's various internal divisions and bureaus would "vie with one another to win special tax provisions for industries under their jurisdiction." Since the demand for special tax measures exceeded supply, MITI was placed in an enviably influential position of distributing benefits to the corporate sphere.

The institutionalization of this process made MITI into a stalwart champion of tax expenditures, as they helped the ministry channel resources into areas that it deemed to deserve them. MITI's institutional interest in fiscal politics thus

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14 A cursory look at the business journals of the period shows a seemingly interminable argument for tax expenditures. In the journal Keizai Rengou, for example, one representative article focuses on the Korean War Corporate Income Tax increase and asks for tax relief through special measures and, if possible, reduced tax rates; see Keizai Dantai Rengoukai, "Toumen no Zeisei Kihon Seisaku ni Kansuru Iken" [Opinions Concerning a Temporary Basic Tax Policy], December, 1952, pp. 24-17. More generally, statements in journals and the press by business leaders, bureaucrats, and others about the need to reform the tax system so as to encourage capital accumulation are striking in their uniformity. Indeed, though the Shoup reforms were guided in part by a desire to bolster incentives for business, much of the sustained attack on Shoup centred on its alleged neglect of the needs of capital. On these issues, see "Genzei oyobi zeisei kaisei no mondaiten: Shaupu zeisei takei no houkai ka" [Issues in Tax Reduction and Reform: The End of the Shoup System?], in Kinnyu Zaisei Jijou, Number 34, Volume 2, August 20, 1951, p. 7; and on the criticisms of Shoup, see Martin Bronfenbrenner and Kichiro Kogiku, "The Aftermath of the Shoup Reforms" (Parts 1 and 2), op. cit.

15 Okimoto, op. cit., pp. 88-89, argues that the work of making trade-offs among the requests from industries was performed in MITI. Specifically, "The Business Behavior Division (Kigyou Koudouka) of the Industrial Policy Bureau (Sangyou Seisakukyoku) decides which industries deserve to receive tax exemptions, and in what amounts, after consulting with all the sector-specific divisions and bureaus and huddling with the Accounting Division (Kaikeika) and the General Coordinating Division (Soumuka) of the Minister's Secretariat (Daijin Kanbou)."
came to centre on advocating increased tax expenditures for its corporate clients. Indeed, in a shocking display of economic heresy for the contemporary neoliberal mind, the ministry even opposed overall cuts in corporate tax rates as an inappropriate means to achieve the goal of capital accumulation.  

By contrast, MOF's Tax Bureau and its associated academics soon became perturbed by the erosion of the CIT base through the 1950s. In the late 1950s, the academics, former bureaucrats, and labour-affiliated members on the GTAC began publicly to voice their disapproval of special measures.  

Some years after the emergence of GTAC's concern over tax expenditures, large corporations gradually began to lose interest in special measures and instead came to prefer outright tax cuts. The latter trend is reflected in Table 6.4, whose columns on corporate income tax "Rates" and "S.T.M." (Special Tax Measures) display the revenue changes due to adjustments made in CIT rates and associated special tax measures from 1950 to 1974.

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16 A typical example is seen in MITI's arguments before the GTAC in August of 1956; "Tsusanshou, Zeisei Kaisei Iken o Torimatome" [MITI's Opinions on Tax Revision], in Kin'yuu Zaisei Jijou, Volume 7, No. 34, August 27, 1956, pp. 10. Note that state activism via the deployment of tax expenditures was hardly unique to postwar Japan, and was one of the main characteristics of advanced industrial states that "supply side" and other neoliberal political movements have sought -- with much success -- to extirpate; see the comments on this in Steinmo, Taxation and Democracy, op. cit.

Table 6.4: Estimated Income Tax Changes in Japan, by Type, 1950-74
(Billions of Yen)

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Corporate Income Tax</th>
<th>Personal Income Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Change</td>
<td>Rates</td>
</tr>
<tr>
<td>1950-53</td>
<td>-25</td>
<td>31</td>
</tr>
<tr>
<td>1954</td>
<td>-3</td>
<td>0</td>
</tr>
<tr>
<td>1955</td>
<td>-12</td>
<td>-14</td>
</tr>
<tr>
<td>1956</td>
<td>14</td>
<td>0</td>
</tr>
<tr>
<td>1957</td>
<td>22</td>
<td>-2</td>
</tr>
<tr>
<td>1958</td>
<td>-22</td>
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<td>-5</td>
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<td>1972</td>
<td>31</td>
<td>0</td>
</tr>
<tr>
<td>1973</td>
<td>27</td>
<td>0</td>
</tr>
<tr>
<td>1974</td>
<td>352</td>
<td>424</td>
</tr>
</tbody>
</table>

Note: S.T.M. = "Special Tax Measures."
Table 6.4 also shows that rate changes to the CIT per se were generally infrequent during the early postwar period and the era of exceptional economic growth. Special tax measures were, by contrast, more frequently applied. However, the late 1960s saw the emergence of a full-scale rollback of tax expenditures for large corporations -- which had drawn the lion's share of the benefits up to then -- and a shift towards introducing special tax measures for small and medium-sized companies.

This shift towards tax expenditures for small and medium-sized companies is seen in public finance circles as in part a consequence of the growing power of LDP *zoku* politicians and the LDPTAC in tax policymaking as well as large Japanese firms' declining interest in tax breaks. The latter benefited less from broad-based special measures as the economy slowed, and they also began increasingly to chafe at MITI's administrative guidance. The late 1960s thus marks the close of the era of large-scale and relatively uniform tax exemptions, the hallmark of bureaucratic tax incentives.

Tax expenditures for the small and medium-sized sectors of Japanese business have since been implemented in fairly large numbers, but their combined effect is far less fiscally significant than was the case in the heyday of tax expenditures for big business. In part, this is because the tax breaks themselves are less comprehensive, but it also reflects the fact that well over half of small and medium-sized businesses are technically unprofitable and
thus exempt from income taxation. Figures for 1994 -- admittedly the peak year of the Heisei recession -- show that 62.7 percent of Japan's close to 2.37 million firms were in the red, with the average since 1970 being 51.8 percent. The available tax expenditures are of little or no use to firms without taxable income, and their large numbers greatly limit the loopholes' capacity to erode national tax revenues.

Thus the aggregate revenue loss from all special tax measures in 1993 was only 520 billion yen, or about 3.3 per cent of total corporate income tax revenues for the same year. This amount contrasts strongly with the peak loss of 28.6 per cent of corporate tax revenues recorded in 1955.

However, this does not mean that large corporate lobbies in Japan simply acquiesced to the closing of special tax measures in the 1960s. In fact, they and their sponsor MITI fought very hard to prevent such closures even when, as was the case with export promotion tax incentives, they violated Japan's international commitment according to trade agreements. One of the major sources of opposition was the concern that eliminating tax loopholes meant, in the absence of rate reductions, an effective tax increase. Hence, the lobbying

\[ \text{18 The data can be found on p. 81 of "Chihouzei Kankei Shiryou Handobukku, Heisei 8-nen, 10-gatsu" [Handbook of Materials on Local Taxation, October 1996], Tokyo: Chihou Zaimukyoukai, 1996.} \]

was often focused on trading off the loss of tax preferences for cuts in the overall corporate rate.\textsuperscript{20}

To sum up at this point, then, tax politics in postwar Japan saw the general rejection of Shoup's insistence on economic neutrality with respect to the structure of income taxation. Indeed, the reforms had hardly been implemented before the rollback began, driven by bureaucratic concern that the level of corporate income taxation not hamper the still-tentative economic recovery during the boom of the Korean War. Where Finance Minister Ikeda sought to increase the CIT rate and thus solve in part the crisis of financing the national budget, the MOF Tax Bureau leadership countered his move with a series of special tax measures.

The special measures rapidly mounted up, though, as a host of corporate lobbies were successful in demanding equal treatment. Moreover, the process of allocation was managed through MITI, which imposed an industrial policy rationale and broad sectoral equity on tax expenditures. As a result, the erosion of the CIT base proceeded apace through the application of special tax measures reminiscent of those instituted during Japan’s crisis of

\footnotesize
\begin{itemize}
\item \textsuperscript{20} Takeda Takao and Hayashi Takehisa, "Zaisai Seisaku no Keisei Katei," in \textit{Gendai Nihon no Zaisei Kinyuu: Showa 30-Nendai}. Tokyo: Tokyo Daigaku Shuppankai, 1978, pp. 256 ff. Note that the logic of the trade-off became very common in the tax reforms implemented among developed countries in the 1980s. "Base-broadening," as the elimination of tax expenditures came to be called, and rate reduction became very popular, even visionary, in the wake of the 1986 U.S. tax reform; see some of the cases in
\end{itemize}
production in the midst of the Pacific War.\textsuperscript{21}

However, the erosion of the CIT’s tax base could not continue indefinitely. One of the limits was the loss of a convincing policy rationale as the award of tax expenditures became an output of the machinery of interest-group politics. As Okimoto’s comparison of tax expenditures in Japan and the US suggests, Japan’s process of allocation remained strongly bureaucratic, meaning tax expenditures applied to whole sectors of industry rather than the much more selective outcomes characteristic of the US. But Japan’s broad-based loopholes also led to a stronger erosion of the tax base that, taken in tandem with the decline of persuasive industrial-policy goals, contributed greatly to growing opposition within the MOF Tax Bureau and the GTAC.

A second limit was imposed by the fact that the cuts in individual income tax burdens were even more deep than those made to the levy on corporate income. Table 6.4 displays this comparatively, and leaves no doubt that the largest reductions were visited on the PIT. The virtually annual trimming of the natural revenue increase from the PIT, even though supported within MOF as a restriction on the growth of the state, imposed in itself an effective limit on how much revenue could be allowed to leak out of the sphere of corporate income.

income taxation. The Tax Bureau’s stance was the dominant influence on
corporate tax policymaking in that period, especially as manifested in the
authoritative reports of the MOF-dominated GTAC. Thus, the stability in the CIT
rates relative to those of the PIT, as we can see from table 6.4, throughout the
postwar period reflects in large part the increasing hesitancy in the Tax
Bureau.

Moreover, table 6.4 shows that the PIT cuts became increasingly pronounced
in the 1970s, whereas the CIT became the target of incremental upward
adjustments. This upward movement in the CIT -- both in terms of the statutory
tax rates and the effective burden -- peaked in 1984, and was unambiguously
a consequence of deep cuts in the regime of personal income taxation.\(^{22}\)

**The Role of MOHA and Local Taxation**

Alongside MOF, an important source of opposition to cuts in the CIT was
MOHA and its predecessors. The postwar record shows MOHA resisted efforts
by the LDP, MITI, and business lobbies to get the corporate tax burden
reduced.\(^{23}\) The reason for this opposition is that corporate taxes are important
to the fiscal health of the local authorities. As was pointed out in the earlier
section, a major function of the 1940 tax reform was to provide the revenues

\(^{22}\) Miyashita Tadayasu and Miyawaki Atsushi, *Zaisei Shisutemu Kaikaku* [Reform of the Fiscal System],
for redistribution and help cope with the recurrent fiscal crises of the local authorities.

Indeed, MOHA's fiscal interest in this regard likely exceeds that of its predecessor Home Ministry. The prewar Home Ministry was effectively unable to control the revenue decisions of the local authorities once they got into fiscal crisis, because the ministry lacked a redistributive structure through which to overcome the problem of widely different tax capacities among its subordinate administrative units. But the Home Ministry had far more potent powers than MOHA through its ability to appoint prefectural governors and use them as instruments of national policy. Postwar reforms and the breakup of the Home Ministry eradicated much of the legal and administrative framework for intervention in local affairs, leaving the intergovernmental fiscal structure as the strongest alternative.24

Hence the fact that MOHA is a channel for redistributing 32 percent of PIT revenues to the local authorities gives it a powerful interest in maintaining that tax base.25 But MOHA's interest in the CIT base has even deeper material roots than this, due to the revisions of the Shoup reforms and especially the passive legislative euthanasia of the VAT. Shoup's plan to implement a VAT at

23 Ohtake Hideo, "Hatoyama, Kishi Jidai no Chiisai Seifu Ron" [The Small State Debate of the Hatoyama and Kishi Years], op. cit.


25 This redistribution is via the Local Allocation Tax, as was described in earlier chapters of this dissertation.
the prefectural level in order to provide a steady source of independent revenues for the local authorities was the focus of strong opposition until the tax was repealed in 1954. The elimination of the VAT forced the fiscal authorities to turn back to the Enterprise Tax -- a tax on profits -- and institute a prefectural inhabitants' tax in order to maintain prefectural revenues. As a result, there are three taxes on corporate activities at the local level in Japan: the already noted Enterprise Tax, which in 1994 supplied 30.9 percent of prefectural tax revenues; and the prefectural and municipal local inhabitants' taxes, which accounted, respectively, for about 5.5 percent of prefectural revenues and 11.7 percent of municipal-level revenues.26

In consequence, Japan's regime of corporate income taxation has an unusually heavy weight of business taxation at the local level. Table 6.5 shows that a much higher percentage of corporate income, measured in terms of GDP, is taxed at the local level in Japan than is the case in a representative sample of other advanced industrial countries. This alone would be sufficient to make MOHA wary of cuts to corporate taxes: the municipal corporation tax is levied as a percentage of the national tax, and therefore the revenues derived from it decline with reductions in the latter's rate.27


27 According to the MOF Tax Bureau's An Outline of Japanese Taxes, op. cit., pp. 244-45, the municipal level's standard tax rate for corporations is 12.3 per cent of the national corporation tax, and -- as is specified by MOHA's tax controls -- "should not exceed 14.7 per cent in any case."
Table 6.5: Corporate Income Taxation at National and Local Levels for Selected Countries as Percentage of GDP, 1991.

<table>
<thead>
<tr>
<th>Country Type and Name</th>
<th>Corporate Income Taxation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>National</td>
</tr>
<tr>
<td>Federal States</td>
<td></td>
</tr>
<tr>
<td>Germany</td>
<td>0.7</td>
</tr>
<tr>
<td>USA</td>
<td>1.8</td>
</tr>
<tr>
<td>Unitary States</td>
<td></td>
</tr>
<tr>
<td>France</td>
<td>2.0</td>
</tr>
<tr>
<td>Japan</td>
<td>3.7</td>
</tr>
<tr>
<td>Sweden</td>
<td>1.6</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>3.2</td>
</tr>
</tbody>
</table>


On top of that consideration, though, is the 32 percent of the national-level CIT earmarked for the Local Allocation Tax. Tax expenditure-induced erosion of the CIT base costs MOHA funds that it transfers to the fiscally weaker local authorities, because the earmarking of the CIT in the Local Allocation Tax is a fixed proportion of the overall revenues, not an absolute sum of revenues. Hence, one sees cooperation between MOF and MOHA towards eliminating
special tax measures that undermine the base of the CIT.\textsuperscript{28}

However, though MOF-MOHA cooperate in certain areas of potential mutual benefit, their split jurisdiction on the corporate tax field also gives rise to conflict. MOF's turf is the CIT, whereas MOHA's is the Enterprise Tax and the prefectural and municipal corporate inhabitants' taxes. The conflict between MOF and MOHA centres on the maintenance of the respective tax bases under their authority, and is implicated in the current anomaly of Japan's comparatively high corporate taxation in spite of having had decades of conservative government.

As Table 6.6 reveals, Japan's corporate tax rates exceed those in the US and the UK, though not the German rates. The argument that intergovernmental fiscal politics exerts a strong influence on Japan's effective corporate income tax rates is, in this example, given support from a comparative perspective. German local governments' heavy reliance on corporate income taxation is a legacy of the Prussian state's enactment of the income tax as a national tax and the consequent transfer of property and business taxes -- taxes on profit -- to the local authorities. The business tax exposes the local authorities in Germany, as is the case in Japan, to the fiscal uncertainty that derives from the fluctuations of the business cycle. However, local governments in Germany

\textsuperscript{28} See, for example, "Sozei tokubetsu sochi no seiri, gourika, taishou no shiborikomi de icchi: zeifu zeichou ga shuuchuu tougi" [Discussions in GTAC centre on rationalizing special tax measures], in \textit{Mainichi Shinbun}, December 3, 1994, p. 11. The article discusses a joint submission by MOF and MOHA for eliminating CIT tax expenditures that the ministries believe have lost their public policy rationale.
strongly defend the tax because of its importance to local finance and the fact that they are in autonomous control of rate setting.\textsuperscript{29}

Table 6.6: Effective Corporate Tax Rates Among 4 Countries, Selected Years.

<table>
<thead>
<tr>
<th></th>
<th>Japan</th>
<th>US</th>
<th>UK</th>
<th>Germany</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>49.47</td>
<td>50.86</td>
<td>52.00</td>
<td>56.52</td>
</tr>
<tr>
<td>1985</td>
<td>52.92</td>
<td>45.00</td>
<td>45.00</td>
<td>56.52</td>
</tr>
<tr>
<td>1990</td>
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<td>1995</td>
<td>49.98</td>
<td>33.00</td>
<td>33.00</td>
<td>48.26</td>
</tr>
</tbody>
</table>

Source: Table 5.1 in Mutai Shunsuke, et al., \textit{Jichitai Zaisei Kiban no Kakuritsu}, op. cit., pp. 212.

Increasingly significant for Japan is that its level of corporate taxation is even more out of line with its actual and emerging economic competitors in East and Southeast Asia. For example, the weight of taxes on business in Hong Kong is a full 21 points less than that in Japan, a fact that contributes to growing Japanese concerns about the potential for “hollowing out” of the domestic industrial base. Indeed, though the focus of attention remains on tax differences with North America and Europe, attention is turning in the 1990s to the even greater gaps with Asia, a trend that is probably linked to Japan’s shift towards higher levels of trade and economic linkages with its Asian

Comparisons of Current Business Tax Regimes

It is somewhat misleading to express tax burdens in simple lump-sum statistics, however, as this approach tends to give little idea of the actual tax circumstances that specific industries face in various constituencies. Fortunately, a study is available that compares the tax positions of selected Japanese companies were they operating in a variety of foreign tax jurisdictions. This kind of detailed empirical study provides a much better indication of the actual comparative tax position of Japanese firms versus their counterparts in trading partners and in regional sites that are often indicated as areas where hollowed out employment and production might migrate. The data reflect what a Japanese manager in a given corporate enterprise must take into account when considering a move offshore, and thus indicate whether competitors overseas have real cost advantages through the tax...
Table 6.6 presents selected data pertaining to Toyota Corporation, a well-known Japanese car-maker (the assumed profit on sales for each country is 1,150,002 million yen).

Table 6.7: Toyota Corporation’s Tax Position, Various Countries.
(Units: Million Yen)

<table>
<thead>
<tr>
<th>Country</th>
<th>Profits and Taxes/</th>
<th>Social Security</th>
<th>National CIT</th>
<th>Local CIT</th>
<th>Property and Con. Taxes</th>
<th>Total Taxes Levied</th>
<th>Total Social Security, Tax Burden</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>33,351</td>
<td>55,726</td>
<td>27,654</td>
<td>13,289</td>
<td>96,471</td>
<td>129,822</td>
<td></td>
</tr>
<tr>
<td>France</td>
<td>90,619</td>
<td>62,168</td>
<td>0</td>
<td>16,804</td>
<td>78,972</td>
<td>169,591</td>
<td></td>
</tr>
<tr>
<td>Germany</td>
<td>69,285</td>
<td>49,052</td>
<td>21,770</td>
<td>19,285</td>
<td>89,507</td>
<td>159,292</td>
<td></td>
</tr>
<tr>
<td>U.K.</td>
<td>27,543</td>
<td>94,108</td>
<td>0</td>
<td>3,540</td>
<td>97,648</td>
<td>125,292</td>
<td></td>
</tr>
<tr>
<td>U.S.</td>
<td>44,341</td>
<td>79,345</td>
<td>18,215</td>
<td>16,553</td>
<td>114,123</td>
<td>159,464</td>
<td></td>
</tr>
<tr>
<td>China</td>
<td>18,548</td>
<td>82,996</td>
<td>14</td>
<td>0</td>
<td>83,010</td>
<td>101,558</td>
<td></td>
</tr>
<tr>
<td>Indonesia</td>
<td>18,548</td>
<td>39,159</td>
<td>0</td>
<td>203</td>
<td>39,362</td>
<td>61,150</td>
<td></td>
</tr>
<tr>
<td>Malaysia</td>
<td>18,548</td>
<td>98,728</td>
<td>27</td>
<td>0</td>
<td>98,755</td>
<td>117,303</td>
<td></td>
</tr>
<tr>
<td>S. Korea</td>
<td>18,548</td>
<td>89,456</td>
<td>0</td>
<td>1,612</td>
<td>97,777</td>
<td>116,325</td>
<td></td>
</tr>
<tr>
<td>Singapore</td>
<td>18,548</td>
<td>82,466</td>
<td>0</td>
<td>159</td>
<td>82,625</td>
<td>101,173</td>
<td></td>
</tr>
<tr>
<td>Taiwan</td>
<td>18,548</td>
<td>52,428</td>
<td>0</td>
<td>1,323</td>
<td>53,751</td>
<td>72,299</td>
<td></td>
</tr>
<tr>
<td>Thailand</td>
<td>18,548</td>
<td>78,516</td>
<td>0</td>
<td>8,297</td>
<td>86,814</td>
<td>105,351</td>
<td></td>
</tr>
</tbody>
</table>

Note: “CIT” = Corporate Income Tax; “Con Tax” = Consumption Tax.

The table shows that the combined tax burden for Toyota is not particularly high in Japan relative to hypothetical competitors, particularly if one includes the often overlooked burden of social security. Including the latter indicates that European firms labour under particularly high costs.
Table 6.8: The Tax Position for Matsushita Electronics, Various Countries.

(Units: Million Yen)

<table>
<thead>
<tr>
<th>Country</th>
<th>Profits and Taxes/</th>
<th>Social Security</th>
<th>National CIT</th>
<th>Property and Con. Taxes</th>
<th>Total Taxes Levied</th>
<th>Total Social Security Tax Burden</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>39,178</td>
<td>34,698</td>
<td>17,952</td>
<td>12,348</td>
<td>63,988</td>
<td>103,176</td>
</tr>
<tr>
<td>France</td>
<td>106,451</td>
<td>10,591</td>
<td>0</td>
<td>10,928</td>
<td>21,519</td>
<td>127,970</td>
</tr>
<tr>
<td>Germany</td>
<td>81,977</td>
<td>29,317</td>
<td>14,898</td>
<td>14,896</td>
<td>59,111</td>
<td>141,088</td>
</tr>
<tr>
<td>U.K.</td>
<td>32,473</td>
<td>44,178</td>
<td>0</td>
<td>3,507</td>
<td>47,685</td>
<td>80,158</td>
</tr>
<tr>
<td>U.S.</td>
<td>52,088</td>
<td>29,411</td>
<td>7,815</td>
<td>16,410</td>
<td>53,636</td>
<td>105,225</td>
</tr>
<tr>
<td>China</td>
<td>21,788</td>
<td>39,207</td>
<td>0</td>
<td>0</td>
<td>39,402</td>
<td>61,240</td>
</tr>
<tr>
<td>Indonesia</td>
<td>21,788</td>
<td>39,159</td>
<td>0</td>
<td>203</td>
<td>39,362</td>
<td>61,150</td>
</tr>
<tr>
<td>Malaysia</td>
<td>21,788</td>
<td>43,487</td>
<td>0</td>
<td>0</td>
<td>43,727</td>
<td>65,515</td>
</tr>
<tr>
<td>S. Korea</td>
<td>21,788</td>
<td>46,599</td>
<td>3,494</td>
<td>1,306</td>
<td>51,399</td>
<td>73,177</td>
</tr>
<tr>
<td>Singapore</td>
<td>21,788</td>
<td>40,072</td>
<td>0</td>
<td>158</td>
<td>40,230</td>
<td>62,018</td>
</tr>
<tr>
<td>Taiwan</td>
<td>21,788</td>
<td>19,438</td>
<td>0</td>
<td>287</td>
<td>19,723</td>
<td>41,511</td>
</tr>
<tr>
<td>Thailand</td>
<td>21,788</td>
<td>37,937</td>
<td>0</td>
<td>8,487</td>
<td>46,424</td>
<td>68,212</td>
</tr>
</tbody>
</table>

Note: "CIT" = Corporate Income Tax; "Con Tax" = Consumption Tax.

The electronics industry is represented in Table 6.8 by Japan's Matsushita Electronics (the assumed profit on sales for each country is 1,143,077 million yen). Note in the table -- based on the same pattern as the one above -- that the tax burden on Matsushita in Japan compares unfavourably with that in trading partners and other countries in the region. Once the social security burden is taken into account European firms are again put at a clear disadvantage, but Japanese electronics firms' competitors tend to be Asian companies or fellow nationals who have set up offshore production sites in the Asian region for import into Japan. This suggests that the generally lower tax
burden in the region is a major problem for Japan, and that concerns about tax-driven hollowing out of this industry are not wild exaggerations or merely corporate lobbies' self-serving propaganda.

Table 6.9: The Tax Position For Representative Steel Companies. (Various Countries)  
(Units: Million Yen)

<table>
<thead>
<tr>
<th>Country</th>
<th>Social Security</th>
<th>National CIT</th>
<th>Local CIT</th>
<th>Property Taxes</th>
<th>Total Taxes Levied</th>
<th>Total Social Security, Tax Burden</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>23,437</td>
<td>28,514</td>
<td>13,941</td>
<td>29,335</td>
<td>71,790</td>
<td>95,227</td>
</tr>
<tr>
<td>France</td>
<td>63,682</td>
<td>16,849</td>
<td>0</td>
<td>21,070</td>
<td>37,919</td>
<td>101,600</td>
</tr>
<tr>
<td>Germany</td>
<td>49,041</td>
<td>17,126</td>
<td>8,486</td>
<td>13,361</td>
<td>38,933</td>
<td>87,993</td>
</tr>
<tr>
<td>U.K.</td>
<td>19,426</td>
<td>44,599</td>
<td>0</td>
<td>8,082</td>
<td>52,682</td>
<td>72,108</td>
</tr>
<tr>
<td>U.S.</td>
<td>31,160</td>
<td>27,302</td>
<td>9,896</td>
<td>37,816</td>
<td>75,614</td>
<td>106,775</td>
</tr>
<tr>
<td>China</td>
<td>13,034</td>
<td>48,623</td>
<td>0</td>
<td>49,002</td>
<td>62,036</td>
<td></td>
</tr>
<tr>
<td>Indonesia</td>
<td>13,034</td>
<td>38,629</td>
<td>0</td>
<td>261</td>
<td>38,890</td>
<td>51,924</td>
</tr>
<tr>
<td>Malaysia</td>
<td>13,034</td>
<td>38,442</td>
<td>371</td>
<td>0</td>
<td>38,813</td>
<td>51,847</td>
</tr>
<tr>
<td>S. Korea</td>
<td>13,034</td>
<td>39,308</td>
<td>2,948</td>
<td>1,180</td>
<td>43,436</td>
<td>56,470</td>
</tr>
<tr>
<td>Singapore</td>
<td>13,034</td>
<td>36,525</td>
<td>0</td>
<td>363</td>
<td>36,888</td>
<td>49,922</td>
</tr>
<tr>
<td>Taiwan</td>
<td>13,034</td>
<td>17,454</td>
<td>0</td>
<td>648</td>
<td>18,101</td>
<td>31,136</td>
</tr>
<tr>
<td>Thailand</td>
<td>13,034</td>
<td>41,055</td>
<td>0</td>
<td>20,034</td>
<td>61,129</td>
<td>74,163</td>
</tr>
</tbody>
</table>

Note: "Corp. Inc. Tax" = Corporate Income Tax.

Table 6.9 is based on the average financial data for two Japanese steelmakers (the assumed profit on sales for each country is 747,593 million yen). It shows that the burden of corporate income and other taxes is generally quite heavy in Japan compared to that in other countries. Moreover, this case also
plainly shows the tax advantage possessed by Japan's closest competitors in South Korea and elsewhere in the region. Therefore, these data would appear to lend further strong support to arguments that Japanese producers' comparatively high tax burdens afford potentially strong incentives to relocate to less costly offshore sites.

**Corporate Taxation and the Fiscal Crisis**

An important backdrop to the above tables and discussion is the fiscal crisis of the early 1970s. In this period, revenue declines from earlier income-tax cuts, plus the post-oil shock slowdown in the Japanese economy worked in tandem with rapid increases in welfare state spending. One consequence of the ensuing haemorrhage of deficit spending was that greater pressure came to be placed on drawing revenues from the CIT. Japan's slide into fiscal crisis in the 1970s was surprisingly steep, with bond issues climbing from 12.4 percent of total expenditures in 1971 to 34.7 percent in 1979.\(^{32}\)

In 1979 Prime Minister Ohira broached MOF's initial plan for introducing a VAT-type tax to stop the snowballing deficit, but the scheme rankled the LDP's core supporters and cost the party dearly in the ensuing general election. With the VAT thus rendered taboo, the focus of policymaking turned to proposals for administrative reform. At the same time, however, MOF continued to hold the

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line on tax expenditures as well as introduce effective tax increases on corporations. Examples of the latter were a 2 percent rate increase in 1981 and a 1.3 percent corporate surtax, introduced ostensibly for two years in 1984 in order to cover the cost of reductions in the income tax; the surtax boosted the national-level income tax rate for large companies from 42 percent to 43.3 percent. Though Keidanren and other industrial lobbies mobilized in opposition to these measures, their efforts were strikingly unsuccessful.  

The business community was therefore bearing much of the cost of fiscal reconstruction. Or to put it a way that highlights the comparatively surprising angle more clearly, corporate Japan was picking up much of the tab for the expansion of the welfare state whereas the general trend elsewhere -- and certainly in Anglo-America -- was to reduce the burden on corporate income. Table 6.3 showed, for example, that between 1965 to 1990 Japan increased its taxation of corporate income (as a percentage of GDP) from 4.1 percent to 6.8 percent, while the OECD America burden dropped from 3.9 percent to 2.3 percent. Admittedly, the OECD Europe burden rose over those years from 1.8 percent to 2.6 percent of GDP; but the overall level was still relatively low and, more important, Europe's economic heartland, Germany, decreased its corporate tax burden from 2.5 percent to 1.8 percent in the same period.

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33 On closing loopholes, see Wada Yahigashi, chapter 8 “Sozei Tokubetsu Sochi no ‘Seiri, Gourika’” [Reforming Special Tax Measures], in Sozei Seisaku no Shintenkai: Zaisei Kaikaku to Zeisei Keikaku [Changes in Tax Policymaking: Fiscal Reform], Tokyo: Bunshindo, 1986. MOP's “war” with Keidanren over the Corporate Income Tax burden was a staple in the press through the mid-1980s; a representative example is “Ishida Keidanren Zeisei linchou, Ookurashou to no Zeironsou de Kyuusen”
By contrast, Japan's taxation of personal income (as a percent of GDP) remained well under the levels in most other OECD states in spite of fairly rapid increases. Thus, while Japan increased its taxation of personal income between 1965 and 1990 from 4.0 percent to 8.4 percent, the OECD America levels went from 6.8 percent to 12.5 percent and the OECD overall saw an increase from 7.1 percent to 11.4 percent.

Japan's tax burdens on corporate income and the fact that they increased over the years is unusual. It may be that the country had little alternative, as over the same years the total revenue take as a percent of GDP (excluding social security) outpaced the OECD average by increasing from 14.3 percent to 22.2 percent versus the latter's more leisurely upward movement of 21.5 percent to 28 percent. Revenues had to come from somewhere, in an era marked by continuing party competition over cuts in the PIT and the stymied plan to introduce a broad-based consumption tax.

*Corporate Taxes and Intergovernmental Fiscal Politics*

Indeed, as noted earlier, MOF had already been effectively increasing corporate taxes by closing loopholes its personnel had helped initiate in the

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Yaburu Hihan no Isshi: "Toshi Genzen Zehi Hitsuyou" [Keidanren Tax Committee Head, Ishida, Breaks Truce in Tax War with MOF], *Nihon Keizai Shimbun*, October 12, 1984, p. 27.
1950s. For intergovernmental fiscal politics, the upshot of MOF’s move against special tax measures is that MOF and MOHA developed generally common interests concerning the CIT field. The shared jurisdiction remains, as we will see below, a potential source of friction that has of late ignited a full-blown case of interministerial tax competition. But there is no evidence that MOHA has sought, unlike MITI, to battle with MOF for tax expenditures and other erosions to the CIT base. On the contrary, MOHA opposed cuts to the tax regime; and quite rationally, as the 1960s saw the protracted economic miracle get solidly under way and, to a large extent, lift local governments out of their long postwar fiscal crisis. MOHA certainly allows temporary adjustments to local corporate tax rates when specific local authorities are in financial difficulty. But shorn of public works and the other line-ministry activities that were part of the old Home Ministry’s vast purview, MOHA has no good reasons to pursue tax expenditures.  

That is to say, MOF and MOHA shared a positive-sum game on the CIT field until recent years. Increases in the CIT, whether through higher rates or base-broadening (i.e., closing loopholes), benefited both bureaucracies in their concern to maintain revenues. The game depended on room for high rates,

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34 The above data are from tables 4, 10, and 12 in Revenue Statistics of OECD Member Countries, 1965-95. Paris: OECD, 1996.

35 In fact, MOHA seeks the elimination of exemptions that in the past were introduced in the Enterprise Tax base. These exemptions, or tokurei sochi, include tax reductions for broadcasters, publishers, and other mass media outlets as well as educational film producers; see, “Rainendo zeisei kaikaku, yuuisochi o minaoshi” [A review of preferences for next year’s tax reform], in Sankei Shinbun, December 3, 1993, p. 11.
which was ample in the era of high growth and a largely closed domestic market. Japanese companies were able to pass the tax burden onto consumers. Moreover, the corporate tax regime provides a further example of MOHA's generally negative stance towards substantive local fiscal autonomy. This is because the ministry, and especially its Finance Bureau, pressures the prefectures not to raise the Enterprise Tax beyond the standard rate. MOHA does this in order to prevent increased local corporate tax revenues from causing automatic reductions in the amount of Local Allocation Tax funds from MOF.

*The MOF-MOHA Stalemate over Corporate Taxes*

However, cooperation between MOF and MOHA concerning the corporate tax field has in the 1990s turned into a zero-sum contest. Corporate tax cuts are virtually inevitable because of the above-noted concerns over strong tax competition from major industrialized and neighbouring Asian countries, competition which carries the threat of hollowing out of employment and industry. As was also pointed out earlier, these concerns have led Japanese tax policymakers to shift more towards the taxation of assets and consumption as opposed to income.

MOF and MOHA are responding to this new context in a way that is consistent with the central thesis of this dissertation: both are hunkered down in the
trenches, employing tactics aimed at ensuring the burden of cuts is borne by the other agency's business tax regime. The ministries have, to this end, conducted extensive lobbying campaigns through various institutions, such as the GTAC, in order to impress their own preferred tax reform scenarios on the agenda. For example, MOF and MOHA have sought information on foreign tax strategies that would help legitimate their preferred approaches to tax reform in Japan.

Hence, MOF's scenario relies on Germany's recent plans to cut local business taxes in order to revitalize the country's underperforming economy. MOHA's strategy includes refuting MOF's arguments through advancing a counter-example, one that suits MOHA's organizational goals. As part of the process of preparing this strategy, in the summer of 1995 MOHA sent a team of personnel to study Michigan state's innovative Single Business Tax. These and other examples were debated extensively before a special study group (kentoukai) of the GTAC, one composed of representatives of MOF and MOHA as well as other experts, during the fall of 1995. The object of the study group was to judge the quality of MOF and MOHA's respective arguments concerning the proper balance of national versus local taxation on the corporate and land tax

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36This information is according to interviews with GTAC members at the University of Tokyo during 1995. See also "Houjinzeiritsu sage kentou: sangyou 'kuudouka' soshi neru" [Studying the reduction of the corporate tax rate: goal is to avoid hollowing out of industry], Nihon Keizai Shinbun, May 3, 1995, p. 3. On the German tax-reform plans, see "Sangyou kyouka e houjinzei keigen: doku no zeisei minaoshi honkakuka" [Corporate tax cuts for industrial revitalization: Germany's tax reform debate goes into high gear], Nihon Keizai Shinbun, February 16, 1996, p. 9 and "Germany: Is the model broken?, The Economist, May 4, 1996, pp. 17-9.
fields. The gravity of the situation can be appreciated by the fact that "this style of examination is an unprecedented measure for the GTAC" [seifu zeichou dewa zenrei no nai shingi sutairu to naru].

The study group was unable to come to any definitive conclusions as a result of the hearings, and thus the issue was put off for further consideration -- to a special GTAC Subcommittee on Corporate Taxation headed by Professor Ishi Hiromitsu of Tokyo's Hitotsubashi University. The stalemate is politically noteworthy because, as we recall, there is a relatively high tax burden on Japanese firms and their political pressure on the issue is so intense. The data presented earlier in this case study certainly show that Japan's effective corporate tax rates and burdens greatly exceed Japanese companies' competitors in East Asia. And pressure for a lower overall tax burden from Japanese business has been evident since the early 1980s when MOF effectively shifted much of the cost of fiscal reconstruction to business, apparently as one way to convince the latter to support the institution of a VAT. But it would appear to be the case that MOF and MOHA's divergent fiscal interests are playing a large role in thwarting corporate pressure for an effective tax cut.


In other words, though the GTAC and its subcommittees generally serve to legitimate MOF's goals, the process in this case bogged down over the two ministries' split jurisdiction on the corporate tax field and their representation of larger fiscal interests. MOF stands for the maintenance of responsible budgeting in a period of repeated fiscal stimulus and demands for reduced income taxes. MOF is thus loath to concede to cuts in its array of revenue sources, especially the lucrative CIT. And MOHA, for its part, is charged with the fiscal stability of local governments, who rely heavily on the taxation of corporate income as well. This Gordian Knot of fiscal interests would not lend itself to a simple and decisive GTAC recommendation for reduced corporate income tax rates, in particular because of MOHA's obstructionism on the issue of revising the Enterprise Tax. MOHA's stalling tactics meant the Enterprise Tax could not be reviewed by the GTAC until 1998 at the earliest, and thus left MOF's corporate tax as the centre of attention for tax cuts.39

Shortly after the October 20, 1996 general election, Nakamura Yoshio, the managing director of the main business lobby, Keidanren, became so frustrated with the process in the GTAC that he spoke out publicly on the issue. According to Nakamura, a major problem with the Japanese tax system generally, and corporate taxation in particular, is that the "authorities in charge of collecting taxes usually have the biggest say" in reform. He pointed out that a major avenue for the bureaucracy's influence is the advisory councils, and

39 "Bappon kaikaku sakikuri tsuyomaru" [Strong possibility full-scale reform will be put off], Nihon Keizai
called on elected politicians to take a more decisive role in policymaking. Not surprisingly, his first task for them was that they cut back corporate tax burdens to levels prevailing in the United States.\footnote{Nakamura Yoshio, “Give companies a break when it comes to taxes,” Japan Times, November 4, 1996, p. 8.}

Some ranking members of the LDP responded favourably to the call for reduced corporate taxes. Yamasaki Taku, the head of the LDP Policy Affairs Research Council, announced himself in support of a 5 percent cut in CIT rates, at a projected cost of 2 trillion yen. This policy statement appeared to throw a wrench into MOF’s compromise strategy -- the CIT being left in the spotlight through MOHA’s intransigence -- of insisting on revenue neutrality via closing loopholes in exchange for any such cuts. But MOF quickly shifted its arguments, and started pointing to the potential political costs of lowering corporate taxes when individuals’ burdens were expected to increase by about 7 trillion yen in 1997, due to slated increases in the Consumption Tax and the end of the 3-year special income-tax cut enacted in 1994.\footnote{"5 % sage nara zaigen ha 2 chou en" [A 5 % cut would cost 2 trillion yen], Nihon Keizai Shinbun, November 9, 1996, p. 3.} Moreover, MOF’s position appeared to receive considerable backing from the LDP’s Tax Advisory Council (LDPTAC) head, Hayashi Yoshiro (himself a former MOF minister). Hayashi let it be known that he regarded securing tax cuts a difficult matter, because Japan’s fiscal problems required there be compensating base-broadening (i.e., revenue neutrality) but closing loopholes would attract
strong political opposition from corporate lobbies and their their allied zoku giin.\(^{42}\)

Shortly afterward, on October 26, the GTAC Subcommittee on Corporate Taxation turned in its report. Reflecting the stalemate in the GTAC between MOF and MOHA, the report essentially rejected business arguments for a tax cut by insisting on the need for revenue neutrality and highlighting the existence of 38 types of special measures that favour large firms.\(^{43}\) This report was followed on the 18th of December by the release of both the GTAC and LDPTAC outlines for tax reform in 1997, neither of which called for a tax cut per se. But in line with the LDPTAC's greater sensitivity than the GTAC to political interests, especially the possibility of a corporate backlash, the LDPTAC report noted that it was only putting off any business tax reform for an additional year. It would appear there was no other route to take, as in a December 3 statement to the Diet Prime Minister Hashimoto Ryutaro had already committed the government to revenue neutrality.\(^{44}\)

Hence, Japan's heavy weight of corporate income taxation is due not only to

\(^{42}\) "Houjinzei genzei nado shouten" [Focus on corporate income tax reduction and other items], Nihon Keizai Shinbun, November 16, 1996, p. 2. On the tax zokugiin, see "Zeisei kaikaku e ugoku zokugiin" [Policy tribes moving in on tax reform], Yomiuri Shinbun, November 13, 1996, p. 3.


\(^{44}\) On the report, see "Houjinzei, tetsukazu" [Corporate tax left untouched], Mainichi Shinbun, December 19, 1996, p. 9. For Hashimoto's statement, note "Yugamu futan: houjinzei, zeiritsu to hikiatekin" [Warped burdens: corporate tax rates and special allowances], Nihon Keizai Shinbun, December 5, 1996, p. 5.
economic peculiarities and the electoral logic that places a premium on personal income tax cuts, making corporate income taxation the ready candidate to provide substitute revenues. An additional strong influence is that both the local and central governments impose taxes on this field; and because of this split jurisdiction within the context of the 1940 fiscal system, neither MOF nor MOHA is ready to yield ground.
The Land Value Tax was adopted when MOHA showed reluctance to reform the Fixed Assets Tax... But concerned at the centre's encroachment on land-holding taxes, MOHA hurriedly raised the Fixed Assets Tax assessment... and sought incremental tax increases in spite of the introduction of a burden-adjustment scheme and the decline in land prices. Because of this, anger with the Fixed Assets Tax has exploded.

Kakinuma Shigeyoshi
Shukan Toyo Keizai
October 5, 1996

Land taxation in Japan has a long and intensely politicized history, as preceding discussions have indicated. This chapter explores the fiscal history in depth, and offers an explanation for why MOF and MOHA have in recent years escalated their conflict on this tax field. The particular significance of this argument is that bureaucratic fiscal competition over land taxation spurred what threatened to become a tax revolt and has strong potential to engender further fractious fiscal politics.

Prewar Politics and the Land Tax

The background to the current politics is found in the infamous land tax, the centrepiece of the early Meiji era (1868-1912) fiscal system. The tax grew increasingly inequitable over the years, bearing down far heavier on rural and
agricultural interests than on the growing ranks of modern urban and capitalist Japan. Taxation of land was also a perennial focus of party politics,\(^1\) especially as the guiding ethic of the prewar era, “rich country, strong army” (fukoku kyouhei),\(^2\) and its polar opposite emphasis on reducing the burden on the public (minryoku kyuuyou), came into conflict. In 1873, the shift from paying the land tax in kind (i.e., rice) to having to pay it with coin in fact brought forth peasant riots throughout Japan. Moreover, to a large extent, the effort to avoid being taxed to pay for the military reinforcement of the turn-of-the-century state saw Japanese business enter into politics as a major actor.\(^3\)

Table 7.1 shows that the land tax remained an important, but dwindling, source of the central state’s revenues right up to the eve of the Pacific War. This decline is in relative rather than absolute terms, and one to be expected due to the inelasticity of the land tax base and the need to find other revenue sources for the expansion of the state.\(^4\) However, the severe revenue shortages that emerged as the war went on saw the state turn again to the tax

\(^1\) This contrasts with the case in the United States, where the tariff was the centrepiece of the national tax regime, and the focus of party politics, until the first world war. On this, see John Mark Hansen, Taxation and the Political Economy of the Tariff,” International Organization, Vol. 44, No. 4, Autumn 1990. Of course, the “unequal treaties” imposed on Japan by the Imperial Powers in the late 19th century restricted her from using tariffs, which left the land tax as the mainstay of the state.


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as a supplantary source of revenues.

Table 7.1: Land Tax Revenues, Selected Years 1880-1947.

(Units: until 1945, thousands of yen; after 1945, millions of yen)

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Total Taxes</th>
<th>Land Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>1886</td>
<td>55,262</td>
<td>42,346</td>
</tr>
<tr>
<td>1890</td>
<td>68,007</td>
<td>40,084</td>
</tr>
<tr>
<td>1900</td>
<td>153,459</td>
<td>46,718</td>
</tr>
<tr>
<td>1910</td>
<td>406,595</td>
<td>76,292</td>
</tr>
<tr>
<td>1920</td>
<td>938,057</td>
<td>73,945</td>
</tr>
<tr>
<td>1930</td>
<td>1,103,085</td>
<td>68,035</td>
</tr>
<tr>
<td>1939</td>
<td>2,927,975</td>
<td>48,685</td>
</tr>
<tr>
<td>1940</td>
<td>4,140,843</td>
<td>3,921</td>
</tr>
<tr>
<td>1941</td>
<td>4,817,942</td>
<td>25</td>
</tr>
<tr>
<td>1942</td>
<td>7,350,520</td>
<td>13</td>
</tr>
<tr>
<td>1943</td>
<td>9,731,154</td>
<td>6</td>
</tr>
<tr>
<td>1944</td>
<td>12,715,146</td>
<td>37,828</td>
</tr>
<tr>
<td>1945</td>
<td>11,541,379</td>
<td>27,651</td>
</tr>
<tr>
<td>1946</td>
<td>37,438</td>
<td>38</td>
</tr>
<tr>
<td>1947</td>
<td>189,600</td>
<td>0</td>
</tr>
</tbody>
</table>


By contrast, the land tax became more significant to the local authorities. This was because they -- through the agency of the Home Ministry -- imposed surtaxes on the tax at the prefectural and municipal levels. In 1939, for example, prefectural and municipal (cities, towns, and villages) surtaxes on the land tax brought in, respectively, 48.3 million yen and 44.0 million yen.
This compares with the same year's total of 48,685 million yen for the national land tax.\footnote{The figures are taken from Tables 463, 463, and 467 of the Japan Statistical Year-Book, 1949. Tokyo:...} 

**Fiscal Democracy and the FAT**

The Occupation's 1945 assumption of virtually dictatorial control over the Japanese tax system brought wholesale changes to the structure and role of the land tax. Rather than leave the tax at the national level and merely permit local authorities to levy surtaxes on it, SCAP handed it over to the prefectures. The municipalities were then permitted to continue levying a surtax on this new prefectural tax. The tax itself was not very productive, due to the fact that its base was rental values and these were set by administrative fiat. Hence the tax rate was frequently increased during the early postwar period in an effort to have it keep pace with the rampant inflation. By 1949-50, for example, the tax rate had reached 250 percent of assessed value. This unstable situation continued until the enactment of the Shoup Tax Commission's recommendation that the tax base be widened to include capital values of land (rather than rental values) as well as depreciable business assets, and that the tax be renamed the "Fixed Assets Tax" (hereafter, FAT). Moreover, reflecting a precept of American fiscal democracy, Shoup proposed that the tax be shifted in its entirety to the municipal level. The rationale underlying this recommendation was that of providing municipalities with a stable and...
independent tax base, one whose rates local electors could determine through their representatives.

The American model to which Shoup turned derives from America’s high rate of home ownership, which made the property tax appear perfectly suited to the task of funding the local community’s historically limited supply of services. Since homeowners pay the tax, the argument goes, they can be counted on in elections to express their fiscal preferences concerning the package of services they desire, thus providing strong supervision to local government. The tax has therefore long been seen in public finance studies, which are dominated by American academics, as the ideal local tax base. This tax ideology also finds concrete expression in Anglo-American local governments’ unusually high reliance on property taxation.⁶

The FAT’s wholesale transfer to the municipal level was thus accomplished through enactment of the Shoup reforms. It remained in place during the revisions of the early 1950s, though an amendment was made in 1954, partly out of concern that the municipalities would not be able to administer the tax on their own. This amendment transferred, to the prefectural level of local government, the FAT for assets whose value exceeded a specified amount. As

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Steiner puts it, "[t]he partial transfer of this tax from the municipalities to the prefectures was a significant reversal" of Shoup's policy to emphasize the strengthening of the municipal tax base.\(^7\) Though Steiner's point about the tax base is correct, for this dissertation the 1940 system received its strongest reaffirmation when control over tax rates was firmly placed in the jurisdiction of MOHA's early postwar predecessors rather than the local communities themselves.

### Table 7.2: Land Tax Revenues by Level of Government, 1930-1944

(Units: Thousand Yen)

<table>
<thead>
<tr>
<th>Year</th>
<th>National Land Tax</th>
<th>Prefectural Surtax</th>
<th>Municipal Surtax</th>
<th>Towns, Villages' Surtax</th>
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</thead>
<tbody>
<tr>
<td>1930</td>
<td>68,035</td>
<td>70,904</td>
<td>7,110</td>
<td>34,605</td>
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<tr>
<td>1939</td>
<td>48,685</td>
<td>48,288</td>
<td>25,117</td>
<td>18,919</td>
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<tr>
<td>1940</td>
<td>3,921</td>
<td>32,088</td>
<td>25,289</td>
<td>43,143</td>
</tr>
<tr>
<td>1941</td>
<td>25</td>
<td>31,619</td>
<td>28,060</td>
<td>47,127</td>
</tr>
<tr>
<td>1942</td>
<td>31</td>
<td>31,809</td>
<td>29,164</td>
<td>50,457</td>
</tr>
<tr>
<td>1943</td>
<td>6</td>
<td>29,618</td>
<td>26,548</td>
<td>49,118</td>
</tr>
<tr>
<td>1944</td>
<td>37</td>
<td>40</td>
<td>22,596</td>
<td>60,881</td>
</tr>
</tbody>
</table>


The 1940 tax reform itself had begun to shift the land tax to the subnational level, and especially to the cities, towns, and villages. This is evident in Table 7.2, which shows that the land tax's decline as a national revenue source saw the opposite movement at the subnational level. The municipal and lower

levels of government began to draw the lion's share of the revenues from this tax base for the first time in 1940. The difference with the Shoup system is that the 1940 reform did not make the local land tax a truly independent tax, but rather transferred it nominally to the local authorities while keeping collection and rate-setting functions firmly under centralized control. The reason for this was that the land tax in 1940 Japan was viewed as the quintessential national tax (cf. the Anglo-American experience). Even the Japanese Imperial Household paid the tax, so its transfer to the cash-strapped subnational level was in name only, as the centre set the rates, collected the revenues, and returned them to the local administrations.8

The Current Property Tax Regime

There are, at present, a range of taxes imposed on land in Japan. The best means to appreciate their incidence is to regard each of them as being levied on a specific step in the treatment of land as a commodity. The acquisition of land is the first phase, on which four taxes are levied. Most of these taxes are minor save the national Inheritance Tax (souzokuzei), which attracts considerable hostility from taxpayers.

The next aspect relating to taxes on land is land-holding, and currently four taxes are levied at this stage, including both the FAT and the Land Value Tax.

8 My thanks to Jinno Nachiko for this information.
(hereafter, LVT). The FAT is the second most important tax at the municipal level, and provided 7.98 trillion yen, or 42.2 percent of municipal revenues in 1994. The LVT, for its part, brought in 4.9 trillion yen, or about 9 percent of national revenues of 54 trillion yen in 1994.

Finally, there are income taxes levied on the third stage, the transfer of land, by both the national and local levels of government. All of these taxes, including the Inheritance Tax, are relevant to this case study, because adjustment of them has become a burning political issue. But certainly the main objects of recent property-tax politics are the FAT and the LVT.

The Land-Price Spiral and the Tax Regime

The current fiscal politics of property taxation are in part rooted, somewhat ironically, in the success of one of SCAP’s reforms. When SCAP dismembered the Home Ministry and created what later became the Ministry of Construction, it eliminated the formerly quite autonomous Home Ministry agency for land use planning. Politicization then suffocated any hope of

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resurrecting the policymaking autonomy needed for systematic land-use planning. In consequence, Japan has a strikingly weak regime of state controls on land use, notwithstanding the country's comparative shortage of usable land. Japanese land has become little more than a speculative commodity because only a weak institutional capacity exists for treating it as a public good.

Further bedevilling land-use planning is the fact that land became the collateral on which corporate interests based their "overloan" levels of borrowing for investment in plant. This role has helped broaden the range of vested interests in keeping land prices high.¹²

The most drastic evidence of land's speculative role was seen in the late 1980s. In this period, massive surges of investment in both land and the stock market rocketed their prices to stratospheric heights. Journalists had a handy new cliche for depicting Japan's alleged inscrutability in the absurdly high price of land. During this era of the so-called "Bubble Economy," the vast inflation of asset values saw commentators almost cheerfully point out that the market value of Japanese real estate exceeded that of the entire United States, even though the latter is about 25 times Japan's size. Another indicator of the price explosion was that land came to constitute 65 percent of Japan's

national wealth, versus 25 percent in the former West Germany, 33 percent in the United States, and only 2.5 percent in Britain.  

Rapid increases in land prices were not, as one would expect from land's relatively unregulated commodification, a new phenomenon in postwar Japan. The latter half of the 1950s and the early 1970s also saw speculative booms that in fact exceeded the year-on-year increase of the late 1980s. The boom of the 1970s was deflated quite rapidly by a policy of monetary restraint; and a similar policy regime adopted in 1989, by Bank of Japan Governor Mieno Yasushi, in time forced land prices well below their peak values of 1990. However, in 1990 there was less talk of turning off the lending faucets that were dispensing seemingly endless streams of yen to even the most dubious of investors. The concern was that doing so would unduly depress the supply of housing and might also bring on a credit crunch of the sort then evident in the moribund American economy.

Instead, attention turned to reforming the tax system to discourage speculation on land. There appeared to be considerable scope to undertake such a policy

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13 The figures are from an Economist article cited in Gavan McCormack, The Emptiness of Japanese Affluence, op. cit., p. 91.


reform, even though the approach clearly sought to treat a symptom rather than the underlying causes of property speculation and price inflation. Municipalities assess local land values for the FAT and, in theory, calculate the tax burden according to an Assessment Standard (*hyouka suijun*) set according to recommendations by the Central Fixed Asset Assessment Standard Advisory Commission (*Chuuou Kouteishisan Hyouka Shingikai*). The commission advises the MOHA Fixed Asset Tax Department (*Kouteshisanzeika*), and includes many OBs from the same department. The Assessment Standard is the basis for calculating the amount owing via the FAT, and is revised by law every three years. But MOHA had allowed its suggested standard to decline relative to the increasing real estate prices, because the acceleration of land prices outstripped the capacity to keep pace. Hence, the average municipal standard dropped from 61.4 percent of the official valuation price in 1979 to 36.3 percent in 1991. The levels reached in urban areas were particularly low, as the central districts of Tokyo stood at 21.9 percent in 1991, while in the same year comparable areas of Osaka reached 14.6 percent. The implication of this decline is that MOHA was allowing local governments to adjust their assessments "in order to avoid raising the property tax burden."\(^{16}\)

This is, in fact, a common problem with property taxes, because they attract such powerful opposition through organizations of local landowners.

\(^{16}\) Ishi, op. cit., p. 350.
California, for example, sought to deal with it by making assessment standards automatic through the 1967 Petris-Knox measure, which “established a fixed relationship between the market value and the assessed value of land and housing for property tax purposes.” But this choice of implement helped bring on the Proposition 13 tax revolt when property values rose strongly in the middle and late 1970s.\textsuperscript{17}

\textit{Skirmishing Within the Tax Advisory Commission}

Property tax issues were examined in detail from April of 1990 by the Subcommittee on Land Taxation of the Government Tax Advisory Commission (GTAC). As noted earlier, MOF Tax Bureau officials play a central role in selecting representatives for the GTAC, determining the information they will discuss, and even writing up their final report. In spite of this scope for manipulation, the fact that the GTAC brings together a wide range of opinion gives the institution a fairly high degree of credibility within policymaking circles. This legitimacy means a GTAC report can give considerable momentum to a policy initiative.\textsuperscript{18}

Moreover, in the initial stage of the Land-Value Tax debate, the Subcommittee

\textsuperscript{17} The background is discussed in Kenneth Woodside, “The Tax Revolt in International Perspective,” \textit{Comparative Social Research}, Volume 5, 1982.

\textsuperscript{18} On the importance of the GTAC, one that “stands like a mountain among the rest,” see Kakizaki Norio, “Shingikai: Kanryou e no Houshin no Kiseki,” [Deliberation Councils: Places of Service to the Bureaucracy], \textit{Ekonomisuto}, July 31, 1979.
on Land Taxation was headed by Professor Ishi Hiromitsu. Ishi is a major figure in both Japanese and international public finance circles, and his views are widely reputed to be rather congenial with those of the MOF Tax Bureau. Whether this alleged convergence of opinion had a strong influence on the deliberations and their outcome is difficult to determine, but certainly bureaucrats in MOHA and many academics believe it did. Some evidence of this sentiment is seen in the eruption of a major controversy at the time of Ishi’s appointment. Other prospective members read the appointment as a signal that MOF had a set policy goal in mind, and some declined to participate in what they regarded as a choreographed piece of political theatre.

In particular, Miyao Takahiro, an economist specializing in land-related issues, insisted at the time that MOF’s depiction of the whole process as consensual and apolitical was aimed at obfuscating a tax grab. He pointed out that bureaucratic politics were rife in the subcommittee deliberations, and argued that it was because MOF’s real aim was less land-price control than securing revenues from an expanding tax field. At the time, Miyao’s protests perhaps appeared to most casual observers as yet another rant from among Japan’s legions of MOF-bashers, who ascribe almost preternatural powers to the agency and its personnel. Certainly the behind-the-scenes bureaucratic

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19 See Tazawa Takuya’s interview with Miyao Takahiro, in “Zelsei koushite kimerareru” [This is how taxes are determined], in Ookura Kanryou no Seitai [The Structure of MOF’s Authority]. Tokyo: Bessatsu Takarajima 214, 1995 as well as the short article by Charles Smith, “The Tax Test,” Far Eastern Economic Review, October 25, 1990, pp. 16-7. The above comments are also based on interviews at MOF and MOHA, and with public finance economists of Tokyo University who have participated in GTAC deliberations.
politics he commented on received virtually no media coverage. But there was in fact a high level of inter-ministerial animosity and subsequent developments suggest Miyao's perceptions were in large measure accurate.

Agenda-setting began in earnest during deliberations in the subcommittee chaired by Ishi. Research done under the auspices of the subcommittee identified two main alternatives for bolstering the tax regime so as to discourage speculation in land. The first alternative was to strengthen the existing tax system, which would include raising the evaluation standards in order to reflect increased asset values. The second advocated a national tax to cope with the gap between assessed and market values, by taxing the speculative increase in property values among businesses and wealthy landholders. When MOHA and representatives of the local authorities were asked, during the subcommittee's deliberations, about the first alternative, they rejected it. They contended that the FAT was designed to serve as a stable revenue base for municipalities and was governed by the benefit principle rather than ability to pay. By this, they meant the tax could not, in principle, be used to appropriate speculative gains, as the rationale for local taxation is to secure compensation for benefits received by local residents and others. These claims, in other words, countered MOF's opening salvo with an appeal to fiscal orthodoxy.

Observers who study the politics of public finance in Japan tend to believe that
MOHA was actually concerned that placing a higher burden on the FAT would lead to fierce opposition among local land-holders, especially well-organized business groups and real-estate companies. Raising the Assessment Standard and enforcing it more diligently would have imposed much heavier levies on politically powerful interests. These groups have many avenues for voicing their opposition, including local and national politicians as well as directly to MOHA itself. An additional means of transmission for such protest would be through the local advisory commissions that study and make recommendations on the Evaluation Standard, as was discussed earlier. For instance, representatives of primary industries, which are generally rooted in local communities, comprise 26.4 percent of the membership of the commission and Nokyou personnel make up 6.6 percent.\textsuperscript{20} Hence, it would appear political calculation underlay MOHA’s refusal to allow the FAT to be used for the purpose of damping down speculative fever in land price hikes, which at the time were still accelerating in major centres such as Osaka and Tokyo.

It would also seem that MOHA did not believe that the second alternative, the new tax on landholding, had much of a chance of being enacted. New taxes are notoriously difficult to implement, and in this case an impressive array of business interests was certain to mobilize against any such levy on an asset

\textsuperscript{20} The data is from Onotera Norihiro, "Koutei Shisan Hyouka Choosa iinkai no Genjou (Ichi Gatsumatsu Genzai) nado ni tsuite" [The Situation with Respect to the Fixed Asset Assessment Standard Advisory Commission], Chihouzei, Volume 47, No. 5, May, 1996.
they still used as collateral for loans. But MOF had given, in retrospect, fairly clear signals that it was moving towards a pre-determined goal. Perhaps reflecting MOHA's rather limited manpower, the ministry failed to anticipate MOF's strategy and in consequence, committed a self-confessed blunder.\textsuperscript{21}

\textit{The MOF Invasion of MOHA's Domain}

MOF then leapt at this chance to invade a corner of the Fixed Assets Tax field. MOF representatives on the Subcommittee pointed to MOHA's reluctance to use the FAT for the extremely important goal of cooling speculative investment, and proposed instead that a new national tax be implemented to this end. The real problem underlying speculative behaviour in Japan was, of course, the excessively loose monetary policy being employed by the MOF-dominated Bank of Japan.\textsuperscript{22} At the time, however, MOF was able to clothe its desire for a corner of the Fixed Assets Tax field in the garb of disinterested policymaking.

MOF's proposal was rather ill-considered, suggesting haste. Close inspection by tax experts has revealed numerous holes in the reasoning employed by MOF to legitimize the tax itself as well as the alleged need to institute it at the

\textsuperscript{21} MOHA bureaucrats describe the episode in such terms. See also the related comments in "Chika' de moukeru jidai wa owatta" [The era of making money from land-price inflation is over], Gekkan Touyou Keizai, May 18, 1991.

national level. Particularly problematic is MOF's claim that the tax should be seen as an exaction based on the principle of ability to pay. The ministry argued that the tax would be levied on wealthy corporations in major cities, and the revenues effectively redistributed through being incorporated in the general account of the national budget. This "Robin Hood" type of rationale has secured the continuing support of the Social Democratic Party and the Local Employee's Union, Jichirou. But from the standpoint of equity in taxation, a more comprehensive form of wealth taxation was called for. According to one tax lawyer, simply imposing a tax on pricey land but not on other forms of investment and wealth is "irrational" (fugouri).

The question thus shifts to asking what MOF was actually after. It turns out that MOF's interest in the Fixed Assets Tax field has several facets. One interest is said to derive from institutional memory, as the predecessor to the FAT is the land tax, which as noted earlier was under the purview of MOF until American-inspired reforms in the early postwar period saw it transferred to the local authorities. This outcome is said to be highly regretted within MOF because the land tax was regarded as the epitome of a national tax, one which even applied to members of the royal family.

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23 The Chief Editor at the Jichirou Political Affairs Department argued, in an interview, that the Left of the Japan Socialist Party, including the party's major support-group, Jichirou supported the MOF position because of the argument that it would be equitable to tax speculative profits accruing to land-owners.

An additional objective that some observers have pointed to is access to revenues. The concern in MOF was said to be the looming cost of programmes related to trade friction. MOF, according to this account, "badly needs to raise additional tax revenues from 1991 onwards to pay for a ¥43 trillion (US$332.8 billion), 10-year public works investment programme that Japan promised to undertake as part of the Structural Impediments Initiative with the US." ²⁵ It seems reasonable to ascribe this motivation to MOF, at least in the general sense that fiscal bureaucrats are usually interested in broadening their sources of revenue when expenditures are slated to increase. Further support for this argument was seen in Table 4.1, which showed that the base of the tax system was being shifted away from income and more towards assets and consumption.

A clearer and comparative view of Japan's property taxation is afforded by Table 7.3. The table reveals that the Anglo-American countries certainly do rely more heavily on property taxes than is the case with other major OECD states. Moreover, virtually all of the property tax revenues collected in Anglo-America are used to fund local government. There is hence a great deal of stability in the tax base as well as a relatively heavy burden placed on it.

By contrast, Japan, Sweden, and the states of continental Europe show different trends. Local governments in all of these countries rely on property taxes for less than half of their revenues; and in the Swedish case, they get their revenues from income taxes instead. Increased levels of local funding from property taxes are evident in France and Italy, however, whose local governments received, respectively 23.1 and 17.5 percent of their revenues from this source in 1975, but 34.9 and 42.1 percent in 1994. This would appear to account for their increased levels of property taxation in that period. But Japan more than doubled its reliance on property taxes as a proportion of GDP in the same period, whereas local government reliance on the tax field only changed from 24.9 percent of local revenues in 1975 to 30.8 of local revenues in 1994. The Japanese central government’s dependence on property taxes as a percentage of its revenue base showed a stronger increase by moving from 6.0 percent in 1975 to 9.9 percent in 1994.

Hence, in the Japanese case, there is a comparatively unusual and rather long-range pattern of increased taxation of the property tax field. In addition, the stream of revenues is being tapped by both levels of government; in other words, by MOF and MOHA as they seek to bring the expanding resources within their jurisdictions.  

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Table 7.3: Taxes on Property as Percentage of GDP, 1965-94

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<td>Australia</td>
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Another apparent reason for MOF's interest is that administration of the prewar land tax involved the regular collection of information on landholding, a source of authority that was lost with the transfer of the tax to the local authorities. Though the current Inheritance Tax also provides MOF with an accounting of particular taxpayers' assets, such as land, this occurs only when they die. Hence, access to more frequently updated records on taxpayers' landholdings is viewed as a further reason the MOF bureaucracy wished to secure a major new tax on land, and why they were adamant it be managed and collected by the central state.
Ascribing the above motivations to MOF is, of course, speculation. But the persuasiveness of the argument is bolstered by the fact, as I will discuss in greater detail below, that MOF has recently revamped its rationale for the LVT in order to maintain the tax in a period when its original *raison d'etre* has so abruptly disappeared. In any case, what is certain is that the October 1990 report of the GTAC dutifully advised there be a new national tax on land, one based on assessment of the asset value itself in accordance with the landowner's ability to pay.

*MOHA's Counterattack*

MOHA reacted swiftly to this proposal, and sought to reverse the momentum of MOF's agenda-setting in the subcommittee. Then, having lost the battle in the GTAC, the MOHA bureaucrats later presented their alternative proposal to the ruling Liberal Democratic Party's Tax Advisory Commission. The MOHA bureaucracy, according to published reports, was concerned that MOF's beachhead on the property tax field would limit MOHA's ability to draw increased revenues from it.\(^{27}\) In a desperate effort to repulse MOF, MOHA abruptly reversed its argument that the FAT was unsuitable for countering the speculative fever in the nation's property markets. MOHA's revised approach

\(^{27}\) Note, for example, the remarks in "Shintochi hoyuuzei go-nengo manaoshi hatsugen, Ookura, Jichiryoushou ni shukudai" [Comments on the five-year revision of the new land ownership tax: homework for the Ministry of Finance and the Ministry of Home Affairs], *Nihon Keizai Shinbun*, November 30, 1990, p. 5.
offered a staged increase, over 5 years, to bring property assessments from about 10-20 percent of publicly assessed land values, in major urban areas, to around 70 percent.

The shift of the tax debate from the GTAC to the LDPTAC brought a new phase in each ministry's strategy. MOF had dominated the debate in the GTAC itself as well as the Subcommittee on Land Taxation, and this gave it momentum going into the more clearly politicized arena of LDPTAC. Though the GTAC had become subordinate to the LDPTAC in the 1980s, its recommendations on policy matters were still taken seriously in the latter -- indeed, the LDPTAC was itself dominated by a coterie of party tax policy experts whose roots were often to be found in MOF.\textsuperscript{28} This suggests that MOHA was in an uphill struggle in contending with MOF's agenda.

But MOHA kept up its pressure to maintain the existing property tax system and use it rather than the LVT to control land prices. This position had some sympathizers among the members of the LDPTAC and its ad hoc Subcommittee on Land Taxation. However, undercutting this influence was the widespread doubt that MOHA would be able to increase the Evaluation Standard in the face of opposition from local interests. In addition to this hurdle, for MOHA, there was a very strong sense even among political actors that something had to be done about the land-price escalation, which threatened

\textsuperscript{28}Yamaguchi Jiro,"Seiji to Gyousei" [Politics and Administration], in Shisou, Number 4, 1994.
to make a mockery of postwar Japan's ideology of equitable distribution. This helps to account for why politicians acquiesced to MOF's tax proposal in spite of immense business interest-group pressures against it.  

MOF's outline for the new tax was considerably amended in the LDPTAC, especially through a reduction of the tax rate to 0.3 percent and the introduction of a nest of exemptions. This part of the process appears to have been of greatest interest to the few analysts who have written on the episode, as it showed how MOF's tax policy proposals are altered in the political arena. On the other hand, one can argue that the most important moves, at least with respect to agenda setting, came prior to the debate in the Diet and even the discussions in the LDPTAC. Intense lobbying against the tax in the LDPTAC certainly limited its already questionable effectiveness as a countermeasure to the land-price spiral. But the politics of revising MOF's agenda seem less impressive than the fact that MOF was able to infringe on the local tax base, secure revenues of 6.2 trillion yen (1993), and gain access to the treasured information concerning corporate taxpayers -- all in the face of unrelenting opposition from business organizations and MOHA.

29Shin tochi hoyuu zei go nen ato minaoshi hatsugen, Okura, Jichi ryoushou ni 'shukudai" [Working on the 5-year review of the new land ownership tax], Nihon Keizai Shinbun, November 30, 1990, p. 5; and "Jimin zeichou, tochi hoyuu zei minaoshi kyougi: Jichishou an ni hiteiteki" [Disapproval in the LDP Tax Commission concerning the MOHA bill on re-examining the land ownership tax], Nihon Keizai Shinbun, November 9, 1990, p. 2.


31One account is Socialist Democratic Party of Japan politician Kan Naoto's Kokkai Ronsou Tochi Seisaku [The Diet Dispute over Land Policy]. Tokyo: Shihyouron, 1992
MOHA and the business community did not give up in their (apparently unrelated) efforts to eliminate the LVT. MOHA's attempts to reclaim its tax turf were to include a direct frontal assault as well as a clear assertion of its sovereign right to the property tax base. The former stratagem centred on plans to hammer out a policy position and present it to the GTAC at the beginning of hearings for fiscal 1995 (i.e., April 1995). However, the January 1995 Kobe Earthquake, which killed over 6,000 people, caused a massive diversion of MOHA's manpower away from tax-related issues. MOHA's small size is often an asset in securing organizational cohesion and responsiveness, but it is also evidently at times a handicap when human resources get overtaxed.32

MOHA then declared its commitment to remain in charge of what it perceived as its tax field. Its strategy to this end took the form of quite rapid and drastic increases in the effective burden of the FAT. This response will be described in more detail presently, so at this point I will merely note that MOHA's action helped set the stage for a tax revolt.

Business has also kept up its strong lobbying against the tax. As one might

32 Based on interviews with public finance scholars close to MOHA and at the ministry itself.
expect, Japan's entire complex of property taxes came under sustained attack during the economic stagnancy of the early 1990s. Greatly exacerbating the opposition was the continuing implosion in land prices after the collapse of the so-called "bubble economy" of the mid- to late-1980s. Interest-rate increases by the Bank of Japan in 1989 deflated the bubble of price speculation and produced a drop in land values that was particularly strong in major urban areas.

Collapsing land values became the rapidly descending shear of a pair of scissors whose ascending counterpart was MOHA's quick increase in the Evaluation Standard. Caught flat-footed by MOF's foray onto the property-tax base, MOHA retaliated by restaking its claim to the tax field. The measures taken above were therefore capped with a 1994 increase of the standard to 70 percent. This meant that MOHA had to lean on many local administrations, in order to overcome their reluctance to face the potential political heat from taxpayers. But as early as November of 1991 MOHA had secured a recommendation from its advisory commission on the standard that called for such an increase. Because the representation on the commission includes many of the adversely affected interests, the recommendation suggests that MOHA was able to mobilize concern by pointing to MOF's encroachment on the local tax base. To leave the Evaluation Standard as it was, though politically the path of least resistance, left open the threat that MOF would increase its new tax in the future and thus infringe further on the local property
tax base. Evidently this argument persuaded local interests.

MOHA's fears about further infringements on the asset tax base were not merely bureaucratic turf-mongering. Having secured the LVT on the basis of the need to control land prices, MOF was quick to revise the rationale for it when land prices plummeted. The legislation governing the LVT clearly specifies its temporary, policy-related character, and so observers could be forgiven for thinking that the implosion in land prices turned the focus of discussion to when to withdraw the new tax. However, this withdrawal seems unlikely to take place. MOF now depicts the LVT as a permanent tax, one designed to help in equalizing the balance of taxation among the fields of income, consumption, and property. At the very least, this facile shift in argument suggests that MOF was all along less concerned with land prices than with enhancing the central state's tax base at MOHA and the local authorities' expense.

But busily absorbed in their tax competition, both ministries found themselves beached in a hostile fiscal environment when the flood of swollen land values receded. As land prices continue their precipitous plunge, dropping below half their peak values, various interests in the private sphere stepped up their lobbying against land taxation, insisting on cuts because of excessive

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33In “Ookurajikan, rainen no genzei keizoku wa yosanhensei toki ni handan” [The MOF Vice-Minister announces decision on continuing tax cut to be made with budget revision], Nihon Keizai Shinbun, June 23, 1995, p. 5.
aggregate tax levies. This is especially true of Osaka and Tokyo, where the pincer of declining land prices and ascending tax assessments caused a furor from 1995 on. In fact, the Japanese public finance community was transfixed for much of 1996 by the looming prospect of a tax revolt. MOF's LVT came under such antagonistic scrutiny that the ministry sought to deflect attention from it by cutting the tax rate in half. Thus the LVT burden declined to 0.15 percent, effective for the 1996 tax year.34

This quick move by MOF meant a reduced stream of revenues from the LVT and did not end the demands for its abolition. But pressure abated somewhat, especially as attention focused on the FAT. The latter had been targeted not only by the usual intense lobbying, but in addition the legality of MOHA's rapid increase in the Assessment Standard was being challenged in the courts.

The court challenges were not directed solely at the FAT, of course, since hostility concerning the burden of property taxes was also being caused by the Inheritance Tax. Some of the assessments made to inheritances were so unreasonable, in fact, that the Osaka District Court ruled on October 17 of 1995 that it was constitutionally questionable for tax burdens to exceed the value of the inheritance per se. But outrageous as several cited instances were, the Inheritance Tax is seldom an issue for most taxpayers. Certainly its potential to mobilize opposition could not begin to compare with the FAT,

34 MOF's tax reduction is cited in "Heisei 8-Nendo Zeisei Kaisei Youkou" [Outline of Tax Reform for 1996].
whose annual assessments were placing ever heavier burdens on large
numbers of proprietors and businesses in spite of the simultaneous and
spectacular drops in the value of their taxable assets.

Two rulings in September of 1996 shook MOHA into action. Both were handed
down by the Tokyo District Court and both challenged the legality of so
dracically altering the Assessment Standard. The first ruling, on September
11, declared that the portion of the plaintiff’s assessment that did not reflect the
current property price was not according to law. The court therefore ordered
the assessing authority -- the Tokyo Municipal Fixed Assets Assessment
Inspection Committee (koutei shisan hyouka shinsa iinkai) -- to reduce their
original decision. The second ruling, handed down on September 30, also
took issue with the assessment method and ordered a local municipal
committee to revise their original decision in light of the court’s judgement.35

MOHA responded to these rulings and the intense pressure from taxpayer
groups36 by selective displays of contrition. Leading up to the ministry’s major
retreat on the issue, it had been signalling its willingness to review its methods
and study how to revise the committee it uses for advice on the general

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35 See “Tochi zeisei hirogaru mujun” [Increasing contradictions in land taxation], Nihon Keizai Shinbun,
October 12, 1996, p. 3.

36 The national newspapers were contributing to the pressure by carrying full-page specials on such highly
politicized tax issues. Many of these articles were reports from symposia dedicated to criticism of the
burden of land taxes (with real-estate groups prominent among the contributors), but others were
Assessment Standard. But on October 15 it made an announcement that got front-page coverage in the serious press. MOHA had evidently determined that the pressure on the issue was simply too great, especially because of the court rulings, and therefore the ministry announced that the 1997 fiscal year would see a nationwide 39.8 percent average reduction in the Assessment Standard. In those areas where the cut in the assessment will result in a drop in local revenues, MOHA has determined that the difference will be made up by transfers from the Allocation Tax.

The above argument has centred on MOF's organizational interests in securing the LVT; it has also highlighted MOHA's organizational motives for opposing the tax and responding with reinforcement of the FAT Evaluation Standard in order to defend the tax field against further forays from MOF. To insist that these are the only matters to consider in explaining the outcome would, however, be far too reductionist. For one thing, there was a great deal of concern in bubble-era Japan about the deleterious effect that skyrocketing asset values could have on the distribution of wealth as well as the country's admirable levels of social peace. MOF bureaucrats, being both members of Japanese society and largely responsible for the speculative bubble, could

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37 MOHA's efforts are discussed in "Kouteishisanzei: 97-nendo futan keigen o kentou" [The Fixed Assets Tax: Studies on cutting the burden for 1997], Nihon Keizai Shinbun, June 2, 1996, p. 3. More recently, the ministry has declared it will set up a system for annual rather than triennial reviews; in "Fufuku chousa seikyuu mainen uketsuke" [System for annual review of complaints accepted], Nihon Keizai Shinbun, January 4, 1997, p. 3.
not but be affected by this concern.

However, this chapter has shown that conflicting bureaucratic interests heavily influenced the outcome. Leaving these interests out of the calculus of forces impinging on property-tax policymaking would, as many accounts do, overlook a powerful principle operating in Japanese tax politics.
Chapter 8

The Consumption Tax Field

The ministries of Finance and Home Affairs had been discussing the institution of a "local consumption tax" since 1993, but when it comes to bolstering local taxes...MOF is a brick wall.

Nonaka Hiromu
Minister of Home Affairs, 1994-95

The taxation of consumption is, as with property, another fertile field in Japan. It is hardly surprising, then, that MOF and MOHA recently fought over this area, goaded in particular by the fiscal stress of personal income-tax cuts. The outcome of the competition was a potentially precedent-setting "soft victory" for MOHA, in the commitment to a Local Consumption Tax (LCT). For fiscal decentralization, however, the results were rather more ambiguous.

A Tax Hike Foretold

Japan's Local Consumption Tax, as of this writing, exists only as a law waiting to take effect. But a major reform to direct and indirect taxes was given assent by the Japanese Diet on November 25, 1994. This reform contained a provision for increasing the Consumption Tax to five percent, which will include a one percent LCT on April 1, 1997. Moreover, the failure of Ozawa Ichiro's New Frontier Party to capitalize on the tax increase in the October 20,
1996 general election removed the last apparent hurdle to implementation. Hence on April 1, 1997 the LCT will constitute twenty percent of the Consumption Tax, and will be earmarked for direct transfer -- through the agency of the MOHA Finance Bureau -- to the local authorities.¹

The above summary suggests a rather perfunctory process of tax reform, but this is not at all the case. The LCT has instead a politically charged history in becoming a portion of the intensely politicized Consumption Tax. The general politics of the Consumption Tax stems from the fact that it applies across the board, unlike selective taxes on commodities and services. Because of the broad base of taxation, the potential revenue yield from the tax is enormous, particularly at double-digit tax rates, but so is the extent of opposition when this type of tax is introduced.²

Moreover, as to the Japanese Consumption Tax itself, its specific politics are rooted in the relative balance of direct and indirect taxes, the organizational mission of MOF, and the salience of small business in the Japanese political economy and tax politics. By contrast, the LCT's more recent history is grounded in local fiscal crisis, MOHA's organizational mission, and interministerial tax-field fights in an era of coalition government.

¹ On the tax reform, see “Shouhizei kaikakuhou ga seiritsu” [Consumption Tax reform law is instituted], Nihon Keizai Shinbun, November 25, 1994, np. Of course, the continuing instability in Japanese politics could yet thwart the tax increase, and the public reaction to it is anyone's guess.

Indirect Taxation Before the Consumption Tax

The overall framework in which the politics of the Consumption Tax and the LCT take place is the relative level of direct and indirect tax and how the respective tax fields should be apportioned between Japan's national and subnational governments. As to the historical weight of taxation in prewar Japan, it centred increasingly on indirect taxes as the state's role expanded in the early 20th century. In 1896, direct and indirect taxes were virtually even as sources of the central state's revenues: the former represented 40.7 million yen in an 81.8 million yen national budget, while the latter comprised 41.1 million yen. In the wake of 1896, though, indirect taxes consistently outpaced direct taxes, expect for when income tax revenues from the first world war flooded in during 1919. From the early 1920s to 1934, indirect tax revenues centred in particular on the liquor tax and provided twice the revenues of direct taxes. It was not until the 1938 fiscal year that direct taxes -- at 1.23 billion yen versus indirect taxes at 1.11 billion yen -- began to draw again the majority share of the revenues. This reliance on direct taxes increased as the Pacific War progressed and the state cast about for ready sources of revenue as well as sought to control prices.³

The war's end saw SCAP seek to rationalize the country's indirect tax base. One major reform in this direction was the 1948 institution of an Turnover Tax levied on sales, but it was abandoned the next year because of difficulties in gaining cooperation from Japan's many thousands of small retailers, who were especially concerned about the paper trail such a tax would leave for the authorities. In the wake of this politically driven repeal of the tax, the Shoup Commission came up with a considerably different and quite original approach, a Value Added Tax (VAT).

The idea for the VAT in fact originated in discussions among the commissioners on how to overcome the problem -- from their perspective -- of having three taxes on business income imposed by various levels of the state. In order to avoid excessively high tax burdens, the commission designed a separate tax base for the prefectures and municipalities, using a tax levied on businesses' sales income less the cost of goods and services purchased from other firms.

However, the VAT was eventually buried due to massive opposition. The

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4 Steiner, Local Government in Japan, op. cit., p. 265. See also Ishi, The Japanese Tax System, 2nd Edition, op. cit., pp. 314-15. The concern of these interest was clearly that they would be subject to more accurate tax assessments. There were also problems in the function of the tax, especially its incentives for vertical integration of firms, but the politics of the tax appear to have been more salient.

central government naturally looked askance at a tax it would not collect and directly control. But in addition, local business interests as well as local leaders stood against the tax, for a variety of reasons whose common ground was opposition to a new tax. Given the general bitterness about taxation under the Occupation, this fiscal "false consciousness" of the early postwar local authorities is entirely understandable.

MOF did not support the VAT because it was to be a local tax, part of the American programme to decentralize the wartime fiscal system. In other words, MOF was not against the concept per se. The VAT or general sales tax thus lingered backstage in MOF's policy scenarios, making fleeting appearances when the ministry grew especially uncomfortable with the relative weight of direct taxation in the postwar tax mix. For example, as early as 1958, there was a MOF proposal to enact a sales tax as an earmarked conduit for welfare revenues. The idea was clearly connected to the concern about excessively high income taxation in a polity that had been conditioned, in the prewar era, to a greater relative measure of indirect taxes. However, a broad-based consumption tax was not to be implemented until 1989, when fiscal crisis, the political exhaustion of revenue-raising alternatives, and the realization of cost-cutting limits in the early 1980s campaign of Administrative Reform forced it

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6 "Ookurashou, zaigen nan kara uriagezei shinsetsu" [Because of fiscal difficulties, MOF is considering a sales tax], *Kin'yuu Zaisei Jijou*, Volume 19, Number 44, November 3, 1958. MOF was studying the possibility of implementing the tax due to the problems in collecting contributions to national pensions.
back onto the stage.  

The Consumption Tax, legislated in 1988, came into effect on April 1 of 1989, and was quickly followed by a massive wave of popular protest that helped undermine then-Prime Minister Takeshita Noboru. Prior to these events, there were two other rounds of opposition that had cost the LDP dearly: in 1980, when Prime Minister Ohira Masayoshi broached the idea of a broad-based tax and brought forth intense hostility from business; and 1987, when Prime Minister Nakasone Yasuhiro's tax reform that attempted to match income-tax cuts with the implementation of a "Japanese-style VAT" was blocked by widespread opposition. In the 1987 case, only the income-tax cuts went through, while the VAT proposal was allowed to die in an LDP compromise with special interest groups and the opposition parties. The Consumption Tax that was finally adopted in 1989 was, not surprisingly, greatly hobbled by concessions to powerful sources of LDP support, most notably the small retailers. This clearly helped the tax weather the storm of protest from citizens' groups, particularly irate housewives whose negative voting in the subsequent general election gave the former Socialist Party an ephemeral renaissance.

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7 Japan is certainly not unique in its tax authorities' efforts to shift the tax system more towards indirect taxation, as this policy orientation was characteristic of many industrialized countries in the 1980s. The comparatively interesting aspect in Japan is the consistent and highly visible role of MOF in advocating specific directions in tax reform. On 1980s tax reforms among OECD countries, see B. Guy Peters, "Tax Reform," The Politics of Taxation: A Comparative Perspective. Oxford: Basil Blackwell, Ltd., 1991, pp. 271-99.


9 On the other hand, MOF avoided some of the major concessions -- such as multiple rates -- that have made European VATs administrative nightmares. See Kato's Bureaucratic Politics in Question, op. cit., pp. 200-10.
The above is the policymaking story of greatest interest to most students of Japanese politics. Various contending political science methodologies have sought to claim that the story of the Consumption Tax bolsters their respective position in the perennial debate concerning the relative powers of Japanese bureaucrats and politicians. Principal-agent theorists, for instance, insist the politicians' alterations to the final tax plan prove the inherent agency role of MOF in the face of political incentives and the constitutionally sanctioned authority of politicians. On the other hand, those who perceive bureaucratic dominance point to MOF's frequent and eventually successful campaigns to have the tax instituted. But as Junko Kato argues in the most detailed account of the Consumption Tax episode yet published, the interesting aspect of the episode is how MOF pursued its organizational goals in setting the agenda of tax policymaking.¹⁰ The same is true of MOHA's long struggle to secure the LCT.

*Intergovernmental Fiscal Politics*

Behind the well-documented drama of interest-group tax politics of the late

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1980s, there was a virtually unnoticed development at the level of intergovernmental affairs. The implementation of the Consumption Tax entailed the elimination and rationalization of several local taxes, including the Gas and Electricity Taxes. Though not major taxes, these two in particular provided an appreciable amount of revenues. Specifically, between 1975 and 1989, the year of the taxes' termination, they supplied an average of between 3 percent and 4 percent of aggregate municipal tax revenues.

MOHA sought replacement for the revenues from these local taxes, and was successful via the institution of the Consumption Transfer Tax. This new tax effectively took revenues that had been concentrated in large urban areas, as had been the case with the Gas and Electricity taxes, and redistributed them through MOHA as general revenues to the local authorities. The move thus centralized, in the interests of efficiency concerning the Consumption Tax and fairness in distribution, a previously autonomous pair of taxes.

There appear to be two major reasons why MOHA went along with the elimination of the local taxes. The first of these is the simple fact that the incidence of the individual local consumption taxes was narrow and hence they were comparatively expensive to collect. There is a strong competitive pressure on tax-collection costs from MOF, which certainly makes MOHA -- responsible for the local tax agencies -- wary of excessive expenses in this
This would suggest that MOHA supported the Consumption Tax in part because of efficiency gains.

A further reason for MOHA's acquiescence was likely its anticipation of increased revenues from a growing fiscal pie. This prospect stems from the fact that MOF seeks to have the Consumption Tax raised gradually to near-European levels. Evidence that large increases in the Consumption Tax are a long-range strategy within MOF is seen, for instance, in its several submissions of proposals for a higher Consumption Tax to the GTAC and other forums during 1994 and 1995, some of which are noted below.12

Running close alongside MOF's protracted interest in a broad-based indirect tax has been MOHA's desire to secure a piece of it. Evidence that MOHA has itself long sought to attach a local levy to the new national indirect tax can be found in the ministry's publications on the issue.13 This would indicate that

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11 During interviews with tax officials at both MOF and MOHA, for example, this author was presented with statistics on comparative tax collection costs without having to ask for them. Whereas the MOF statistics focus on the admittedly higher costs of local collection, the MOHA statistics present figures showing that, over the 1980s and 1990s, the local tax offices have raised their efficiency faster than have the national authorities.

12 This long-range aim for the Consumption Tax was freely discussed by MOF personnel during interviews; they emphasized that it was part of a package of reforms designed to shift the tax burden more towards indirect sources. Interviewees noted, however, the difficulty of reducing the income tax burden on corporations while simultaneously increasing the Consumption Tax. The preferred approach to resolving this problem appeared to be one of allowing the burden to decline in relative terms through price movements in a more competitive economy. Also, Igarashi Fumihiko notes that MOF officials suggested, during meetings of the coalition government's tax commission in 1994, that a 15 percent rate for the Consumption Tax would inevitably be necessary; see Ookurashou Kaitairon, op. cit., p. 91.

13 See, for example, "Chihou Shouhizei Giron no Keii" [Details of the Local Consumption Tax Debate], Chihou Zeisei Shoukai, 1995, pp. 42-6, which indicates that the concept of the local version of the tax dates back to at least 1978. Also, note the December 11, 1991 Yomiuri Shimbun article, "Heisei 4-nendo no chihoukoufuzeikin, 1 chou en ijou gengaku" [1992 Allocation Tax funds: a 1 trillion yen cut], which
MOHA was not averse to the Consumption Tax, at least in principle.

Third, and probably most important, MOHA came under pressure from the LDP. Under former Prime Minister Takeshita, the party had decided to implement a Consumption Tax but at the same time avoid the political backlash that destroyed the previous Nakasone Cabinet and before it the Ohira Cabinet. This determination put a premium on ensuring that potential sources of opposition were minimized as much as possible. Personalities tend to be emphasized in this account as well, because the LDPTAC was under the control of Yamanaka Sadanori, who possessed great authority and credibility with the bureaucracy through his knowledge of the tax system and his forceful character. These political considerations and actors are said to have brought MOHA in line with the objective of securing the Consumption Tax.  

The Local Consumption Tax

The pressure from LDP politicians reflects their willingness to get seriously involved in policymaking processes when their core interests are involved. In

observes that MOHA had an LCT proposal written into the outline for the General Consumption Tax (ippan shouhizei taikou), and sought to use this as a "weapon" (buki) in an effort to "expand its turf" (nawabari kakudai) and secure more stable revenues for local government. The fact of MOHA's protracted interest in the LCT was proudly pointed out to the author by a member of MOHA's Tax Bureau, who wanted to emphasize that MOHA's efforts in 1993-94 were not opportunistic.

14 The focus of attention in the Consumption Tax episode has been MOF and the LDP, with no written work that addresses the role of MOHA per se. However, public finance scholars at Tokyo University indicate that the role of Yamanaka and others in the LDP core of tax experts was quite persuasive in getting other interests, such as MOHA and LDP backbenchers, to support the policy under the Takeshita

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the case of the Consumption Tax, the two previous failures to introduce such a major indirect tax had cost the LDP much in the way of political capital and momentum in policymaking. The main impediment to implementing the tax was the political effectiveness of the small-scale retailers and other interests that stood in opposition to the policy. The LDP leadership learned through the bracing experience of policy failure, and as a result often sought to model circumstances so as to maximize the opportunity to get its preferred version of tax reform implemented. This was even evident, for example, in the failed tax reform effort by Prime Minister Nakasone, who placed 10 personally selected experts onto the GTAC so as to control the deliberations going on in the council and the nature of the report that it would issue.\footnote{In Kenji Hayao, \textit{The Japanese Prime Minister and Public Policy. op cit.,} pp. 73-4.}

On the other hand, the influences on the policymaking process that produced the Consumption Tax do not stop with the LDP, interest groups, and the MOF. Like Holmes' dog that failed to bark in the Baskervilles, sometimes what does not happen is as important as what does. It is thus worthy of note that MOHA put up no visible fight at all against the Consumption Tax. The lack of even a token expression of misgivings suggests that not only LDP demands entered into the ministry's calculus of pros and cons. Other ministries that have been compelled, by their political masters, to yield on a measure they opposed have

\footnote{In Kenji Hayao, \textit{The Problem of Bureaucratic Rationality. op cit.,} pp. 192.}
made their position known and have often sought to stymie the process.\footnote{One salient case is the Hosokawa Administration's pursuit of structural reform through the Hiraiwa Group [Advisory Group for Economic Structural Reform]. Noguchi Yukio writes that the Hiraiwa Group "was unable to break down the walls of bureaucratic sectionalism or loosen the Ministry of Finance's control over the budget" due to the opposition it faced. See Yukio Noguchi and Jirou Ushio, "Reforming Japan's 'War-Footing Economic System," Japan Echo, Volume 21, Number 2, Summer 1994, pp. 13-18, esp. p. 17.} Had MOHA been implacably opposed to the policy, it is likely there would be a record of it, even in the absence of successful opposition. Moreover, MOHA attempted to silence opposition from several prefectures to the 1987 Nakasone tax reform effort. These prefectures were coming under severe electoral pressures against the tax, and hence the local leaders chose to ignore MOHA's threats to penalize them through transfers if they did not comply with directives to include projected revenues from the new indirect tax in their budgets.\footnote{Note that there were politicians opposed to the rationalization of local taxes who made their position known in the LDPTAC, so MOHA could have allied itself with these individuals had it been adamantly against the Consumption Tax. Also, opposition to the tax was so strong that even after it was implemented, the central government had repeatedly to order the local authorities to include it in local charges; see "Ryouinzei, sekiyuzei nado shingata kansetsuzei o tanjun heika: Ookura, Jichishou, Jimin Zeichou ni teiji" [MOF, MOHA present a report to LDPTAC on bringing several local taxes into the new indirect tax], Nihon Keizai Shinbun, June 1, 1988, p. 3, Kato Junko, The Problem of Bureaucratic Rationality, op. cit., p. 181, and Ishi Hiromitsu, The Japanese Tax System, op. cit., p. 330.}

That the record shows no steadfast opposition from MOHA indicates it was not deeply against the tax, and the fiscal interest underlying this acquiescence would seem largely the prospect of an enhanced pool of revenues. Table 8.1 gives an indication of how comparatively low was Japan's take from the consumption tax field, both relative to other major countries in the OECD as well as Japan's own fiscal history. The 1985 low of 3.3 percent of GDP was the
nadir not only for Japan since 1965 but indeed compared to all of the other countries in the table, including the US which is notorious for being fiscally constrained by its lack of a nationwide tax on consumption.\textsuperscript{18} Japan clearly had, in consumption, a fertile field for fiscal exploitation.

\begin{table}[h]
\centering
\caption{Consumption Taxes as Percent of GDP}
\begin{tabular}{lcccccccc}
\hline
\hline
Australia & 7.0 & 6.7 & 7.1 & 7.9 & 8.6 & 7.2 & 6.7 & 6.6 & 6.8 & 7.1 \\
Canada & 9.0 & 8.7 & 8.4 & 7.8 & 8.6 & 8.7 & 8.8 & 8.8 & 8.8 & 8.7 \\
US & 4.8 & 4.8 & 4.6 & 4.1 & 4.2 & 4.0 & 4.2 & 4.2 & 4.3 & 4.4 \\
Japan & 4.6 & 4.1 & 3.2 & 3.6 & 3.3 & 3.6 & 3.6 & 3.6 & 3.7 & 3.8 \\
France & 12.9 & 13.0 & 12.0 & 12.3 & 12.8 & 12.0 & 11.5 & 11.3 & 11.3 & 11.6 \\
Italy & 9.4 & 9.5 & 7.4 & 7.6 & 8.2 & 9.9 & 10.1 & 10.1 & 10.1 & 10.9 \\
Sweden & 10.3 & 10.6 & 9.8 & 11.0 & 12.8 & 13.4 & 13.6 & 12.7 & 13.2 & 12.9 \\
UK & 9.4 & 9.8 & 8.4 & 9.7 & 11.0 & 10.7 & 11.1 & 11.6 & 11.2 & 11.5 \\
\hline
\end{tabular}
\end{table}


Another point to note in this respect is that MOHA did not formally control the rates of some of the local taxes that were eliminated in the reform of indirect taxation that accompanied the enactment of the Consumption Tax. Because of this, it is reasonable to argue that MOHA did not have a strong institutional

\textsuperscript{18} Sven Steinmo, "Why is the Government So Small in America?" \textit{op. cit.}
interest in struggling to maintain the taxes as they were.

Yet the precise reasons notwithstanding, the most important point for our purposes here is that MOHA went along with the overall idea of the Consumption Tax and even tried to suppress dissent from local authorities that came under popular pressure to oppose the new tax. These facts further substantiate the argument that it is less devoted to fiscal decentralization per se, than it is to a type of decentralization that will afford it greater control over tax revenues. This argument can also be extended to the LCT, which is the focus of the remainder of this section.

*The Return of the Consumption Tax Issue*

The Consumption Tax remained provoked further controversy under the coalition governments of 1993 to 1995. The MOF Tax Bureau was adamant, during this period, that a Consumption Tax increase be put firmly onto the agenda, as party competition and constant pressure from business, labour, and academe threatened to focus fiscal reform efforts exclusively on income-tax cuts. MOF’s core goals for the tax system in this effort were to secure revenues to cover income-tax cuts and shift the tax structure more to consumption and away from income. These goals could both be met by a higher Consumption Tax rate, but the opposition of the Socialists stood in the way once they became partners in the non-LDP coalition that took power on
August 6, 1993.

*Getting The Tax on the GTAC Agenda*

The pressure for the LCT per se began in 1993 with strong appeals from the Prefectural Governors' Association (*Zenkoku Chijikai*) and others of the 6 associations of local leaders (*Chihou Roku Dantai*, or CRD). These organizations are, it will be recalled, the lobbies for locally elected politicians. The CRD had, under the leadership of then-Tokyo Governor Suzuki Zenko, set up a special group to study the expansion of local fiscal autonomy. On October 26, 1993, the prefectural governors' group published a report titled "An Emergency Appeal Concerning Replacement of the Local Transfer Tax with a Local Consumption Tax as Part of Thoroughgoing Tax Reform." The main concern of these local politicians was that discussions on tax reform included a seeming unstoppable momentum towards an income-tax cut, due to party competition and concerns about the length of the Heisei Recession (which did not end until late 1994). Such a tax cut would not only produce revenue losses for the central state but the local authorities as well, since the latters' income-based Inhabitants Tax was also slated to be reduced. To the local authorities in the prefectures, who were already suffering greatly because of the havoc the recession was playing with their direct-tax centred tax structures, a further decline in revenues was unacceptable. Moreover, MOF's Budget Bureau was simultaneously pressing to cut the Allocation Tax. Hence, the prefectural
authorities -- though still smarting through their loss of the Electricity and Gas taxes\textsuperscript{19} -- appealed to MOHA to intervene on their behalf.

This course of action speaks volumes about the relative political impotence of the local authorities in the Japanese state system. As noted above, the French unitary state system provides more direct means for the assertion of local interests. But in Japan, the locals have to make do with MOHA as a precarious counterweight to the power of the central state, and especially MOF.\textsuperscript{20}

MOHA clearly stands in a relation of dominance vis-a-vis the local authorities, but it is not in a position to ignore local demands whenever it likes. This is especially the case when the locals are virtually unanimous, at least on the surface, on an issue.\textsuperscript{21} The ironic aspects of its role notwithstanding, MOHA's function as a bureaucracy is to represent the local interest to the central state; and were MOHA to become seriously negligent in this regard, it could well find itself bypassed in favour of other means of representation, especially by the

\textsuperscript{19} This big cities at times raised the issue as one rationale for the Local Consumption Tax. See "Saifu mo Chihou Bunken o: Chihou Shouhizei no Shinsetsu Yousai" [Towards decentralized finances too: The demand to implement the Local Consumption Tax], \textit{Asahi Shinbun} (evening edition), November 13, 1993, p. 9.


\textsuperscript{21} The eagerness of the municipal authorities has to be questioned here, as many of them clearly were not averse to the status quo due to their reliance on relatively stable property taxes and their concern about how the tax reform would distribute revenues. The Chairman of GTAC, Hiroshi Katou, insists that when MOHA "sent out a directive concerning preparations for this tax, I got calls from people in municipal offices saying that while they were complying with the directive, I shouldn't judge their true feelings by that. They are, they said, against the tax"; see Hiroshi Kato, "Thoughts on the Tax Reform Fiasco," \textit{Japan Echo}, Volume 21, Number 2, Summer, 1994, pp. 33-9, especially p. 35-6.
larger metropolitan areas such as Tokyo and Osaka. Certainly in some administrative areas -- i.e., not in taxation matters -- local actors have found various means of exploiting the inter-agency competition implied in the term "vertical administration." Moreover, as has already been discussed, MOHA was itself very much in favour of securing the LCT.

In consequence of this apparent pressure and its own institutional self-interest, MOHA made a surprise proposal to the GTAC in November of 1993, the primary site for raising issues of local tax reform. MOHA's submission to the GTAC argued that the commission's deliberations should consider the possibility of a LCT. The reasoning in the submission centred on the need to bolster the revenues of the local authorities, especially the prefectures, in an era when welfare demands could only reasonably be expected to increase.

As we have seen, the idea of a local version of the national broad-based indirect tax had been mooted as far back as 1978, but had lacked the necessary coalition of interests to propel it towards implementation. In 1993, however, there was in place a coalition government whose most prominent members -- including then Prime Minister Hosokawa -- had in the past been prefectural governors and mayors. They had moved "decentralization" back to the centre of the political agenda, at least as political rhetoric. In fact, at the opening of the GTAC on September 3 of 1993, Hosokawa made a point of attending and declaring that the LDP-era eclipse of the GTAC by the more
politicized LDPTAC would not be repeated under the coalition. The central issue was the income-tax cut that had been at the forefront of the political agenda for several months.\textsuperscript{22} But there was also an explicit recognition that the cut would affect the local authorities' Inhabitants taxes, due to the fact that they share essentially the same tax base. The cuts were depicted as part of the deemed need to shift more towards indirect taxation, and so in that sense as something of an inevitable policy trend. However, there was also comment, at the opening of the GTAC, on the importance of making up the revenue shortfall at the local level through autonomous taxation.\textsuperscript{23}

Moreover, the former Socialist Party was strongly represented in the cabinet -- being the largest of the coalition partners -- and was being pressed by its largest interest group, the Local Employees' Union (\textit{Jichirou}), to lobby on behalf of the LCT. The union's position on the tax was not so much in support of MOHA, as it resolutely opposes MOHA's role as the overseer of the local authorities. Rather, the union lobbied for the tax out of concern for the long-range fiscal health of the local authorities. And in back of that concern lay the calculation that local governments, particularly the municipalities, would be more interested in pursuing increased decentralization if they had more ample

\textsuperscript{22}On Hosokawa's unprecedented attendance at the opening of the GTAC, see Shiota Ushio, "Ookurajimujikan no tatakai, Dai 5 kai: Hosokawa Morihiro to Saito Jirou no Kankei" [The Struggle of the MOF Vice-Minister, part 5: The relationship between Hosokawa and Saito], \textit{Gekkan Toyo Keizai}, December 3, 1994, pp. 86-9, especially p. 88-9.

\textsuperscript{23}"Shouhizeiritsu hikiage rongito chihoushouhizei rongi no fukkatsu" [The debate over the Consumption Tax increase and the revival of the local consumption tax argument], \textit{Jichitai Zaisei Kiso no Kakuritsu}, \textit{op. cit.}
The Debate in the GTAC

MOHA's submission to the GTAC was quite coolly received by the largely MOF-selected members and the MOF Secretariat. The MOF-affiliated members went quickly on the offensive, doing their best to cast the MOHA arguments as ill-conceived. As a result of this stonewalling on theoretical issues, MOHA bureaucrats reported a great degree of frustration to the press. What MOHA was seeking in the late fall of 1993 was to have an explicit statement of intent to study the LCT issue written into the mid-term report of the GTAC, a report that was presented to the ruling coalition on November the 19th of that year. But the MOF personnel in the GTAC Secretariat were adamant that this be avoided, as they were keen to maintain their monopolization of the consumption tax field. MOF Tax Bureau members therefore seized on the fact that MOHA's tax proposal would see collection divided between the local tax agencies, under MOHA, and the National Tax Authority, which is attached to MOF. The MOF personnel argued that splitting collection of the tax would complicate the tax system and hence be a

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25 Masato Sano in Nihon Keizai Shimbun, May 4, 1994, "Jishu Zaigen Juujitsu, Shouhou ni Ikichigai: Jiritsu no Rinen Ka Sumu, Oukurashou 'zeisei konran' to hanpatsu'[There are conflicting ideas on how to enhance independent revenue sources. The idea of independence is hazy, and MOF is strongly opposed to what it calls 'tax confusion'].

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retrograde step in the context of administrative reform. Below the surface of the contest between the ministries, MOF was simultaneously offering to make up the anticipated cuts in local taxes through adjustments to the Local Allocation Tax and Consumption Transfer Tax. But MOHA firmly rejected this, based on the argument that adjustments to those taxes would make up for lost revenues but would also shift the local tax mix more towards reliance on transferred tax revenues from the central government. MOHA's position was consistent with the fact that it was more organizationally advantageous to control a guaranteed portion of consumption tax revenues rather than settle for increases in the transfers that MOF often seeks to cut.

The stubbornness over the issue shown by the MOF bureaucrats so upset the MOHA Minister, Ito, that when the mid-term report was being presented he noted that the LCT should be a major issue in the current period of decentralization. He then lowered his voice and said that the GTAC was not in fact a government tax commission (seifu zeichou) but rather one run on behalf of the central authorities (koku zeichou).

With the delivery of the GTAC mid-term report, deliberations came to a close for the year. The GTAC, following its regular schedule, did not resume deliberations.

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26 Details of MOHA's reasoning and the reactions of MOF can be found in "Zeisei kaikaku: 'chihou shouhizei' sousetsu mo shouten" [Tax Reform: Construction of a local consumption tax is a focus], Yomiuri Shinbun, November 6, 1993 [Evening Edition], p. 3.
meetings until the opening of the next fiscal year, in April of 1994. In the interim, MOHA and MOF organized their arguments and firmed up their coalitions of supporters for another round of contests over the consumption tax field.

February 3 of 1994 saw Hosokawa's announcement of a National Welfare Tax. This proposal was apparently not revealed to MOHA bureaucrats prior to its being made public, which seems clear from the press accounts of strong reactions from MOHA. Some of the MOHA personnel in fact described the process of announcing the proposed new tax as "fascist tactics," reflecting frustration at a tax reform deal seemingly having been worked out successfully behind the scenes. However, the National Welfare Tax idea was stillborn. Thus consideration of the direction of tax reform returned to the confines of the GTAC and the coalition's tax policymaking council, in an atmosphere of heightened distrust between MOF and MOHA.  

The initial step taken by the GTAC leadership, with the commission's reopening in April of 1994, was to put the LCT issue to a subcommittee of "learned persons." This subcommittee was the "Working Group on the Local
Tax Issue" [chihou zeigen mondai waakingu guruupu], and into the membership MOHA was able to insert some of its chosen academics alongside MOF's coterie of supporters.²⁹

The subcommittee heard submissions from the agencies involved in the tax contests as well as other interested parties. During one of these briefing sessions, MOHA presented a proposal on the new tax that starkly revealed its self-interested conception of fiscal decentralization. At this stage of the discussions within the subcommittee, the theoretical aspects of a locally based consumption tax and how it might be realized in the context of Japan were being reviewed. MOHA's proposal rudely slashed through a lot of this debate by suggesting a relatively strict model of control for a local consumption tax. In MOHA's presentation, the tax reform would see only the shift of tax authority from MOF and the National Taxation Agency to MOHA itself. The rate and other important details of the tax, rather than being matters decided at the prefectural level, would be determined within the MOHA Tax Bureau and applied uniformly across Japan. This apparent attempt to pre-empt debate at such an early stage of conceptualization upset even many of the MOHA-linked members on the subcommittee. Their angry reactions show that they believed the principle of local fiscal autonomy should have been at the centre of the debate, not how MOHA might efficiently go about substituting its control over

²⁹ For example, one of the members was Tokyo University Professor Jinno Naohiko, whose work on the Japanese tax system shows him to be clearly desirous of moves towards fiscal decentralization. My account of the debate undertaken within this committee has benefited from several discussions with Professor Jinno during 1994 and 1995.
part of the tax regime for that of MOF's.\textsuperscript{30}

The results of the subcommittee's hearings were incorporated into the June 6, 1994 GTAC mid-term report. This report recommended a political judgement be rendered on the issue after an extensive investigation and deliberation. Because of the shifting base of the Japanese political leadership during this period, the report did not go to the coalition under Prime Minister Hata Tsutomo, Hosokawa's successor. Instead, the document was brought before the new coalition of the LDP, the Socialists, and Sakigake, which came to power on June 29. As part of the process of organizing this new coalition, a policy agreement had been instituted, one that dealt with the need to reform the Consumption Tax and also promote policies that would bolster local finances.\textsuperscript{31}

Political involvement notwithstanding, the tax issue remained largely a contest between the two ministries, MOF and MOHA, one centred on their Tax Bureaux. The debate between the two came to focus on the issue of the VAT in the context of the European Union. In that example, the variation among national VAT structures presented a problem for the requisite policy harmonization necessary to reduce impediments to the freer movement of goods and services across national borders. Europe represents one possible

\textsuperscript{30} Some of the reaction is noted in "Chihou Shouhizeian"[The plan for the local consumption tax: a retrograde step for the idea of decentralization], \textit{Nihon Keizai Shim bun}, May 8, 1994, p. 4.

\textsuperscript{31} MOHA source, pp. 295-6.
future type of VAT regime, wherein the VAT rates are high enough that it is feasible -- cf. Japan, which has a low rate of VAT -- to introduce exemptions and other measures that are intended to promote social welfare and other public policy goals. But in order to avoid tax competition, which threatens to drive the VAT regime in Europe to the lowest common denominator, agreement on a fair degree of uniformity is crucial.

Moreover, the European system must also contend with the fact that taxes paid in a certain jurisdiction are often in excess of the relative provision of services. This discrepancy arises in particular from the concentration of head offices in particular urban cities, even though the consumption of services in producing value-added is more widely distributed. A similar problem is seen to occur when transborder shipments of goods in the production process confounds the automatic match of tax burdens and benefits. In both cases, the EU developed a clearinghouse arrangement that proposed to collect VAT revenues and redistribute them on the basis of agreed standards.

Japan has similar problems due to the centralization of corporate head offices and other activities in Tokyo. MOHA therefore tried to adapt the European model to the circumstances in Japan and thus provide a convincing LCT programme to MOF. However, MOF was not at all swayed by MOHA's response to the former's critique of the earlier tax proposal. It became apparent that MOF would not be prepared to yield on the matter of local
Meanwhile, MOF and MOHA began a very public war in the press even as their Tax Bureaux negotiated behind the scenes. Press reports began to carry allegations from MOF Tax Bureau personnel that the MOHA position was irrational and reflected MOHA's desire to recapture the vast bureaucratic turf of its infamous predecessor, the Home Ministry. Without indicating what an acceptable alternative might look like, the MOF bureaucrats also claimed they were not against the concept of the LCT per se, just the version that MOHA had proposed.

MOHA Tax Bureau personnel, for their part, gave as good as they got in this trench war of the one-liners. They confessed that their proposal had some flaws, but argued that there was no other on the table at a time when there was a pressing need to decentralize and transfer secure sources of revenues to the local authorities. Moreover, they also critiqued MOF's stand by suggesting that the ministry simply wanted to maintain control of taxation, including local taxes. Still smarting from their defeat in the Land-Value Tax incident, the MOHA bureaucrats also claimed that MOF's reasoning in the

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32 On the use of the European model and the stalemate over collection, see "Yotou ni kyougi danzokuron: chihoushouhizei, sakiokuri e" [The argument to postpone discussion in the coalition and put off the issue of the local consumption tax], Nihon Keizai Shinbun, September 13, 1994, p. 3. Also, the degree of centralization in Tokyo is discussed in Richard Chil Hill and Kuniko Fujita, "Osaka's Tokyo Problem," International Journal of Urban and Regional Research, Volume 19, No. 2, 1995.
case of the LCT was just as strange (okashina rikutsu).  

*Party Politics and the Compromise*

The tax issue became a focus of party politics as well, with the LDP no longer in a position to govern alone. The ruling coalition had earlier set up a special committee for studying tax policies, and the Socialists showed that they regarded implementation of an LCT as a core policy goal. There was even a certain leniency on the issue within the LDP, though the party's core of tax experts -- who are strongly linked to MOF -- resolutely opposed the tax and especially local collection. The other coalition partner, the Sakigake, opposed local collection of an LCT on the grounds of a narrow interpretation of administrative reform, which is a potent buzzword in Japanese politics and one the party was using in a vain effort to beef up its electoral appeal.

The stalemate over the tax dragged on through the summer of 1994 and into the early fall, with neither MOF nor MOHA willing to concede on the central point of local collection. MOF knew it would have to make some concession, because of the presence of the Socialists in the cabinet and MOF's desire to get their agreement or at least acquiescence to an increase in the Consumption Tax. The delicacy of the matter can be appreciated by the fact

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33 "Chihou shouhizei sousetsu, ryoushou no anteizaigen bundori kassen hakunetsu, sanpi meguri ippo mo yuzurazu" [Setting up the local consumption tax: The fight between MOF and MOHA for stable revenues is white-hot, and neither is yielding an inch], *Sankei Shimbun*, June 15, 1994, p. 9.
that only several months before, the Socialists created endless headaches for the Hosokawa and Hata coalitions because many members on the left of the party were elected in 1989 on an anti-Consumption Tax platform. They were reluctant to go into the summer 1995 Upper House elections having agreed to a hike in a tax they were elected to eliminate.

The twists and turns of the debate reveal much of the ministries’ essential interests, as was evident when MOHA prematurely expressed its desire for a uniform tax that it had authority over. Technical issues became levers for setting the agenda, pitting the MOF and MOHA Tax Bureaux and their respective academic allies against one another.\(^{34}\) The goal of the MOF personnel was to uncover and focus on any possible reason that could be used to suggest it was unwise to have local collection of the tax. In this respect, MOF appeared to have already conceded the shift of titular authority over a portion of the Consumption Tax but was attempting to limit policy change to that alone. Such a concession was characteristic of MOF’s approach to tough negotiations. MOF personnel are highly trained in the art of making strategic concessions of matters that are not considered essential. The strategy is referred to as “setting the weight bases,” and the MOF centre in this case was clearly collection by the central state rather than the local authorities.\(^{35}\)

\(^{34}\) An example of this participation of academics is seen in the editions of the MOHA-influenced journal, *Chihouzei* [Local Taxation], through 1993 and 1994. Many of the articles published during this period directly address issues raised by MOF as well as more general theoretical matters connected to a Local Consumption Tax.

The MOF Tax Bureau was indeed quite vigorous in leading the campaign against local collection. During the open contest in the media, in fact, there was a revealing episode that saw an internal memo from MOF's Tax Bureau find its way into the hands of a reporter for a major and highly respected business weekly. The magazine included the memo in an article that focused on MOF's reasons for opposing the LCT.

According to the memo, control of tax collection and distribution of the revenues are key pillars in the overall structure of MOF's authority, and thus losing control over even a portion of the Consumption Tax was unacceptable. Moreover, the memo claimed the struggle was a good opportunity to trim MOHA's wings somewhat, as well as reinforce the local authorities' fiscal dependence on the centre.36

In tandem with this strategic outlook, the MOF Tax Bureau personnel presented as many reasons as they were evidently able to find in order to subdue the call for local collection. Many of the issues raised were highly technical concerns, such as the question of how to apportion revenues collected in one constituency that theoretically belonged to another because

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36 The article is in Touyou Keizai as well as the January 1995 edition of Tokyo Business Today, op. cit. I would note that interviews in the MOF Tax Bureau and Fiscal History Section have elicited only denials that such a memo was produced by MOF. One interviewee was adamant that the magazine in question was little more than a scandal sheet.
of the benefit principle.\textsuperscript{37} For example, a firm might have its headquarters and hence its staff concentrated in one jurisdiction -- likely Tokyo -- whereas many factories and other installations might be scattered around the country. MOF emphasized this aspect in its propaganda efforts, evidently because it sought to drive a wedge between the different fiscal interests of the larger local authorities, where the bulk of Consumption Tax revenues are collected, and the smaller local authorities, whose jurisdictions include few of the corporate headquarters designated as taxpayers.

These were relevant points to raise in the debate on the tax, but that does not mean they were hurdles that could not be resolved. As I pointed out in chapter 2, there a wide number of tax styles in intergovernmental fiscal relations. MOHA's counter to this particular argument was that it would be possible to change the mechanism of redistribution of Consumption Tax revenues to one that took note of where corporations have their employees, using the firms' retail sales balances, rather than where their headquarters are located.\textsuperscript{38}

MOF was not prepared to give up on this attempt at dividing the local authorities. In submissions presented to the GTAC meetings during the late spring of 1994, MOF argued that a local two percent tax of the type advocated

\textsuperscript{37} This principle was discussed in the introductory section to this dissertation.

\textsuperscript{38} Oishi Nobuyuki, "Regional governments link debate on indirect tax to political decentralization: Controversial issue enters new dimension," \textit{The Nikkei Weekly}, April 25, 1995, p. 3; and "Chihoushouhizei: choushuuhou taiitsu nokosu" [The Local Consumption Tax: conflict over collection remains], \textit{Nihon Keizai Shinbun}, September 12, 1994, p. 1.
by MOHA would see Tokyo’s revenues increase by as much as 25.9 percent, whereas 34 of the 47 prefectures would experience losses in Consumption Tax revenues that would reach a maximum of 42.5 percent. MOHA countered this line of argument by conceding that there would indeed be losers with regard to the changes in revenues from the Consumption Tax per se. But the ministry also insisted that these changes would be greatly alleviated by the fact that the Allocation Tax could be used to even out some of the differences.  

Indeed, one of the major points that was missed by MOF in its efforts to discredit the tax was that it was conceived of as a prefectural tax. Igarashi notes, in this regard, that the argument was contradictory because the tax was advocated as a means of coping with increased local welfare expenditures, which are concentrated at the municipal level. It would have made sense, from the point of view of targeting the new revenues, to have planned to pass the bulk of them onto the municipal level rather than implement that tax as a prefectural tax per se.

With two such diametrically opposed agendas rooted in the interests of their Tax Bureaux, the ministries were not able to resolve the issue on their own. MOHA clearly sensed that MOF would have to make some degree of compromise in order to placate Socialist opposition to the projected

39See Nakamae Hiroshi, "Finance Ministry rains on local-tax idea: Plan termed threat to poorer areas," The
Consumption Tax increase. This problem became particularly acute as the Socialists allowed the reformist coalition under Hata to fold via joining with the LDP and Sakigake in June of 1994 to form a coalition. The return of the Socialists to the government brought the influence of both the anti-Consumption Tax Socialist parliamentarians as well as the pro-LCT Local Employees' Union (Jichirou) to bear on the issue.

Moreover, as if the party and union pressure was not sufficient, there was in addition the fact that the new LDP-led coalition (with the nominal role of Socialist leader Murayama as prime minister) appointed Sakigake's Takemura as Finance Minister. Takemura's role as Finance Minister was doubly bad news for the ministry because he was both a former MOHA bureaucrat and still quite upset with the MOF's leadership as a result of the fiasco of the National Welfare Tax. Takemura had deliberately been excluded from the circle of people knowledgable about Hosokawa's forthcoming announcement, even though Takemura was the Deputy Prime Minister in the Hosokawa coalition. The experience had evidently left Takemura wary of MOF's bureaucratic motives in tax reform in addition to his natural sympathies for the MOHA position as a consequence of human relations.40

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40 Nikkei Weekly, June 13, 1994, p. 3.

"On these points, see for example, Igarashi Fumihiro, Ookurashou Kaitairon, op. cit. pp. 184-85; and Shiota Ushio, "Ookura Jimujikan no tatakai, Dai 10 kai: Zeisei kaikaku ni miru seijika kouryaku" [The struggles of the MOF Vice-Minister: Capturing politicians in tax reform], Gekkan Toyo Keizai, January 14, 1995, pp. 106-9, especially p. 106.
However, there was a strong constraint acting in MOF's favour. This was the fact that local collection of the LCT would have required additional personnel at the local level in order to collect a portion of a tax that was already being collected at the national level. Not only were business groups opposed to this as an unnecessary complication of the tax regime, but Sakigake's efforts to stand out as a political vehicle centred on the pursuit of administrative reform issues and a general commitment, at least in rhetoric, to eliminate waste. The party in fact emphasized this point in all discussions of tax reform.

Yet even with the consistent position of the Sakigake party as a whole and its leader Takemura, who was Finance Minister, the resolution of the issue in favour of centralized collection was not quick. A significant fraction of the Socialists' membership obstructed a decision through the early part of September, insisting that collection of the LCT be placed in local hands. This was evidently a last-ditch stand by Socialists who had earlier opposed the increase in the Consumption Tax completely, and in this case either saw a chance to win a concession for the local autonomy desired by Jichirou or sensed their final opportunity to stymie the tax increase itself.

41 "Chihou shouhizeian: haibun kijun minaoshi, Jichishou, shichoson no genshuubun kouryo" [Local consumption tax bill: rethinking the standard for distribution -- MOHA considers the cut in municipal revenues], Nihon Keizai Shinbun, June 21, 1994, p. 10.

42 See, for example, Igarashi Fumihiko, Ookurashou Kaitairon, op. cit. p. 185. Also, Yoshitsugu Hiroshi describes how Takemura emphasized administrative reform in discussion of tax reform among the LDP-Socialist-Sakigake coalition leadership; see "Zeisei kaikaku: Sore zore no ketsudan" [Tax reform: the decisions one by one], Nihon Keizai Shinbun, September 29, 1994, p. 5.

43 "Yotou zeichou saishuu chousei: chihoushouhizei o sousetsu, choushuu jimu wa kuni ni inin" [The final adjustments in the ruling party tax council: implement the local consumption tax but leave collection to the central government], Sankei Shinbun, September 18, 1994, p. 1.
But once the question of collection was the only item left to be decided, the time-honoured practice of politicians adjudicating between the competing objectives of bureaucratic agencies asserted itself. MOF Minister Takemura started the process officially with a speech he gave in Kyoto on the 17th of September. In this speech he made a clear statement of support for entrusting collection of the LCT to the National Tax Authority (Kokuzeikyoku), and after that MOHA gradually came to recognize it was not going to secure its goal on collection. The deal that emerged was given assent by the MOF and MOHA ministers at the Prime Minister's residence on the evening of the 20th of September.

Most important for our purposes here is the fact that a compromise was eventually worked out, one that split the aims of the two ministries along the terrain of the governing coalition. The details of the agreement include an increase in the Consumption Tax rate to five percent on April 1, 1997, along with the the implementation of a one percent LCT that by law is collected -- "for the time being" (toubun no aida) -- on behalf of the local authorities and as part of the existing Consumption Tax.44 The revenues from the new tax are to be transferred to MOHA's Finance Bureau and thence to the local authorities.

44 "Chihoushouhizei sousetsu de goui: Ookura, jichisho chouzei, toubun wa kuni" [Agreement on instituting the local consumption tax: MOF, MOHA minister leave collection to central government for time being], Asahi Shinbun, September 21, 1994, p. 1.
The implications of the new tax for local fiscal autonomy do not, however, appear very promising. MOHA and its sympathizers at first saw the compromise as a defeat, but later MOHA bureaucrats took to referring to the outcome as a “soft victory” (sofuto bikutorii). The reason is that they believe the wording of the compromise represents a toehold for later justifying a shift of the tax completely within their sphere of authority.\textsuperscript{45} The local authorities, on the other hand, are in many cases less than enthusiastic. Some of their representatives, especially bureaucrats and politicians at the municipal level, have expressed concerns regarding MOHA’s capacity to control the tax, due to ambiguities in the regulations governing the distribution of the revenues.\textsuperscript{46} Moreover, some of the prefectural leaders clearly wanted to have the tax rates set at the local level, but MOHA itself was not in favour of this.\textsuperscript{47}

Nonaka Hiromu, the MOHA minister during the latter portion of this episode of fiscal politics, depicts the LCT as a great example of fiscal decentralization.\textsuperscript{48}

\textsuperscript{45} One of the supporters was MOF Minister Takemura, who in fact judged the outcome a win for MOHA, because it overcame MOF’s stubborn opposition to the very concept of the LCT; see in Igashi Fumiko, \textit{Ookurashou Kaitairon}, p. 187. The MOHA argument of a “soft victory” is based on interviews with a MOHA Tax Bureau section chief in the wake of the LCT tax deal.

\textsuperscript{46} A professor of public finance at the University of Tokyo reported to the author in 1995 that he had received expressions of concern on this point from tax officials. Kato Hiroshi, the head of the GTAC, also revealed that several municipal-level officers revealed to him their opposition to the LCT, based on their different fiscal interest from those of the prefectures and MOHA’s understanding of fiscal decentralization; see “Thoughts on the Tax Reform Fiasco,” \textit{Japan Echo}, Volume 21, Number 2, Summer 1994, p. 35-36.

\textsuperscript{47} The Governor of Saitama Prefecture gave MOHA’s efforts faint praise when he argued that the tax should have been brought under the control of the prefectures. See “Tsuchiya Chiji, chihoushouhizei sousetsu ‘kakkiteki kangei’” [Governor Tsuchiya welcomes the Local Consumption Tax as ‘epoch-making’], \textit{Nihon Keizai Shinbun}, September 22, 1994, p. 40.

\textsuperscript{48} Nonaka recently wrote his memoirs as minister; see Nonaka Hiromu, \textit{Watashi Wa Tatakau} [I Struggle]. Tokyo: Bungeishunju, 1996, pp. 157-60.
However, the outcome is clearly ambiguous rather than being the stirring case of fiscal decentralization Nonaka depicts it as. The LCT episode is in fact less an example of fiscal decentralization, than it is yet another episode that fits into the overall pattern of fiscal competition between MOF and MOHA.
Chapter 9

Conclusion

For government, though high and low and lower,
Put into parts, doth keep in one consent;
Congreeing in a full and natural close,
Like music

Shakespeare
"King Henry V"

In this dissertation I have sought to demonstrate two major points: 1) that fiscal centralization in the Japanese tax state is a politically meaningful phenomenon and is perpetuated, in large part, by bureaucratic competition over tax fields; and 2) that this tax competition reveals a large realm of bureaucratic discretion, in the politically hypersensitive area of tax policymaking. I believe that this work has been successful on both counts.

In achieving the first objective, I have been aided a great deal by previous work that shows Japan's 1940 fiscal regime to be highly centralized, especially through MOHA's fiscal controls. Other studies have been drawn on in order to demonstrate that Japanese bureaucracies, such as MOF and MOHA, are often animated by a keen sense of organizational mission in specific areas of policymaking. My own research on recent episodes in intergovernmental tax politics has been given a strong focus through the
insights provided in these earlier works as well as through research on tax politics outside of Japan. The latter are an invaluable aid in distinguishing what is comparatively common, such as the wartime centralization of the tax state, and what is particular to Japan, such as the effect that MOF and MOHA’s split jurisdiction on the tax fields has on tax policymaking.

My second aim was to demonstrate that the incidents of tax competition reveal a large sphere of bureaucratic discretion. This argument challenges a growing body of rational choice work, especially the principal-agent variant, which is reviewed in detail in the following appendix. Rational choice approaches tend to claim that bureaucrats have little or no autonomy, but I believe that my case studies have convincingly shown that Japanese tax policymaking is often driven by the conflicting interests of MOF and MOHA. Of course, in many cases these ministries’ organizational interests are simply reflections of the broader context of intergovernmental fiscal affairs; and therefore showing that specific goals were enunciated in policymaking fora by MOF or MOHA is not at all profound. Such instances are clearly examples of the agency role for which bureaucrats, at least in theory, get paid their salaries. However, I have described at length several examples where MOF and MOHA have used policymaking fora to advance their own idiosyncratic aims of controlling fiscal resources.

To recount one concrete example, I have argued that bureaucratic conflicts
underlie much of the increasing contention over land taxation. In seeking to
defend its tax turf against MOF's incursion via the Land Value Tax, MOHA
drastically increased the Evaluation Standard of theFixed Assets Tax.
Plummeting property prices have produced an inordinate growth in tax
burdens relative to actual market values and hence enormous pressures on
ruling politicians. One notable principal-agent paper on the Japanese
bureaucracy suggests that the test of an agent's policymaking autonomy is
whether "legislators are actually made worse off by the actions chosen by their
agents than if the agents had not acted at all."\(^1\)

Certainly a politically contentious burden of land taxation due to bureaucratic
fiscal competition would seem to fit this description, as stimulating opposition
to taxes jeopardizes the state's capacity to raise funds in the future. Politicians,
to the extent that they gain support from distributing public works and other
forms of pork, as well as social security, would seem to be net losers from the
recent trench warfare on the property tax field. Thus the rational choice test
itself indicates that MOF and MOHA exhibited appreciable policymaking
autonomy in this case.

However, it is in fact analytically fruitless to argue in such a polarized way
about the role of the bureaucracy, whether in Japan or anywhere else.

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Bureaucrats rarely find it necessary or advisable to act in open defiance of their political masters, so such incidents are quite rare. Nor should the test of bureaucratic policymaking autonomy be a search for decisions that made politicians worse off. The approach is likely to see the student, bearing an unrealistically precise calculus of costs and benefits, go in search of cases of unambiguous policy failure. But since few bureaucrats -- at least in Japan -- are routinely incompetent or go out of their way to devise poor policies, the evidence here too is likely to be scarce. Moreover, via the time-honoured practice of "passing the buck," bureaucrats will often try to evade responsibility when things go awry. Hence, even in cases of poor policymaking it might be very difficult, if not impossible, to assign blame.²

Institutions and Intergovernmental Tax Politics

Seeking clear examples of bureaucratic recalcitrance drives the analysis of bureaucratic influences on policymaking down a very narrow path, one hemmed in by presuppositions about conflict-ridden relations between politicians and bureaucrats. One route out of this restrictive false dichotomy is suggested by work that shows the postwar history of Japanese policymaking exhibits a strong convergence on goals between ruling politicians and the

² A classic case of this was seen in the Canadian Liberal Federal Government's 1981 tax reform fiasco, which is reviewed in the author's M.A. thesis ("Fiscal Politics and Canadian Tax Reforms," York University, 1989). The incident was rooted in the fiscal preferences of the MOF Tax Bureau, and cost then Minister of Finance Allan MacEachen his hopes of becoming prime minister. Scapegoats were made of progressive tax advisors, especially York University Professor Neil Brooks, brought in to help write
bureaucratic elite. As Pempel and Muramatsu so aptly put it, "collaboration rather than confrontation between the worlds of politics and bureaucracy has been a dominant political motif in postwar Japanese policy formation." One can find cases where bureaucrats thwarted a politician's expressed goal, as we saw in the MOF Tax Bureau's use of tax expenditures to alleviate the effect of Finance Minister Ikeda's corporate tax rate increase. Yet such instances are the exceptions that prove the rule. Japan's bureaucracy is neither an omnipotent clique of puppet-masters nor merely a dutiful squad of clerks, and therefore both bureaucratic dominance and rational choice principal-agent frameworks deflect attention from the truly interesting institutional issues.

My argument in this work has thus suggested that the focus rather ought to be on examining how the institutional fact of the bureaucratic organization -- related to its location in the state, its organizational mission, its capacity for strategic action -- imposes itself on policymaking in a particular political community. Or to put the argument more into the language of fiscal sociology, I have maintained that the Japanese bureaucracy plays a crucial role in reproducing the highly centralized 1940 fiscal system. Certainly my mix of meso- and macro-level approaches is not analytically lean. But as I have stressed throughout this dissertation, explaining the role of the state in the reform bill; but MOF's fiscal interests clearly underlay the effort to claw back tax expenditures that other ministries had turned to as a substitute for spending.

3 T.J. Pempel and Michio Muramatsu, "Structuring a Proactive Civil Service," The Japanese Civil Service and Economic Development. Recent works have also made this point with respect to areas of policymaking in the United States.
tax policymaking requires a measure of eclecticism.

Another reflection of the need for a nuanced institutionalist approach was seen in the discussion of fiscal centralization. The phenomenon does not lend itself to simple summations based on a restricted set of variables or a rigorous theoretical model. There are too many elements of potential importance, and their meaning has to be assessed both comparatively and from within the context of which they are a part.

For example, one cannot be certain, from a simple table of comparative indices, whether a high or low level of intergovernmental transfers of general subsidies means greater or lesser fiscal autonomy. The same is true of local taxes, at least until the researcher addresses the question of where the rates are set and related decisions made. Moreover, the number of national-level bureaucracies with jurisdiction over subnational governments also carries potential significance for fiscal autonomy. Detailed research is necessary before one can conclude whether the institutional environment allows local governments to play the central ministries off one against the other, or whether the central agencies zealously oppose even informal fiscal decentralization because of zero-sum turf wars. Other items of importance in setting the institutional context include the nature of subnational governments' representation in the central state, the extent of party-political interest in fiscal decentralization, movements in the macro-economy and the supply of fiscal
resources, and shifts in the larger tax regime.

In other words, the study of bureaucratic interests and intergovernmental fiscal politics comes face to face with the problem of institutional density. Or rather, this is a problem for aggressively parsimonious approaches that insist there is a simple and readily portable toolkit of assumptions whose explanatory power can cut through the problem of complexity. Fiscal sociology, for its part, finds its limits in the difficulty of teasing out institutional variations while looking down from a macro perspective. The historical institutionalist approach, in turn, trades a measure of theoretical rigour for meso-level realism, and seeks to understand the relationship between institutions and actors' preferences. These approaches are most useful for analyzing intergovernmental fiscal politics.

Prospects for Fiscal Decentralization

My argument has stressed that the interests of MOF and MOHA block, in large measure, movements toward fiscal decentralization. The 1940 system of centralized taxation and the deconcentrated provision of public services, along with restricted channels for local participation in decisionmaking, remains very much in place. Even in recent examples of fiscal politics, the outcomes do not exhibit a clearcut devolution of authority over fiscal resources.
However, the system of intergovernmental fiscal institutions is not hewn from stone. Such structures are capable of change, especially when pressure for reform builds up and spills over into the sphere of party politics. This has been the case in France and Thailand, to take two of the examples drawn on earlier. The United Kingdom, by contrast, has seen a drastic decline in local fiscal autonomy through Tory recentralization of tax controls and collection as well as the reorganization of local administration. Over time, most countries in fact give evidence of institutional changes that lead to some degree of increased or decreased centralization.

In the Japanese case, though, one notable feature is protracted institutional stability in the sphere of intergovernmental relations. In the wake of the rollback of SCAP's reforms, intergovernmental fiscal politics have been played out in a comparatively unaltered institutional order. There have been, to be sure, alterations in the range and rates of taxes and so forth, but the overall pattern of the 1940 fiscal system remains strikingly evident.

A key contributing factor to the institutional stability, I have argued, is the role of party politics. Diet politicians seek to influence the distribution of resources, especially specific subsidies, while leaving the overall fiscal structure and institutions intact. Though all political parties in Japan support decentralization, Japan has not yet had, unlike France, the rise to power of a
reformist party seriously bent on fundamental changes to intergovernmental relations.

Of course, the framework of Japan's party politics itself remained quite stable over much of the postwar period within what was referred to as the "1955 System." The characteristic feature of this system was the one-party dominance of the Liberal Democratic Party (LDP). But tax policymaking has become more uncertain under Japan's string of coalition governments since the LDP lost its majority in 1993. Furthermore, changes to the electoral system have replaced the multimember districts with 500 seats, of which 300 are to be elected from single-member districts and 200 via proportional representation. Most observers expect this new electoral system to narrow the number of parties and sharpen the debate on policymaking. Only time will tell the extent to which these predictions are realized and whether they register greatly on intergovernmental fiscal politics.

But demographic change and other stresses are almost certain to wield a profound influence on the agenda of intergovernmental fiscal politics. Japan is rapidly becoming one of the world's most aged societies, and its politics are
beginning to register the influence of that monumental shift. The delivery of public services will of course be affected, and this is one reason for the increasing pressure for administrative decentralization. The taxation end of the equation will also come under increasing strain, as the number of income earners declines relative to the elderly who largely consume and long-range prospects for economic growth subside to the norm among advanced capitalist countries. Indeed, these changes are implicated in the shift to a heavier burden of consumption taxation.

Hence there are intergenerational fiscal issues to take into account. But for our purposes here, a more significant phenomenon will be potential interactions between the demographic change and the structure of intergovernmental redistribution. This is because one of the striking features of contemporary Japan is the movement of the young from the countryside, leaving behind communities with high percentages of the elderly. There is no doubt that this change will burden the system of fiscal transfers further, but beyond that it is unclear what is likely to happen. No one can say whether electoral system changes will lead to a sharper rural-urban split in party platforms, tensions that for years have been more or less contained within the catch-all party the LDP

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5 Edward Lincoln (Special Economic Advisor to the US Ambassador to Japan), in a June 27, 1996, message to DFS, a Japanese politics e-mail group, commented that between 1985 and 1994, overall declines in some rural populations occurred "despite rapid increases in the elderly population. In Hokkaido, for example, the overall population dropped a minor 0.01 percent, but the population over age 65 shot up a huge 47 percent (and the population aged 0-14 dropped 25 percent)."
sought to be. Nor is it clear what effect the increasing share of fiscal transfers delivered as general subsidies (i.e., via the Allocation Tax) will have. The declining level of special subsidies suggests a reduction in Diet politicians' ability to skew patterns of expenditure. One might therefore expect a stronger institutionalization of less politicized intergovernmental redistribution to regions with growing numbers of elderly recipients of services.

But as I argued in chapter 5, the potential exists for politicization of the rule-making process for general subsidies, something that at present happens with a degree of subtlety that keeps it from becoming a major source of distortion. Were zoku politicians to migrate strongly in this direction in search of pork, though, there would seem little MOHA could do but accept the need to negotiate with a wider range of interests. Local governments' relative lack of institutionalized access to the circles of decisionmaking might then cause enough problems to require full-scale reform and the bypassing of MOHA as an institution, which is the longtime objective of the local government employees' union, Jichirou.

Another looming issue concerns corporate taxes. I have argued that the hollowing out debate is more than mere opportunism from business circles. Japanese capital has increasingly to compete with dynamic competitors in Asia, whose tax burdens are relatively low, and hence faces strong incentives to move production offshore. The extent of these incentives are debatable, of
course, but there can be no doubt that they are registering in political circles. The upshot is that the shift away from income taxation is likely to be accelerated.

Property taxes, too, appear to have become quite politicized, through the mobilization of opposition and the use of the courts. The consequence could be stronger constraints on both MOF and MOHA in their efforts to exploit the tax field.

As for concrete proposals for fiscal decentralization, most progressive local public finance scholars desire a form that will provide greater local control over decisionmaking plus the institutionalization of a "civil minimum." This latter would guarantee a certain minimum standard of social services in any given constituency. Services beyond that level, however, would be subject to the respective community's fiscal capacity and the willingness of local electors to be taxed for extra services. This is a compromise between American market-regulated federalism and Japan's current centralization under MOHA's strong fiscal controls. It would also be a compromise between the interests of young urban residents, who presumably want more local services for their tax burden, and those of the growing number of older and less well-off rural residents, who do not have the incomes to supply a decent standard of public

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6 A discussion of the issues can be found in Jinno Naohiko, "Fiscal Reform and a Strategy for Enhancing Local Government Revenues" (unpublished translation by Andrew DeWit), March, 1996. A copy of the paper is in this author's possession.
services. It seems, therefore, an obvious choice for reasonably far-sighted politicians, but it is a choice that would greatly erode MOHA's powers. The record examined in this dissertation suggests that such a reform would be quite contentious, to say the least.

These comments hardly exhaust the list of impending pressures on Japan's 1940 system of intergovernmental fiscal relations and possible directions for change. No one can predict what will happen, but it does seem a safe bet that some significant institutional revision will occur within the next several years. One major reason for this speculation is the profound fiscal crisis Japan has encountered in the mid-1990s, itself the consequence of revenue shortfalls and the unfavourable politicoeconomic circumstances for the income tax. Schumpeter suggested eight decades ago that the contours of the fiscal regime never appear so obvious as when they are in the midst of a systemic crisis. Perhaps, then, the deeper meaning of the recent trench wars and their heightened exposure of the overall 1940 fiscal system is that the latter is entering into a period of crisis and transformation.
Appendix

Institutions and Tax Politics

The history of state revenue production is the history of the evolution of the state.

Margaret Levi
Of Rule and Revenue

Levels of Analysis

Fiscal sociology, I have argued, is particularly suited to the task of exploring intergovernmental fiscal politics from a macro-level perspective. Schumpeter’s classic paper on the crisis of the tax state, for example, depicted the emergence of the state per se as a consequence of the “common exigency” brought about by the increasing cost of war. He examined broad social change, which is often neglected in meso- and especially micro-level analyses. Schumpeter’s aim was to highlight how the shifting background of the social order can cause systemic crises, the compounding rise of intractable problems that signals the end of one regime and heralds the contours of the next.¹

Moreover, Schumpeter’s insight concerning the political importance of the fiscal system is profoundly institutionalist since it implies that fiscal structures

¹ See Schumpeter, op. cit.
both affect and are affected by social forces and other variables common to political analyses. An elaboration of this inchoate institutionalist perspective can, as Campbell has indicated, be achieved by drawing on historical institutionalism’s non-reductionist model of preference formation. Preferences, in this view, are not the exogenous utilities assumed in rational choice work, but rather are the product of specific institutional structures. The nuanced, meso-level point of view thus highlights the interactions among political and fiscal institutions and their effect on what actors perceive to be in their best interests. Put another way, this angle of approach directs the inquiry towards the potential effects that intergovernmental fiscal arrangements have on rationality and political action.

The value of the macro-level perspective is most evident in considering the protracted crisis of the prewar era’s largely non-redistributive tax state. Local governments in Anglo-America, Europe, and Japan, burdened with increasing tasks as their societies industrialized, ran into severe fiscal stresses during the Great Depression that were irresolvable under the contemporary tax regimes. But efforts to reform the intergovernmental fiscal systems, in countries as

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3 A discussion of this point can be found in Sven Steinmo and Kathleen Thelen, “Historical Institutionalism in Comparative Politics,” Structuring Politics: Historical Institutionalism in Comparative Analysis, ed. by Sven Steinmo, Kathleen Thelen, and Frank Longstreth, New York: Cambridge University, pp. 1-30.

4 A larger and more deliberately comparative exercise than the present work would examine variations among fiscal systems for their influence on actors’ preferences concerning redistribution and local fiscal autonomy. However, the present work is more narrowly focused on the rationality that underlies turf warfare in Japanese intergovernmental fiscal politics.
diverse as Australia, Canada, and Japan, faced the hostility of powerful actors with a stake in the old system. Not until the outbreak of world war two were such countries able to overcome this opposition. The reforms then undertaken generally shifted the most lucrative tax bases to the central state, amplifying and institutionalizing hitherto marginal, ad hoc systems for redistributing revenues to local and regional governments.

Because of this larger canvas of the fiscal state, alternative methods used to study both tax politics and the Japanese political economy\textsuperscript{5} - especially Marxism, pluralism, and rational choice institutionalism - do not provide nuanced accounts of the role of state agencies and, in particular, MOHA's organizational mission. I critique these approaches as well as recent work principal-agent work on Japan, in order to review and respond to conceptions of bureaucrats' role in the operation of the Japanese political economy and the politics of taxation.

\textit{The Return of the State}

Historical institutionalism owes much to the efforts of Theda Skocpol and others, who argued - in a book that became both influential and controversial\textsuperscript{5} I am using the term "political economy" with an emphasis on politics rather than economics. That is, I draw on a tradition that owes far more to the classical political economists, such as Marx and Smith, than it does to the later marginalists and the more narrowly economistic work they have inspired in public choice and related models. But macro-level political economy approaches need to look more carefully at the realm of institutions.
in political science⁶ - that state agencies have their own abiding interests. Theirs was, in short, a deliberate programme to raise the state to the status of an independent variable in studies of policymaking. By contrast, most earlier work had depicted the state as a dependent variable in analyzing politics and policy outcomes, and was trapped in a stagnating debate between variants of pluralism and their diametrically opposed counterparts among the Marxist and neo-Marxist schools. Pluralist and neo-Marxist frameworks are true children of the behaviourist revolution, as they centre, respectively, on the activities and characteristics of interest groups and social forces and both tend to neglect the institutions of the state:

The majority of these approaches thus left the state untheorized as an actor in its own right. A powerful arm of the pluralist tradition, for instance, presumes the state is an impartial arbiter of interest group pressures. The classic expression of this point of view is David Easton’s systems-theoretic model, where the state is reduced to a black box and referred to in a deliberately anodyne way as “the political system.” Other pluralist work is rather more catholic in its view of the state’s structure and role in the social order, and some -- especially neo-pluralism⁷ -- differs little from the milder variants of neo-

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⁷ The best-known expression of this school is Charles Lindblom, *Politics and Markets*. New York: Basic Books, 1977. Lindblom's critique of the basic pluralist assumptions concerning the role of the state and the power of capital is stated quite concisely in his comment that "The large corporation fits oddly into democratic theory and vision. Indeed, it does not fit" (p. 356).
Marxism. But the overriding pluralist concept is that liberal democratic society is animated by a contest of interest groups interacting with a neutral state.  

A pluralist view of tax politics is offered by Richard Musgrave, probably the most respected figure in contemporary public finance studies. Musgrave maintains that "[f]inal voting power rests with the public" (p. 183) and that the role of the state is minimal because "the fiscal process reflects the interactions of pluralistic interests and interest groups" (p. 184). Musgrave's argument is in fact an important contribution because it discusses the influence of "fiscal interest groups," such as the elderly and other too-often-ignored agents in tax politics. But his pluralist assumptions do not afford much scope for analyzing patterns of influence from state agencies, likely because his implicit point of reference is the American state. In contrast, Japanologists who, as I explain later, turned to pluralist frameworks in the 1980s tended to greatly modify their pluralism (e.g., "patterned pluralism") in order to express the strong role of bureaucrats in Japanese policymaking.

The neo-Marxian concept of the state differs notably from that evident in the pluralist model. Neo-Marxists reject, some of them quite vehemently, the

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pluralist view of the state as a neutral arbiter, and assert instead that the state is a class-biased site intimately involved in the reproduction of capitalist hegemony. In this research programme, attention to the state centres on exposing policy outputs that favour the capitalist class, or important fragments of it. This focus derives to a great extent from the concern to explore the state’s functional role of maintaining conditions that encourage capital to invest a sufficient portion of the social surplus.¹⁰

Certainly the best-known and most influential Marxian analysis of tax politics is James O’Connor’s The Fiscal Crisis of the State.¹¹ O’Connor argues the capitalist political economy is driven towards fiscal crises because capital, allied with big labour, dominates tax politics and is thus able to evade adequate taxation of its inequitably distributed assets. Indeed, the state is functionally compelled to subsidize capitalist accumulation, through imposing a light tax burden, even though this restricts the revenue base required for funding the complementary role of legitimation.¹²


¹¹ A strong reaction to such functionalist work developed in the literature during the latter part of the 1980s. See, for example, Bob Jessop, "Marxism, Economic Determinism and Relative Autonomy," State Theory: Putting Capitalist States Back in their Place, op. cit., pp. 79-104.


¹³ Note that O’Connor draws explicitly on the fiscal sociology approach of Goldscheid and Schumpeter. The latter in particular highlighted the conundrum caused by the tax state’s dependence on the private sector for revenues. Schumpeter’s argument was that the expanding "sphere of social sympathy" would cause the tax state to collapse and therefore bring about a socialist transformation. O’Connor’s argument thus reworks that of Schumpeter in functionalist Marxian terms.
True to the Marxian paradigm, O'Connor is far more concerned with the interests and activity of social forces than he is with those of state actors and agencies. His framework therefore fails to disaggregate the state into its component agencies, nor does he offer a comparative analysis to test his hypothesis. This is in spite of the fact that many states have powerful ministries of finance that are more or less effective sentinels for the revenue base. Moreover, O'Connor's functionalist account of fiscal politics fails to explain -- as we will see presently in the work of Sven Steinmo -- why capital is taxed less heavily in social-democratic Sweden than in the U.S., the heartland of economic liberalism.

Statists sought to cut through the stalemate between society-centred pluralist and neo-Marxist approaches. They argued that the state, as both a set of institutions and an independent actor, had been relatively neglected in the other literature and had to be "brought back in[to]" the analysis of policymaking. Though statist work has apparently not examined intergovernmental tax politics, per se, its research programme would certainly accommodate such studies. However, its macro-level perspective would encounter difficulties in dealing with the great cross-national diversity in this area.

Statist work has indeed come under strong criticism for the lack of a theoretical means through which to examine variations among the preferences of state actors in different nations or even within different agencies. The competing
arguments run the gamut of policy areas, and for reasons of space and relevance to the focus of the present work they cannot all be reviewed here.\textsuperscript{13} Instead, I will turn to consider more recent institutionalist studies. "Neo-institutionalism," as it is referred to, has become prominent in political science research overall as well as the subfields of tax politics and the Japanese political economy.

\textit{The New Institutionalisms}

Institutionalist frameworks, like statist ones, grew in part out of disenchantment with behaviourism's overemphasis on collective actors and its neglect of the institutional environments that shape their strategic action as well as their preferences. This is not to suggest, however, that major branches of institutionalism share much in common beyond the rejection of behaviourism. In fact, there are two conflicting lines of institutional analysis: rational choice institutionalism and historical institutionalism. I will discuss the former, turn to examine other relevant models used in Japanese politics, and then dwell more at length on historical institutionalist work.\textsuperscript{14}

\textsuperscript{13} Useful texts and articles critiquing statist work can be found among the citations in Bob Jessop, "Anti-Marxist Restatement and Post-Marxist Deconstruction," \textit{op. cit.} A good discussion of the background to, and faults with, the statist approach can also be found in Nishikawa Jinichi, "Kokkaron apuroochi to Shinseidoron" [The Statist Approach and the New Institutionalism], \textit{Meiji Daigaku Keizaironshu}, Vol. 64, No. 3-4, March 1996.

Political science variants of rational choice institutionalism are rooted in studies of the American Congress, especially efforts to explain legislative stability and the successful passage of bills in spite of the variety of interests and issues separating the participant legislators. The answer to the question of how the American legislature could function effectively was sought in institutional rules and the way actors respond to them in their efforts to maximize their self-interest. Institutions, according to this perspective, resolve collective-action problems by providing participants with information about others' behaviour and, in some cases, shaping the alternative courses of action individuals are presented with.\textsuperscript{15}

Of great heuristic significance for our purposes here is Margaret Levi's rational choice study of political institutions and taxation. Levi's work is in fact best described as rational choice fiscal sociology, as she offers a "micro-macro theory that includes both individuals and structures" and is well-versed in the major works of the school. Explaining changes in tax policy through transformations in the larger apparatus of the state, and vice-versa, is a major facet of Goldscheid, Schumpeter, and others' fiscal sociology. Levi's macro-level framework draws heavily on this tradition, and thus for example

\textsuperscript{15} Rational choice institutions provide actors "with more information about the likely behavior of others and opportunities to make 'credible commitments' or enforceable agreements with others which allow them to 'gain from exchange.'" See Peter Hall and Rosemary Taylor, "Political Science and the Four New Institutionalisms" (paper presented to the 1994 American Political Science Association Annual Meeting), p. 6.
highlights the increasing cost of warfare as key to the rise of the tax state.

Levi takes issue with the abstract character of Skocpol and other statist's work (Levi refers to these theorists as the "new structuralists" and their approach as "state-centred structuralism"). In her words, "individuals become little more than the embodiment of the structures they represent. Structural explanations provide little scope for individual choice" (p. 197). Levi suggests that politics is full of choices, but the question of how and why choices are made cannot be dealt with by theories that focus on the macro-sociological level of analysis in the search for independent variables. Or to phrase the problem in the way it is expressed in this dissertation, the macro-level accounts do not do a good job of explaining the variations evident at lower levels of analysis.

Levi's "theory of choice" focuses on the "predatory ruler" (in a modern democracy, the president or prime minister), a rational, self-interested actor who seeks to maximize the revenue he can obtain from his subjects or the citizens. Constraints on the ruler's revenue extraction include transaction costs and the discount rate. The former refers to the difficulty entailed in collection, such as the scale of necessary administrative machinery, while the latter involves the ruler's time horizon, which means his degree of willingness to impose moderate exactions in order to foster stable or even expanding revenues in the future. Thus the ruler in a warring state extracts what he can in the present because his personal future is uncertain.
These constraints vary according to the era Levi examines, as her case studies stretch across the ages to encompass tax farming in ancient Rome as well as the role of the income tax in modern Australia. Over the centuries an increasingly important restriction on the ruler's ability to maximize his self-interest is his dependence on political support within the polity and "the construction of institutions that encourage compliance without resort to coercion and other costly kinds of inducement and enforcement" (p. 181).

Yet Levi opts for parsimony rather than persuasiveness as state and society grow more complex. There is certainly a strongly tautologous sense to her model of the predatory ruler, since if the ruler abstains from plundering the polity, this is said to be maximizing behaviour but within a longer time horizon. Since my concern here is not ancient society, though, I leave open the question of whether Levi's model fits the facts in periods when the ruler can be identified with a particular person or a small clique as the locus of decisionmaking within a larger sphere of fiscal institutions.

What is, however, clear is that methodological individualism becomes increasingly inapt as Levi grapples with the complexities of the modern period. Moreover, her application of the model to the Australian Commonwealth's wartime (1942) centralization of the income tax shows no evidence of a comparative sense of this relatively common fiscal development, which
compounds the flaws in her argument. This failure to subject her model to even a rudimentary comparative test is odd because rational choice work heavily advertizes its alleged universal applicability.

The 1942 reform saw the Australian Commonwealth, or federal government, impose a uniform income tax and compel the states to cease levying their own taxes in the same field. Levi interprets this according to the theory of predatory rule, which implies that "prime ministers will institute reforms and changes in tax arrangements that enhance net revenue to the central government" (p. 145). She points out, correctly, that Australia's 1942 reform was not impelled by wartime exigencies, as is commonly held among Australian academics interested in public finance issues. The prewar period saw a slow evolution towards the reform, driven by growing discontent due to a rat's nest of income taxes levied at both the state and federal levels as well as by the federal state's growing need for revenues. What was lacking was a context, such as a war, in which the ruler's bargaining power could override the objections of the states to the loss of a large portion of their fiscal autonomy. The second world war was thus an opportunity for fiscal centralization rather than a crisis that compelled it.

But this analysis only challenges a superficial explanation for the centralization of the Australian income tax and substitutes, in place of the war, a reductionist account of individual motives. In fact, the phenomenon was not
at all confined to Australia, and therefore forcing its utility-maximizing prime minister into the foreground obfuscates a vast terrain of comparative fiscal history that is central to this dissertation.

Institutions and Wartime Tax Centralization

Methodological individualism and exogenous preferences do not explain the wartime centralization of the Australian income tax. This criticism is an important one because it relates directly to the choice of methodologies to underpin fiscal sociology and study intergovernmental fiscal politics. Hence, I amplify the point even further by looking in some detail at the comparative example of Canada and to a lesser extent the Japanese case.

As in Australia, the war afforded a context for Canada's fiscal centralization. A landmark study, the Rowell-Sirois Report, had analyzed Canada's fiscal chaos during the Depression and the wasteful burden of the country's "tax jungle." The Report advocated a sweeping overhaul of Confederation, including advice that the federal government have access to sufficient tax room to fund a major system of redistribution, one that would help equalize the delivery of welfare and related services in spite of the diverse fiscal capacities among the Canadian provinces. Not surprisingly, the 1940 release of the Report met with rejection of its recommendations by, for the most part, the provinces which stood to pay for instead of gain financially from redistribution.
But the pressures of warfighting gave Prime Minister MacKenzie King an excellent opportunity to plead necessity and impose a system of “tax rentals,” that saw the federal government return a portion of the income tax revenues it collected from within a given province. If we apply the theory of predatory rule, we might therefore argue that King was, like his Australian counterpart, simply maximizing his self-interest in the midst of changed transaction costs and a shortening time horizon.

However, centralizing the income tax in Canada met a wide range of institutional objectives, especially the goal of equalization. The Rowell-Sirois Report, reflecting a larger consensus in bureaucratic and academic circles, called for intergovernmental transfers of “national adjustment grants.” In addition, the income-tax agreements that ensued became the linchpin of the later system of fiscal transfers as well as the institutions that expanded together with the tax state. In other words, modern tax-transfer mechanisms arose in tandem with bureaucratic and political institutions for coordinating the new industrial and welfare state. At the heart of the new state “was a small and influential group of federal public servants and advisors with a clear plan in

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16 A good comparative discussion of fiscal centralization in wartime Canada and Australia can be found in Kenneth Wiltshire, “Federal State/Provincial Relations,” Federalism in Canada and Australia: Historical Perspectives 1920-88. Peterborough, Canada: Trent University, 1989, pp. 181-99. Note also that Canada’s constitutional division of powers made it impossible for the federal level to forbid provincial income taxation. However, King believed that provincial leaders would not risk electoral punishment for double taxation (ie, continued occupancy of the relevant tax fields). See, for example, Richard Simeon and Ian Robinson, State, Society, and the Development of Canadian Federalism. Toronto: University of
mind," who sought to impose a highly centralized social policymaking regime based on the now overwhelming fiscal capacity of the federal authority.17

Canada's constitutional regime, effectively decentralized through British Privy Council decisions and socioeconomic change, later allowed the provinces to thwart the organizational mission of centralized federalism. Elements of the wartime tax state have stayed largely in place -- especially those under the purview of the Finance Ministry.18 But the central pillar of the wartime system was severely weakened in 1954, when Quebec opted out of the structure by resuming autonomous income taxation. The federal government hence found itself compelled in 1957, because of the politics of uniform treatment for all provinces, to dismantle the centralized tax system and offer increasing shares of the income tax to the provinces.19

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The institutional density of the modern state is left largely unexamined in Levi's model of predatory tax grabs. The politics of Canada's redistributive state exhibits a profusion of agendas and contingent influences, making a nuanced, meso-level analysis more appropriate. This point is made even more clearly when we reflect on Japan's wartime reform, which also sought to shift the fiscal system more towards income taxation and redistribution. As we have seen, the Japanese bureaucracy's interests and actual role in the 1940 reform were too great to attribute the outcome solely, or even largely, to the utility-maximizing aims of then-Prime Minister Tojo Hideki and other elements of the military clique. The latters' fiscal wish-list in the long years of warfighting centred on financing expenditures on munitions, whereas the bureaucrats concerned with intergovernmental affairs had larger and more long-range ambitions for the reform of the fiscal state.

The Principal-Agent Approach

Concerning the politics of Japanese policymaking in particular, the most noted applications of rational choice frameworks are those by Mark Ramseyer and Frances Rosenbluth as well as a volume edited by Peter Cowhey and Matthew McCubbins. Their accounts are based on the principal-agent paradigm (hereafter, PA), which stresses the ruling political party's role in
controlling the bureaucracy. Such work is of obvious significance for this dissertation, because if the bureaucracy in fact had virtually no autonomous organizational interests (save that of satisfying its political bosses) or capacity to realize them in policymaking, then it would be erroneous to posit bureaucratic tax competition as an impediment to fiscal decentralization.²⁰

The methodology of PA derives from business economics studies of how corporate shareholders control managements, and incorporates the notion of agency "slack" to represent the agent’s delegated authority and instances where it gets out of hand. The model is concerned with the problems that arise in such relationships because of the agent's possession of specialized information and the fact that the principal is not always able to monitor the agent. PA's basic framework, imported into American political science, examines how the electoral incentives facing politicians induce them to impose their constitutionally mandated control over their bureaucratic agents in the administrative state. The PA research programme, in short, seeks the means through which principals ensure that agents act in the formers' interests. Particular matters of concern to the PA paradigm are the rules that give the principal authority over the agent as well as the concrete mechanisms of disciplining recalcitrant agents. These latter techniques of controlling agents include interfering in bureaucrats' promotions and post-retirement job

prospects.

However, PA approaches simply enumerate mechanisms through which legislators control bureaucrats, and thus ignore the range of incentives facing agencies within the state. In many respects, this neglect of the policymaking influence of bureaucratic agencies is reminiscent of the 1980s neo-Marxian debate on the relative autonomy of the state. Marxism’s stale debate insisted that the state’s capacity to act in what it perceived to be the general interest was subject, "in the last instance," to the control of capital. Various mechanisms, especially the investment strike, were adduced to explain how capital could bring the activist state to heel. Both PA and Marxist approaches thus offer a dry formalism in place of open-minded empirical investigation of the role of the state and its bureaucratic agencies. The perspectives posit indistinguishable “ready to wear”\textsuperscript{21} states: for the universal functions of structuralist Marxism,\textsuperscript{22} PA substitutes harried bureaucrats whose driving ambition is to seek rewards from, and avoid punishment by, their political masters. This almost Skinnerian model makes theorizing bureaucratic action akin to predicting that rats on treadmills will run away from pain and towards

\textsuperscript{21} As Adam Przeworski and Michael Wallerstein note concerning Marxism, “The state is ready-to-wear; it is fully tailored before class conflicts, as if in anticipation of those conflicts, appearing fully clothed whenever these conflicts threaten the reproduction of capitalist relations.” Cited in Atkinson and Coleman, op. cit., p. 209\textsuperscript{fn3}.

\textsuperscript{22} The clash between the historical and rational choice variants of institutionalism echoes an earlier debate between the historical Marxism of E.P. Thompson and the theoretical reductionism of Althusserian Marxism. See Thompson’s engaging and withering critique of his opponents, stressing the need for good historical research, in his \textit{The Poverty of Theory}. London: Merlin Press, 1978.
simple behaviouralist rewards.\textsuperscript{23}

PA models rely too heavily on assumptions that politicians' formal authority explains policymaking outcomes\textsuperscript{24} and that conflict between principals and agents is the norm. But policymaking in a democratic state is extremely complex, and bureaucrats and politicians often have no strong differences of interest and understandings about how to attain goals. It appears that PA has limited validity even in studies of American policymaking, since no PA-inspired study has "assessed the role of bureaucracies in agenda setting or policy adoption despite the descriptive literature that shows agencies actively lobby their political superiors for changes in law or policy...More serious, however, is the failure to go beyond counts of enforcement actions and assess whether or not agencies influence the direction of public policy and, in turn, policy outcomes."\textsuperscript{25}

Moreover, as Pempel and Muramatsu point out in their work on the Japanese

\textsuperscript{23}Note that there are strong critiques of such reductionist principal-agent theorizing within economics as well. Experiments testing the standard simplistic frameworks depicting the relationship between managers and workers or boards of directors and managers have yielded results contrary to predicted outcomes; and thus some theorists have turned to social-exchange and other more sociologically aware models of human behaviour in organizations. See, for example, Harry G. Barkema, "Do Top Managers Work Harder When They Are Monitored?" Kyklos, Vol. 48, Fasc. 1, 1995.

\textsuperscript{24}That is, PA implies that since politicians have the constitutional authority to veto policy proposals, the fact of a policy's implementation reveals their preference. It is therefore a classic case of post hoc reasoning.

bureaucracy, "collaboration rather than confrontation between the worlds of politics and bureaucracy has been a dominant political motif in postwar Japanese policy formation." John Campbell's richly empirical treatments of changes in ageing-society policy regimes also show that Japanese bureaucrats often take the role of policy entrepreneur and impress their agency's agendas on policymaking. In short, there are good reasons to believe that Japanese bureaucrats wield at least some degree of autonomous influence in policymaking.

**Modified Pluralism and Policymaking in Japan**

Japan has, of course, long been depicted as a country whose policymaking is strongly influenced, if not dominated, by bureaucratic actors. Chalmers Johnson's pathbreaking work on the political economy of Japan's miraculous postwar economic recovery and development gave pride of place to the Ministry of International Trade and Industry. Later studies sought generally to temper the exaggerated statist model that was associated -- often unfairly -- with Johnson's work, but few credible students of Japanese politics were inclined to erase bureaucratic activism from the political equation of

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26 T.J. Pempel and Michio Muramatsu, "Structuring a Proactive Civil Service," *The Japanese Civil Service and Economic Development*. Recent works have also made this point with respect to areas of policymaking in the United States.

policymaking in Japan.\textsuperscript{28} However, the trajectory of debate on the bureaucracy's role did, especially in the 1980s, turn to question the often assumed quiescence of politicians in policymaking.

Recognition of the strong role of politicians and political parties was greatly stimulated by notable bureaucratic failures, such as the reversals of MITI's staunch opposition to stringent anti-pollution policies. Moreover, the institutionalization of Liberal Democratic Party rule saw the development of policymaking arenas, or even subgovernments, centred on the party's Policy Affairs Research Council and the \textit{zoku giin} that took a strong, albeit often negative, hand in policymaking.

Krauss and Muramatsu, for example, reviewed the rise of politicians and interest groups in policymaking over the course of the postwar period, and declared Japan a case of "patterned pluralism." This label encapsulates their observation that:

there are fairly consistent coalitions of actors with relatively predictable degrees of influence on policymaking. The bureaucracy, the dominant party, and the major social allies of the dominant party are usually involved in most policy issues. Elements of each of these, organized around a common issue or interest, have relatively institutionalized

\textsuperscript{28} Richard Samuels' work, \textit{The Business of the Japanese State}, op. cit., argues for example that industrial policymaking in Japan involves negotiation between bureaucrats and business, as state actors possess jurisdiction but not always effective control. This would seem a useful caveat for PA theorists to keep in mind concerning politicians' assumed dominance of bureaucrats.
Kent Calder drew many of these pluralist themes together, and suggested that Japanese policymaking -- especially where budgetary allocations were involved -- was often driven by ruling-party politicians' desire to address declines in their electoral fortunes. Calder suggested, however, that in between periods of electoral challenge, the bureaucracy returned to a powerful, if not pre-eminent, role in managing the political economy.\(^{30}\)

But somewhat scarce in Calder and many others' accounts is detailed empirical research on how bureaucrats get involved in policymaking and why they do. PA works offer one avenue of study, but insists we confine our sense of bureaucratic incentives into the smallest possible space. In seeking more balanced research paradigms on policymaking, ones that draw on the insights from rational actor models, it is not necessary to opt for such reductionism. Patrick Dunleavy, for example, argues that bureaucrats face a range of incentives. Dunleavy's micro-level institutionalist analysis indicates bureaucrats have a preference for high-status work. As he puts it,

The characteristics of public-service employment systems make it likely that the welfare of higher-ranking bureaucrats is closely bound up with the

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intrinsic characteristics of their work, rather than near-pecuniary utilities. Rational bureaucrats therefore concentrate on developing bureau-shaping strategies designed to bring their agency into line with an ideal configuration conferring high-status and agreeable work tasks, within a budgetary constraint contingent on the existing and potential shape of the agency’s activities.\textsuperscript{31}

However, Dunleavy’s model lacks the theoretical scope to appreciate the rise of an organizational mission based on bureaucratic experience rather than economistic incentives. By contrast, Junko Kato’s study of MOF and the Consumption Tax attempts to build a more realistic conception of the incentives facing Japanese bureaucratic institutions.

\textit{Bureaucratic Rationality}

Kato’s work on bureaucratic rationality deliberately refutes the Principal-Agent approach.\textsuperscript{32} It is worth examining in some depth because it focuses on the core question of whether bureaucratic interests can strongly influence policy outcomes in fiscal politics. Though Kato herself employs a rational choice framework, she argues that MOF’s “fiscal bureaucrats” had a clear set of institutional goals that impelled them to lobby for the adoption of the Value Added Tax. In her view, MOF sought the tax as a means to keep control over the budget, as MOF’s influence in macro-budgeting relies on a moderate


\textsuperscript{32} Junko Kato, \textit{The Problem of Bureaucratic Rationality}, op. cit. Kato rightly notes that the PA approach “does not necessarily comprehend all the possible cases and processes” and so directs her study towards “conditions that facilitate bureaucratic influence”; see pp. 26-30.
degree of fiscal looseness. This condition, rather than the extremes of fiscal
tightness on the one hand and very loose budgeting on the other, she argues
is ideal for MOF. Hence her work challenges the claim that the electorally-
derived preferences of politicians alone are driving policymaking.

An important objective of Kato’s study is thus to show that MOF is organized in
such a way as to inculcate its member bureaucrats with distinctive
organizational goals. To this end, she draws on John Campbell’s argument
that MOF’s primary influence in budgetary policy is in macro-budgeting, since
the ministry had gradually lost control over micro-budgeting due to the rise of
pressures from the LDP.33 As noted, Kato argues one condition for protecting
control over macro-budgeting was to find a secure source of revenues. This
objective, derived from MOF’s location in the state, was able to gain the
adherence of the bureaucrats in the institution because Japanese
bureaucracies have specialized patterns of recruitment and are able to afford
members with ample incentives for acting in the organization’s interests.34

MOF’s capacity to get the adoption of the VAT onto the policy agenda relied
heavily on MOF’s institutional means for narrowing the debate on alternative
policy options in tax reform. Kato uses Kingdon’s theoretical distinction
between “agenda setting” and “alternative specification.” The former involves

33 John C. Campbell, Contemporary Japanese Budget Politics. Berkeley: University of California Press,
getting the problem onto the agenda as such and linked to the desired solution, while in the second process the desired solution is made to stand out against the range of possible alternatives. Unwanted solutions become the focus of actions and arguments aimed at making them appear unfeasible or ill-advised.\^35 A key point to make in this regard is that a proposal being touted as technically superior to alternatives is actually being advocated by the bureaucracy because it advances the agency's own interests.

Kato points out that the MOF bureaucrats used the GTAC to advance their cause and were also able to interact effectively with ranking LDP politicians in the party's Tax Advisory Council. These politicians, many of them former MOF bureaucrats, formed the core group of influential members with considerable accumulated expertise on taxation.\^36 Often this group cooperates with MOF in advancing the bureaucrats' preferred version of tax reform, going so far as to persuade other party members as well as interest groups standing in opposition to a given policy proposal. Though rank-and-file LDP politicians in the tax agency played a major role in stymying the two earlier efforts at introducing the VAT, the core group's efforts were "critical for the bureaucrats to obtain a final acceptance of their proposal by all the LDP members" (p. 97).

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\[^36\] Kato's research confirms Yamaguchi Jiro's remarks in his article, "Seiji to Gyousei," [Politics and Administration] in *Shisou*, Number 4, 1993. Yamaguchi points out that the seed membership of the LDP's Tax Advisory Commission consisted of many former MOF bureaucrats, which made them more sympathetic than the ordinary politicians to MOF's tax reform proposals.
It is also important to note, as Kato does, that MOF's failures along the way to implementing the policy indicate that "the bureaucratic power of agenda setting hinges on contingent factors that cannot be explained by institutionalized patterns of behaviors nor predicted by decision-making routines" (p. 86). In other words, the bureaucratic organization uses the means at its disposal -- including its monopolization of specialized information -- to pursue the solution it prefers, but there is no guarantee of a satisfactory outcome from the organization's perspective.

Kato's type of research on bureaucratic incentives is necessary, but is missing from PA and other approaches. There are, however, some problems with her analysis, especially her argument that the VAT was chosen solely because it met MOF's requirements and not because other revenue sources were constrained. Kato insists that "The existing income tax before the reform could have increased the tax revenue automatically by leaving it unadjusted to inflation and economic growth. If the MOF had wanted only to increase taxes, doing nothing would have achieved this without political costs" (80). Yet Japan's MOF has long worried about the balance of direct and indirect taxes; and in the 1980s, about the growing alienation and frustration of the salaried urban worker, whose income tax burden increased while major newspapers wrote openly of the income-tax evasion commonly practiced by farmers and
small businessmen. The suggestion that a do-nothing stance would have brought few political costs contradicts the evidence from Japan as well as tax politics overseas. For example, in the United States, the long postwar reliance on just such a strategy helped in large measure to produce the anti-income tax sentiments exploited by the Reaganite Republicans in the 1980s.

Moreover, though Kato's work plays a useful role in attempting to shift rational choice studies towards a serious investigation of the state, it neglects the important comparative dimension of tax policymaking. Similar to the faults with Levi's case study of predatory rule in wartime Australia, Kato does not look in any depth at how and why foreign Finance ministries seek to influence policymaking, especially on the adoption of tax reform proposals such as the VAT. This gap is unfortunate and unnecessary, because there is a literature on these issues, one that might have broadened the application of Kato's analysis of bureaucratic incentives for activism in policymaking.

Comparative work might have alerted Kato to the problem of posing a

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monocausal explanation for MOF's pursuit of the Consumption Tax. This is not, even within the rational choice school, a realistic representation of bureaucratic or political actors as "we lose a lot in complex situations by imagining that only one kind of utility is being maximized, or only one preference being pursued."\textsuperscript{40} The challenge for rational choice theory is to build on Kato's empirical work and provide even more developed accounts of what motivates MOF and other bureaucracies to take activist roles in policymaking.

Historical Institutionalism

Historical institutionalism contrasts strongly with the rational choice methods discussed earlier. Being less methodologically rigorous and reductionist than its rational choice counterpart, historical institutionalism is able to incorporate into its explanatory toolkit more of the sociologically and historically complex terrain of actual policymaking. In particular, its stress on the role that history and power relations play in institutional development give it a strong edge in explanatory realism. These facets are important for the present work because a proper political analysis of the origins of Japan's intergovernmental fiscal regime extends into the pre-world war two era.

Sven Steinmo's historical institutionalist work on the role of political

\textsuperscript{40} My thanks to Margaret McKean for this point, via private correspondence on December 14, 1995.
institutions in shaping tax systems in the U.K., the U.S., and Sweden has contributed much to the approach taken in this dissertation, and is thus examined at some length below.41

Steinmo's argument centres on the fragmentation of political institutions in the United States, the single-member plurality system and parliamentary government in the U.K., and the institutional durability of Swedish corporatism. Through these institutions he explains the counter-intuitive fact that America's tax structure is shot through with selectively targeted exemptions and yet is more progressive than that of Sweden. By contrast, Sweden's tax system raises a major portion of national revenues through relatively regressive means, an outcome one would not expect in a social democratic regime. Britain is in a class of its own, due to the "fiscal incoherence" of a tax system that changes abruptly and remarkably with alternations in government.

Steinmo's work on the politics of taxation poses an interesting and hitherto unresearched comparative problem in tax policy and applies a consistent but nuanced framework towards explaining it. His argument rejects culturalist and other possible accounts for each nation's fiscal peculiarities, and instead points to the rationality that is a product of their institutional makeup. Steinmo contends not only that institutions affect the balance of power among interest groups, a common enough claim in the political science literature; he argues

41 See, in particular, Taxation and Democracy. op. cit.
that "the structure of a polity's decision-making institutions also profoundly affects how interest groups, politicians, and bureaucrats develop their policy preferences." In other words, "rationality itself is embedded in context," such that the very same act can be a positive and useful strategic choice in one institutional context, and become irrational and even foolhardy in another context.\textsuperscript{42}

This notion of rationality is quite different from that of the rational choice school. The latter, true to its origins in economics, leaves untheorized the source of preferences and instead treats them as an exogenous variable. By contrast, the historical institutionalist approach sees preferences as endogenous and thus as an appropriate focus of investigation and explanation.\textsuperscript{43}

Steinmo suggests, therefore, that the relevant actors in each country he examines make rational tax policy choices, but only within specific institutional contexts. Participants in Swedish corporatism, for example, knew that the Social Democrats would most likely be in power, but probably not as a majority government, and thus policy preferences among both capital and labour were shaped by the political institutions generating such an outcome. The Social Democrats as well as Swedish labour and capital realized they

\textsuperscript{42}Ibid., p. 7.

\textsuperscript{43} A discussion of this crucial difference between the two institutionalisms is in Sven Steinmo and Kathleen Thelen, "Historical Institutionalism in Comparative Politics," in Sven Steinmo, Kathleen Thelen, and Frank Longstreth (Eds). \textit{Structuring Politics: Historical Institutionalism in Comparative Analysis}. Cambridge: Cambridge University Press.
could not get everything they wanted, but the interest groups also knew that the terms of agreements reached between them would be honoured. Social Democrats therefore shifted their position on the taxation of capital, and Swedish labour acquiesced to heavy consumption taxation. Consumption taxes are anathema to the left and labour in the United States, however, because America’s fragmented political institutions preclude the kinds of trade-offs possible under the stability of Swedish corporatism. America’s tax system is, instead, notable for its numerous highly specific loopholes, precisely the outcome one would expect given the nature of American institutions.

Britain is a fiscal chaos of frequent reversals. This outcome is due to an electoral system that encourages majority governments and strong party discipline that allows cabinets to carry through on their fiscal commitments and preferences. Where Swedish capital was compelled to accept compromises under the protracted governance of the Social Democrats, business and the wealthy in the U.K. sought to secure all they could when the Tories were in power. The same was true of labour interests in the U.K. when the Labour Party was in office. As a result, politically charged aspects of the tax system have varied according to the political stripe of the government of the day.
Critiques of Historical Institutionalism

Criticisms of the historical institutionalist approach tend to focus on its lack of a rigorous method. Peter Hall and Mary Taylor, for instance, toss in a critique much like the one that greeted Hall’s 1986 institutionalist study, Governing the Economy. While conceding that historical institutionalism has generated interesting and relatively well-developed literatures in a variety of sub-fields, Hall and Taylor argue that “the concept of ‘institutions’ is often employed quite loosely and relatively little attention has been devoted to building clear micro-foundations for an institutional analysis.”

These claims are in part true. Historically oriented work in political science certainly has to keep in mind that some variables matter more than others in explaining outcomes. Cut adrift from concerns about causality, work can easily fall prey to anecdotes and selective empiricism. But on the other hand, incorporating a rigid set of micro-foundations would, as was seen earlier with Levi’s rational-choice fiscal sociology approach, push the approach too far towards an unpersuasive reductionism. Hall and Taylor comment on the ease with which many historical institutionalist studies “could readily be translated into rational choice terms,” but give no apparent thought to the potential for

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44 Peter Hall and Rosemary Taylor, "Political Science and the Four New Institutionalisms," op. cit. p. 4.

45 These problems are particularly evident in work driven by moral agendas, such as studies of racism and patriarchy. Much feminist work rejects even mildly quantitative methods and the concern for clarifying independent and dependent variables as “masculinist”; see Noretta Koertge and Daphne Patai, Professing Feminism: Cautionary Tales from the Strange World of Women’s Studies. New York: Basic Books, 1994.
economistic micro-foundations to restrict the capacity to do nuanced historical studies, whether on intergovernmental fiscal politics or other areas.

*Opting for Eclecticism*

Positions pro and con concerning rational choice mark an expanding, acrimonious divide in the social sciences. But this is not at all novel, as social science has time and again been set astir by loud but indecisive clashes between those armed with highly reductionist paradigms and those equipped with thick descriptions of specific places and the past. In the early part of the present century, for example, institutional economists and their mathematically inclined opponents began their own protracted battle. Stentorian predecessors of their contemporary rational choice cousins, the mathematicians declared that the economic historians were atheoretical. In this case, the mathematicians have largely carried the day, leaving modern economics unmatched among the social sciences in its theoretical elegance and almost haughty detachment from the history and institutions of its terrain of study.

The growing irrelevance of economics as a discipline, due in no small measure to the triumph of its relentlessly micro-level focus, is surely a warning against methodological complacency for other areas in the social sciences. But some academics in such disciplines as political science, sociology, and so
forth appear to regard the challenge from rational choice approaches as akin to an invasion. This perspective encourages a tendency to fire hastily and blindly, as if in the hope that a fusillade of insults will scare the "enemy" off. Yet as I have argued concerning rational choice, as well as Marxian and pluralist approaches, the most academically fruitful way to deal with reductionism is to expose its shortcomings. Rational choice has a host of limitations, and having the opportunity to critique them has strengthened this dissertation's fiscal sociology approach to the politics of intergovernmental finance. Having no particular analytical axe to grind, fiscal sociology shows considerable potential for development by eclectic accretion rather than the rational choice alternative of increasingly ethereal refinement via reduction.

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46 For example, the Presidential Roundtable at the 1997 annual meeting of the Asian Studies Association raised many such concerns about rational choice, but several of the criticisms seemed less than informed as opposed to incendiary.
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