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THE SYSTEM OF GRANTS-IN-AID FOR THE ADJUSTMENT OF LOCAL FINANCE

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“An all-round revision of the taxation system, national and local,” is a problem which has been outstanding in Japan for the past few years. Although a fundamental solution of this problem has had to be deferred temporarily, due to the outbreak of the Sino-Japanese conflict, the matter must be taken up as soon as normal conditions are restored. Insofar as the national taxation system is concerned, a fairly extensive reform has already been effected from the necessity of providing for the necessary expenditures connected with the China affair, and consequently what is yet to be achieved refers chiefly to the revision of the local taxation system, the adoption of grants-in-aid for the adjustment of local

finance especially. The problem of grants-in-aid for the adjustment of local finance has been pending for some years, and its settlement, which would otherwise have been achieved last year, has been put off by the outbreak of hostilities. Nevertheless, it is bound to be taken up in the near future in conjunction with the wholesale revision of the taxation system, both national and local.

The problem of grants-in-aid for the adjustment of local finance stands out conspicuously among the financial issues claiming attention at present, but some other methods have also been suggested for the reform of local finance. It will be recalled that before this issue came to the front, the transfer of the land tax to the local treasuries and the defrayal of the entire compulsory education expenditure out of the national treasury had been strongly urged in many quarters. And the spirit of these proposals ought to be held in as much regard now as then. It is for this reason that, in the present article, I propose to deal, first of all, with various plans for the reform of local finance including these two proposals, then to describe the development of the system of grants-in-aid for the adjustment of local finance, and finally to consider the future of this system.

CHAPTER 1. VARIOUS MEASURES FOR THE REFORM OF LOCAL FINANCE

1. *National finance and local finance*

Japan's national finance is on a war-basis at present, and all financial matters—expenditure, bond issues, taxation, etc.—are administered mainly with the object of meeting the needs of national finance. In the past financial administration, however, local finance, that is, the finance of prefectures, cities, towns, villages and water-utilisation guilds, held an important position commensurate with that of national finance, and care must be taken to see that it does not lose its importance in the future financial ad-

Table No. 1.
Comparison between national and local expenditures.

| Fiscal years | National expenditure* | | Local expenditure** | | National expenditure classified (%) | | |
|--------------|------------------------------|--------------|------------------------------|--------------|-------------------------------------|-----|------|
| | Actual figure (In ¥1,000) | Index number | Actual figure (In ¥1,000) | Index number | Admin-istrative | War | Loan |
| 1891—92 | 83,556 | 100 | 43,881 | 100 | 50 | 28 | 22 |
| 1914—15 | 648,420 | 776 | 327,629 | 747 | 52 | 26 | 22 |
| 1915—16 | 583,269 | 698 | 317,872 | 724 | 48 | 31 | 21 |
| 1916—17 | 590,795 | 707 | 334,606 | 763 | 44 | 36 | 20 |
| 1917—18 | 735,024 | 880 | 387,802 | 884 | 42 | 39 | 19 |
| 1918—19 | 1,017,035 | 1,217 | 504,688 | 1,150 | 51 | 36 | 13 |
| 1919—20 | 1,172,328 | 1,403 | 662,578 | 1,510 | 45 | 46 | 9 |
| 1920—21 | 1,359,978 | 1,628 | 962,872 | 2,194 | 45 | 48 | 7 |
| 1921—22 | 1,489,855 | 1,783 | 1,092,530 | 2,490 | 43 | 49 | 8 |
| 1922—23 | 1,429,689 | 1,711 | 1,309,129 | 2,983 | 50 | 42 | 8 |
| 1923—24 | 1,521,050 | 1,820 | 1,275,107 | 2,906 | 56 | 33 | 11 |
| 1924—25 | 1,625,024 | 1,945 | 1,327,691 | 3,026 | 60 | 28 | 12 |
| 1925—26 | 1,524,988 | 1,825 | 1,429,433 | 3,258 | 56 | 29 | 15 |
| 1926—27 | 1,578,826 | 1,890 | 1,618,097 | 3,687 | 58 | 27 | 15 |
| 1927—28 | 1,765,723 | 2,113 | 2,000,805 | 4,560 | 56 | 28 | 16 |
| 1928—29 | 1,814,855 | 2,172 | 1,924,692 | 4,386 | 55 | 29 | 16 |
| 1929—30 | 1,736,317 | 2,078 | 1,737,783 | 3,896 | 55 | 29 | 16 |
| 1930—31 | 1,557,863 | 1,864 | 1,775,065 | 4,045 | 54 | 28 | 18 |
| 1931—32 | 1,476,875 | 1,768 | 1,646,328 | 3,752 | 55 | 31 | 14 |
| 1932—33 | 1,950,140 | 2,334 | 1,920,685 | 4,377 | 53 | 35 | 12 |
| 1933—34 | 2,254,662 | 2,698 | 2,558,084 | 5,830 | 46 | 39 | 15 |
| 1934—35 | 2,163,003 | 2,589 | 2,266,668 | 5,165 | 40 | 43 | 17 |
| 1935—36 | 2,206,477 | 2,641 | 2,229,444 | 5,081 | 36 | 47 | 17 |
| 1936—37 | 2,317,724 | 2,774 | 1,918,269 | 4,372 | 38 | 46 | 16 |
| 1937—38 | 2,872,135 | 3,437 | 2,078,905 | 4,738 | 37 | 49 | 14 |

* National expenditure represents settled accounts up to 1935, that for 1936 represents the working estimates, and that for 1937 the estimates. It shows the expenditure of the general account only, the expenditure of the special accounts not being included.

** Local expenditure embodies the outlays of prefectures, cities, towns, villages and water-utilisation guilds. It represents the settled accounts up to 1935, that for 1936 and 1937 represents the estimates. Prefectural expenditure represents general account expenditure only, not inclusive of special account expenditure. Municipal, town and village expenditure is the total of general and special account expenditure.

ministration. In order to show the position which local finance occupied in the past, I have compiled Table No. 1, in which the national expenditure is compared with the local expenditure over a number of years.

Taking the figure for 1891 to be the standard (100%), the figure for the national expenditure for 1937 works out at 3,437% and that for the local expenditure at 4,738%. That is to say, the local expenditure has grown more rapidly than the expenditure covered by the general account of the national treasury. Moreover, since about 60 per cent. of the national expenditure is accounted for by war and loan expenditure, local expenditure will be found to be of greater significance than national expenditure, when a comparison is made between them in regard to the outlays for civilian and pacific purposes only.

It would be too hasty to conclude, however, that because local expenditure has expanded at a greater rate, local finance has become more strained than national finance. It must be noted, to begin with, that the national expenditure given in Table No. 1 represents expenditure in the general account only; it does not include expenditure in the special accounts, which number over thirty. Nor does it cover the temporary war expenditure, which forms a special account by itself. The figure in Table No. 1 does not, therefore, embody the entire defrayals out of the national treasury. Secondly, due note must be taken—though this applies chiefly to local expenditure—of the nature of the items of expenditure which have expanded. Roughly, items of expenditure may be classified into two kinds. Items such as the pay of primary school teachers, which, representing expenditure, pure and simple, do not in any way operate to increase revenue, fall under one category, while items such as gas and electric works expenditure, which operate to increase revenue, belong to the other category. If an increase of expenditure occurs in items falling under the latter category, it does not necessarily mean a proportionate increase in tax burden. For these two reasons, the burdens of national and local

Table No. 2.
Comparison between the burden of national taxes and
that of local taxes.

| Fiscal years | National taxes | | | Local taxes | | |
|--------------|------------------------------|--------------|----------------------|--------------------------|--------------|----------------------|
| | Total amount (In ¥ 1,000) | Index number | Amount per household | Total amount (¥1,000) | Index number | Amount per household |
| 1891-92 | 64,507 | 100 | ¥8.263 | 30,045 | 100 | ¥ 3.849 |
| 1914-15 | 343,708 | 533 | 33.563 | 181,238 | 603 | 18.166 |
| 1915-16 | 312,745 | 485 | 30.256 | 178,481 | 594 | 17.428 |
| 1916-17 | 348,673 | 541 | 32.710 | 188,018 | 626 | 18.173 |
| 1917-18 | 430,604 | 668 | 42.075 | 215,297 | 717 | 21.037 |
| 1918-19 | 519,293 | 805 | 49.644 | 268,644 | 895 | 25.681 |
| 1919-20 | 672,386 | 1,042 | 63.542 | 384,050 | 1,278 | 36.293 |
| 1920-21 | 696,257 | 1,079 | 65.795 | 533,347 | 1,775 | 47.527 |
| 1921-22 | 785,852 | 1,218 | 70.028 | 596,292 | 1,985 | 53.136 |
| 1922-23 | 896,407 | 1,390 | 79.879 | 653,278 | 2,174 | 58.214 |
| 1923-24 | 787,203 | 1,220 | 70.148 | 602,028 | 2,004 | 53.646 |
| 1924-25 | 887,238 | 1,375 | 79.062 | 620,656 | 2,066 | 55.307 |
| 1925-26 | 894,809 | 1,387 | 74.559 | 635,972 | 2,117 | 52.992 |
| 1926-27 | 886,999 | 1,375 | 73.908 | 654,322 | 2,178 | 54.521 |
| 1927-28 | 898,673 | 1,393 | 74.804 | 627,886 | 2,090 | 52.318 |
| 1928-29 | 915,909 | 1,420 | 76.317 | 658,233 | 2,191 | 54.847 |
| 1929-30 | 893,505 | 1,385 | 74.450 | 667,546 | 2,222 | 55.622 |
| 1930-31 | 835,041 | 1,294 | 65.721 | 602,899 | 2,007 | 47.450 |
| 1931-32 | 735,504 | 1,140 | 57.887 | 534,027 | 1,777 | 42.030 |
| 1932-33 | 695,837 | 1,079 | 54.765 | 523,590 | 1,743 | 41.208 |
| 1933-34 | 748,566 | 1,160 | 58.915 | 561,857 | 1,870 | 44.220 |
| 1934-35 | 843,183 | 1,307 | 66.362 | 598,664 | 1,993 | 47.117 |
| 1935-36 | 899,899 | 1,395 | 66.662 | 936,927 | 2,120 | 47.182 |
| 1936-37 | 923,302 | 1,431 | 68.395 | 660,580 | 2,199 | 48.934 |
| 1937-38 | 1,250,727 | 1,939 | 92.650 | 707,104 | 2,353 | 52.380 |

taxes have been compared in Table No. 2.

It will be seen from the above table that whereas the national and local taxes amounted to ¥ 64,507,000 and ¥ 30,045,000 respectively in 1891, they stood at ¥ 923,302,000 and ¥ 660,580,000 respectively in 1936, the disparity in amount between the two being thus considerably reduced. The above figure for national taxes—¥ 923,302,000—includes

the revenue from indirect taxes, of which the Customs duties and the *Sake* tax alone total something like ¥400,000,000. When, therefore, the direct national taxes only are compared with the local taxes, the latter show a figure a little larger than the former. It is true that the national taxes have been very much greater in their total amount than the local taxes since the fiscal year 1937—1938, in consequence of the Sino-Japanese conflict, but a survey of the conditions prior to the fiscal year 1937—1938, will convince anybody of the importance of the local taxes.

Inasmuch as the current hostilities will necessarily cause an increase both in war expenditure and in national bond issues, it is inevitable that all sources of revenue should be exploited in order to increase the national finance, with the natural result that local finance will be sacrificed on the altar of national finance both as regards taxation and as regards bond issues. After the termination of the hostilities, however, people will look to the activity of local finance for the successful operation of peace-time undertakings. When account is taken of the size of local expenditure and the incidence of local taxes in the past, as well as of the future of local finance, it is obvious that the question of the reform of local finance calls for a great deal of careful attention.

*2. The transfer of the land tax to the local treasuries
and the defrayal of the entire compulsory education
expenditure out of the national treasury*

The remarkable progress made by Japan during the past fifty years has brought about great changes in the state of local finance. Fifty years ago, prefectures, cities, towns and villages functioned admirably as perfect economic units, but with the subsequent development of the means of communication, changes in the distribution of population and the shifting of economic centres, their *raison d'être* has

necessarily undergone a change. It is due to this change in the general situation that Japanese local finance has reached an impasse under the present system of local government. Another point worthy of note is that Japan's progress has been more on national than on local lines, so that the business of local public bodies has gradually come to take on the aspect of national administration more and more pronouncedly. This accounts for the fact that the expenditure of local public bodies has increased in regard to such items as are concerned with national administration, with the result that the attention of advocates of the reform of local finance is largely directed to the question of how expenditure bearing on national administration should be defrayed in future. Since the compulsory education expenditure is the biggest of the items relative to State administration which, under the present system, burden municipal, town and village finance, it is but natural that this particular item of expenditure should claim the special attention of those who are interested in the problem of the reform of local finance. In spite of the fact that local expenditure is rapidly expanding, practically all fruitful sources of revenue are monopolised by national finance. Herein lies the main cause of the plight of local finance. The growth of the view in favour of the transfer to local authorities of a part of national tax revenue is also attributable to the same cause. Of the various proposals hitherto advanced for the reform of local finance, the following four may be mentioned as the relatively more important.

First, there is a proposal for a radical reform of the local government system. It is argued that as the prefectures, cities, towns and villages, as they are now constituted and organised are hardly calculated to meet the requirements of the day, they should be re-demarcated. In this connection, the redivision or amalgamation of prefectures, cities, towns and villages and the introduction of a special municipal system for big cities are alike suggested, with a view to ensuring the efficient performance of their functions by these local bodies.

The idea is, no doubt, commendable, but when it comes to putting it into practice, supreme difficulties arise. This is especially so with a country of Japan's ceaseless progress. As her constant progress involves constant changes in domestic conditions, the most perfect re-demarcation of local administrative districts will soon be found to be inadequate to meet the new conditions that arise. However, as a powerful Commission is actually studying the ways and means of reforming the local government system, it is to be hoped that good plans will be evolved in this regard, but the fact remains that a new demarcation of the local administrative districts alone would not solve the question of reform.

A second plan is that the Central Government should take direct charge of all businesses pertaining to State administration and that in case any business bearing on State administration is to be committed to the care of local public bodies, the State should bear the expenditure involved in the conduct of such business. But it is admittedly difficult to give a clear definition of State administration business. Even where this is possible, the local public bodies will not relish the idea of having the branches of the Central Government in their midst to transact such business. Nor is it likely that such an arrangement will tend to increase business efficiency. It is, of course, advisable to look into local expenditure concerned with business bearing on State administration, for it will prove beneficial to both national and local finance if this leads to the adjustment of State subsidies. But the reform of local finance cannot be achieved by this means only.

A third plan refers to the transfer of the land tax to the local treasuries. The question of the transfer of the land tax to the local treasuries was taken up for practical discussion, for the first time, when the Temporary Finance and Economic Commission studied it in July, 1922, in its relation to the plan to levy a property tax. Later, the Seiyukai thought fit to include the transfer of the land tax to the local treasuries in its financial programme, and

introduced two Bills—the Municipal, Town and Village Land Tax Bill and the Bill providing for the enforcement of the Municipal, Town and Village Land Tax Law—in the 51st session of the Diet, though these Bills failed to pass. Some time afterwards, the Tanaka Cabinet laid a Bill providing for the abolition of the Land Tax Regulations and sixteen other connected Bills before the 56th session of the Diet, but these measures were shelved by the House of Peers. In view of the specially close interest which local public bodies have in land, the idea of making the land tax a source of revenue for the local public bodies is, no doubt, commendable in principle, but the transfer of the land tax to the local treasuries is open to objection in that it affects the system of national taxation. Moreover, when it is remembered that the centre of gravity of wealth has moved from rural to urban districts, that movable property now forms more important component elements of wealth than immovable property and that the rental value of residential land surpasses that of arable land, it is doubtful whether the stability of local finance can really be attained simply by converting the land tax into the mainstay of local revenue. Although the transfer of the land tax to the local treasuries no longer figures as a controversial political issue, the spirit of this theory, which is to furnish local finance with a stable source of revenue, must be upheld. It may here be mentioned that the national land tax revenue amounted to ¥ 58,000,000 in the fiscal year 1937—1938.

The fourth plan is that the entire expenditure involved in compulsory education should be defrayed out of the national treasury, and this scheme was championed by the Minseito. Inasmuch as the compulsory education expenditure constitutes one of the main items of municipal, town and village expenditure, and especially as the salaries paid to primary school teachers account for no negligible proportion of the ordinary expenditure of the town and village administration, the reform of local finance will, do doubt, be advanced, if ordinary primary school (*jinjo shogakko*)

teachers' salaries are paid out of the national coffers. The subsidy granted by the State to the municipalities, towns and villages so as to bear part of this particular expenditure stood at ¥ 10,000,000 in 1918, while it grew to ¥ 40,000,000 in 1923, to ¥ 70,000,000 in 1926, to ¥ 75,000,000 in 1927 and to ¥ 85,000,000 in 1930. On the other hand, the salaries paid the ordinary primary school teachers totalled ¥ 168,000,000 in 1935. As there has been an yearly increase in this expenditure since, the State will have to disburse another ¥ 90,000,000, if it is to bear the total cost of the pay for these primary school teachers. The Law governing the State subsidy for the municipal, town and village compulsory education expenditure (Law No. 20, promulgated on March 28th, 1923), to which attention may well be directed, contains the following provisions:—

Article 1. Part of the pay-bill for municipal, town and village ordinary primary school teachers shall be defrayed by the national treasury.

Article 2. The amount to be defrayed annually out of the national treasury under the foregoing Article shall not be less than ¥ 85,000,000.

Article 3. Two-thirds of the total amount to be defrayed out of the national treasury, exclusive of the amount to be granted under Article 5, shall go to the cities, towns and villages and the remaining one-third, exclusive of the amount to be granted under Article 4, to the towns and villages. In each case, one half of the amount shall be distributed in proportion to the total number of ordinary primary school teachers on June 1st of the preceding year and the other half in proportion to the number of children attending these schools on the same date.

Article 4. The Government can, pursuant to the provisions of an Imperial Ordinance, increase the grants to such cities as it deems deserving of special consideration for financial or other reasons, within the limits of a figure not exceeding 50 per cent. of the amount to which the cities concerned are entitled under the foregoing Article.

Article 5. The Government can, pursuant to the provisions of an Imperial Ordinance, increase the grants to such towns and villages as it deems deserving of special consideration for financial or other reasons, within the limits of a figure not exceeding one-tenth of the amount defrayed out of the national treasury.

It will thus be seen that although the State subsidy is, as a rule, distributed among the cities, towns and villages in proportion to the number both of the ordinary primary school teachers and of the children attending such schools, cities, towns and villages in financial difficulties are given grants at higher rates. Indeed, some towns and villages are actually receiving grants equivalent to 98 per cent. of the total amount of the salaries which they are paying to their primary school teachers. Such being the case, this State disbursement partakes of the nature not only of a subsidy for the primary school teachers' pay but of a grant-in-aid for the relief of local finance. If, therefore, it is converted into a State subsidy, pure and simple, for the pay of ordinary primary school teachers, by adding another ¥ 90,000,000 to it, the result will be to benefit rich cities, towns and villages more than poor ones. This will not provide a good solution of the problem. Expenditure for compulsory education being State administration expense by its very nature, it stands to reason that ordinary expenses, such as school teachers' salaries, should be a charge on the national treasury, even if extraordinary expenditure, such as the expense of building schools, be left a burden on the cities, towns and villages concerned. This is easier said than done, but as much effort as possible should be made to give effect to the spirit of this theory. The plan to look into the expenditure in which local public bodies are involved in the transaction of business relative to State administration and to increase the State subsidy in the light of the results of this inquiry is good in its way, but the execution of such a plan will not, of itself, solve the problem. Nor can the reform of local finance be achieved either by

the plan to transfer the land tax to the local treasuries—at the hazard of dislocating the system of national taxation—in order to provide local finance with a fresh source of revenue amounting to ¥ 58,000,000, or by the plan to draw another ¥ 90,000,000 from the national treasury with which to subsidise the entire compulsory education expenditure. In such circumstances, the idea was conceived of creating the system of grants-in-aid for financial relief, with the reform of local finance also in view.

CHAPTER 2. THE DEVELOPMENT OF THE SYSTEM OF GRANTS-IN-AID FOR THE ADJUSTMENT OF LOCAL FINANCE

1. *The so-called Home Office plan*

Various measures have been evolved in regard to the reform of local finance, and some of them have been carried out, though not, as yet, with very good results. The adoption of the system of grants-in-aid for the adjustment of local finance was urged, notably by the Local Affairs Bureau of the Home Office, when, some years ago, a disastrous fall in the prices of agricultural and fishery products pressed for the elaboration of some pertinent measures for the relief of farmers and fishermen. But the first advocate of the system was probably Mr. Shigeo Miyoshi, whose article, "On the system of grants-in-aid for the adjustment of finance," appeared in the *Jichi Kenkyu* (Study of Self-Government) in June, 1931.

In August, 1932, an outline of the system advocated by the Local Affairs Bureau of the Home Office was published in the same magazine. The present writer then felt that a revolutionary change was forthcoming in the local finance system. This is what is called the Home Office plan or the Local Affairs Bureau plan. It was along the following lines:—

(a) The total amount of the grants-in-aid and the sources of revenue. The grants-in-aid to be financed by the revenues accruing from the increase in the B-class income tax (by 50

per cent.), the increase in the interest-on-capital tax (by 100 per cent.), the increase in the succession tax (by 50 per cent.) and the creation of a luxury tax (at the rate of 10 per cent. of the proceeds of sales). The revenues from these sources, minus the cost of collection and the business expense, to constitute the total amount of the grants-in-aid. The total amount to be paid out in the initial year to be something like ¥ 57,000,000, a sum which corresponds to about 10 per cent. of the aggregate of the local taxes. This amount expected to increase in consequence of an increase in the succession tax.

(b) The ratio of allotment. One-third of the total amount to go to the prefectures and two-thirds to the cities, towns and villages.

(c) The standard of distribution for the prefectures.

(1) The general grants-in-aid—One-third of the total to be distributed in proportion to the size of population.

(2) The grants-in-aid for the benefit of poor public bodies—Two-thirds of the total amount, minus the grants for special public bodies (3), to be divided into two parts, each of which to be distributed according to the standard specifically fixed.

(3) The grants for special public bodies—Grants to be made at higher rates for special prefectures, provided the total amount of these special grants does not exceed one-fifteenth of the total amount of the grants-in-aid.

(d) The standard of distribution for the cities, towns and villages.

(1) The general grants-in-aid—One-third of the total to be distributed in proportion to the size of population.

(2) The grants-in-aid for the benefit of poor public bodies—Two-thirds of the total amount, minus the grants for special public bodies (3), to be distributed first among the prefectures according to the standard specifically fixed, and then the rest to be distributed among the cities, towns and villages according to the standard specifically fixed.

(3) The grants for special public bodies—Grants to be

made at higher rates for special cities, towns and villages, provided the total amount of these special grants does not exceed one-fifteenth of the total amount of the grants-in-aid.

(e) The uses to which the grants-in-aid are to be put. The grants to be employed for reducing the burden of taxation. The taxes to be reduced to be roughly as follows:—

- | | | |
|----------------------------------|---|--|
| (1) Prefectural taxes | { | (a) Taxes of various kinds levied in excess of legal limits |
| | | (b) House tax, business tax and miscellaneous tax |
| (2) City, town and village taxes | { | (a) Household rate (<i>kosuwari</i>) and the house surtax which is levied as substitute for household rate |
| | | (b) Taxes of various kinds levied in excess of legal limits |
| | | (c) To meet the reduction in the surtax revenues resulting from the reduction of prefectural taxes |

Since the above plan was made public, many other similar plans have been evolved, but it is noticeable that they have all been modelled on the Local Affairs Bureau plan. It is noteworthy that, in this plan, the uses of the grants-in-aid are limited to the reduction of taxes. All other plans equally stress the need for applying the grants to the lightening of the burden of taxation.

2. The two Bills which were passed by the House of Representatives but shelved by the House of Peers

All political parties in the House of Representatives vied with one another in introducing in January, 1934, in the 65th session of the Diet Bills of their own drafting providing for grants-in-aid for the adjustment of local finance, and finally the Grants-in-Aid for the Adjustment of Local Finance Bill, in which were incorporated the Minseito's Local Finance Adjustment Bill, the Seiyukai's Bill for Grants-in-Aid for the

Adjustment of Local Finance and the Kokumin Domei's Bill for the Equalisation of Burden for Agrarian Relief, as the result of a compromise reached among these parties, was passed by the House of Representatives, though it was shelved by the House of Peers.

In the 67th session of the Diet the following year, the Seiyukai and the Kokumin Domei introduced jointly a Temporary Local Finance Adjustment Fund Bill, while the Minseito laid a Local Finance Adjustment Bill before the Diet. The former Bill was passed by the House of Representatives, but it was again shelved by the House of Peers.

Both the Grants-in-Aid for the Adjustment of Local Finance Bill of 1934 and the Temporary Local Finance Adjustment Fund Bill of 1935 were substantially the same in their contents as the so-called Home Office plan. One striking point of contrast between the two Bills was that whereas Article 1 of the former Bill provided simply for the conferment of the grants on the prefectures, cities, towns and villages for the adjustment of local finance, Article 1 of the latter Bill carried a qualifying phrase to the effect that the grants should be allowed "for the time being."

If it is really intended that the system of grants-in-aid should be firmly established, it is hardly proper to prefix the word "temporary" to the name of a Bill or to add the proviso that it should be in force "for the time being." Much less is it proper to attempt to dispose of this important problem without providing definite sources of revenue.

As already noted, these two Bills failed to pass into law because they were shelved by the House of Peers. The measures which were actually put into force later were the temporary subsidy for town and village finance and the temporary subsidy for local finance.

3. *The temporary subsidy for town and village finance and the temporary subsidy for local finance*

With the object of reducing the excessive burden of local taxation, the Law for a temporary State subsidy to cover

town and village primary school expenditure was enacted in 1932. The Law consists of the following Articles:—

Article 1. The amount of money to be duly budgeted shall be defrayed out of the national treasury every year from the fiscal year 1932—1933 to the fiscal year 1935—1936, with the object of subsidising the ordinary expenditure of city, town and village ordinary primary schools.

Article 2. One half of the subsidy mentioned in the foregoing Article, minus the grants mentioned in Article 3, shall be distributed among the towns and villages in proportion to the number of primary school teachers on June 1st of the preceding year and the other half in proportion to the number of children attending such school on the same date.

Article 3. The Government shall specifically add 70 per cent. or less of the subsidy mentioned in Article 1 to the grants for the towns and villages falling under the purview of Article 5 of the Law for the State subsidy for the city, town and village compulsory education expenditure.

The Government can specifically grant a sum not exceeding 0.5 per cent. of the subsidy mentioned in Article 1 to cities falling under the purview of Article 4 of the Law for the State subsidy for the city, town and village compulsory education expenditure.

Article 4. The grants made under the present Law shall be applied to the payment of salaries of primary school teachers.

In cases where the aggregate of the subsidy granted under the present Law and the grants made under the Law for the State subsidy for city, town and village compulsory education expenditure exceeds the total expenditure for the pay of town or village school teachers, the surplus may be applied to items of ordinary expenditure other than the pay of town or village primary school teachers.

This subsidy was paid during the four fiscal years 1932-33, 1933-34, 1934-35 and 1935-36, and in this sense it was a temporary expedient. The amount of the subsidy was ¥ 12,000,000

in the three fiscal years 1932-33, 1933-34 and 1934-35, and ¥ 9,000,000 in the last fiscal year 1935-36. This subsidy was nominally concerned with the city, town and village ordinary primary school expenditure, but as can be seen from Paragraph 2 of Article 4: "In cases where the aggregate of the subsidy granted under the present Law and the grants made under the Law for the State subsidy for the city, town and village compulsory education expenditure exceeds the total expenditure for pay of town or village primary school teachers, the surplus may be applied to items of ordinary expenditure other than the pay of town or village primary school teachers," it partakes more of the nature of a financial relief fund than that of grants for educational purposes.

In 1935, in view of the growth of the popular demand for the reform of local finance, the Okada Cabinet introduced in the 68th session of the Diet a Bill providing for a subsidy for the relief of town and village finance as a temporary emergency measure, in accordance with the "Interim Report of the Commission on the Reform of Local Finance." The Bill fell through due to the collapse of the Okada Cabinet, however, and the Hirota Cabinet, which succeeded it, re-introduced the Bill in the 69th session of the Diet, the requisite expenditure being appropriated in a Supplementary Budget. The Bill was passed. Whereas the temporary State subsidy for town and village primary school expenditure embodied a quasi-financial relief fund, this temporary subsidy for town and village finance was a financial relief fund, pure and simple. Let me now compare this subsidy with the so-called Home Office plan for grants-in-aid.

(a) The total amount of the subsidy and the source of revenue. The total amount was fixed at ¥ 20,000,000, which was defrayed out of the national treasury in the fiscal year 1936-1937 only. Whereas the so-called Home Office plan provided for regular sources of revenue, this subsidy lacked this provision.

(b) Allotment of the subsidy. The subsidy was intended solely for the relief of towns and villages in financial distress.

Its scope of application was narrower as compared with the Home Office plan, which provided for the distribution of the grants among all prefectures, cities, towns and villages.

(c) The uses of the subsidy. As a rule, the subsidy was intended for the purpose of reducing the excessive burden of taxation, but where it was deemed necessary to supplement the temporary subsidy granted in the previous fiscal year for the city, town and village primary school expenditure or where the step was otherwise deemed imperative for financial reasons, part of the money could be applied to other uses with the permission of the Government offices in control. Here, it differed from the Home Office plan, which confined the use of the grants to the reduction of the burden of taxation.

A fundamental reform of finance, to which the nation had long been looking forward, was expected to be carried out by the Hirota Cabinet in 1937, but in consequence of the fall of the Cabinet, the plan fell through. The Hayashi Cabinet, which succeeded the Hirota Cabinet put a temporary system of subsidy for local finance through the 70th session of the Diet as a provisional arrangement. The amount of this subsidy was originally fixed at ¥ 70,000,000, but it was increased to ¥ 100,000,000, the additional sum of ¥ 30,000,000 being appropriated in a Supplementary Budget. Let me explain the main points of this subsidy.

(a) The total amount of the subsidy and the source of revenue. The subsidy was fixed at ¥ 100,000,000. As its disbursement was confined to the fiscal year 1937—1938, no regular source of revenue was provided for.

(b) The ratio of distribution to prefectures, cities, towns and villages. The amount allotted to prefectures was ¥ 27,500,000 (a quarter of the total) and that allotted to cities, towns and villages ¥ 72,500,000 (three-quarters of the total). This subsidy differed from the temporary subsidy for town and village finance in that it was distributed among the prefectures as well.

(c) The standard of distribution for the prefectures.

The sum of ¥ 7,500,000 was distributed in inverse proportion to the tax-bearing capacity of prefectures, while ¥ 20,000,000 was distributed in direct proportion to the amounts required by prefectures in reducing taxes. The subsidy was, however, either withheld from or given at reduced rates to the prefectures which conformed with certain specified standards.

(d) The standard of distribution for the cities, towns and villages.

(1) The general subsidy (¥ 67,500,000)—Of this sum, ¥ 32,500,000 was distributed among the cities (except those with a population of over 50,000), towns and villages in inverse proportion to their tax-bearing capacity, while ¥ 35,000,000 was distributed in proportion to the amount of the household rate collected in excess of legal limits. The cities, towns and villages which conformed with certain specified standards either received no subsidy at all or got it at reduced rates.

(2) The special subsidy (¥ 5,000,000)—This sum was distributed among the seven islands of Idzu, the Bonins and the cities, towns and villages which, due to special circumstances, were overburdened with taxation.

(e) The uses of the subsidy (in units of ¥ 1,000).

| Subsidy for prefectures | 27,500 | Subsidy for cities, towns and villages | 72,500 |
|--|--------|--|--------|
| (a) Reduction of taxes | | (a) Reduction of taxes | |
| Land surtax | 13,473 | Household rate | 58,167 |
| Special land tax | 3,242 | Miscellaneous surtax | 6,517 |
| Miscellaneous tax | 8,989 | House surtax | 556 |
| House tax | 914 | Land surtax | 45 |
| Others | 7 | Special land surtax | 19 |
| Total | 26,626 | Business surtax | 8 |
| (b) Making up revenue deficit | 362 | Others | 58 |
| (c) Expediting the redemption of loans | 510 | Total | 65,374 |
| | | (b) Making up revenue deficit | 116 |
| | | (c) Expediting the redemption of loans | 13 |
| | | (d) Uses undefined | 6,996 |

The Konoe Cabinet set up a Taxation System Commission with a view to carrying out a radical reform of the taxation system, national and local, but due to the outbreak of the Sino-Japanese conflict, it had to suspend this plan. To meet the resulting situation, it secured the approval of the 73rd session of the Diet this year for a measure to maintain for the current fiscal year the temporary subsidy for local finance, with the amount of the subsidy increased to ¥130,000,000.

4. The draft Bill providing for grants-in-aid for the adjustment of local finance and its future

The system of grants-in-aid for the adjustment of local finance has aroused much interest in many quarters since the so-called Home Office plan was published. The political parties introduced their Bills in this connection, but none was put through the Diet, and so far only provisional expedients in the shape of the temporary subsidy for the city, town and village primary school expenditure, the temporary subsidy for town and village finance and the temporary subsidy for the relief of local finance have been put into force.

During the Hirota regime in 1937, a Bill providing for a permanent system of grants-in-aid for the adjustment of local finance was drafted by Dr. Baba, the then Finance Minister, Mr. Yamada, Director of the Taxation Bureau, and Mr. Matsukuma, Chief of the National Taxation Section, with the collaboration of Mr. Ushio, the Home Minister, and Mr. Omura, Director of the Local Affairs Bureau, but unfortunately circumstances prevented it from being introduced in the Diet. However, it is advisable that any permanent plan for the adjustment of local finance that may be elaborated hereafter should follow the main lines of this draft Bill.

Inasmuch as a grant-in-aid for the adjustment of local finance is bound up with a fundamental reform of the national and local taxation systems, I shall review the or-

ganisation of national finance in explaining the contents of Dr. Baba's financial reform plan. Classified with reference to the ordinary revenue, Japanese finance consists of two systems, national taxation and local taxation, but under Dr. Baba's plan, it was divided into three systems, namely, national taxes, local taxes and grants for the relief of local finance.

Let me first examine national taxation. The national taxes on profit consist of the land tax, the business profit tax and the tax on interest on capital; the house tax not being included in the system. Under Dr. Baba's plan, the house tax was converted into a national tax so as to complete the system of national taxes on profit. It provided for the creation of a special tax on bonds in foreign currencies. In Japan, there is no general property tax, though there is a special property tax in the shape of the succession tax. In his plan, Dr. Baba attempted to create a property tax as an emergency source of revenue. Again, in regard to national "circulation" taxes, property "circulation" taxation is in its infancy in Japan, though prices "circulation" taxation is well developed. For this reason, he attempted to create a transactions tax and a tax on the transfer of negotiable instruments as emergency sources of revenue. The projected gasoline tax was based on the fuel policy. Of these projected revisions, the transfer of the house tax to the national treasury was destined to affect local finance directly.

The local taxes can be divided into surtaxes and independent taxes. Under Dr. Baba's plan, it was so arranged that prefectures alone could levy the income surtax, the rate being fixed at 10 per cent. (as provision was also made for the collection of an income surtax of 20 per cent., to be devoted to the fund for the adjustment of local finance, the income surtax totalled 30 per cent.). The house, the land, and the business surtaxes were fixed at 130 per cent. of the principal taxes (70 per cent. for the prefectures and 60 per cent. for the cities, towns and villages). In this way, it was intended to put an end to the existing anomalous state of

affairs, in which the imposition of surtaxes in excess of legal limits is the rule rather than an exception. Of the independent taxes, the household rate was to be abolished altogether and the miscellaneous tax reformed.

The system of grants-in-aid provided for in Dr. Baba's plan was quite epoch-making in its nature. It was proposed that inequality in prefectural finance should be adjusted with the money to be provided by an income surtax of 20 per cent., by an interest on capital tax and by a special tax on bonds in foreign currencies, while inequality in city, town and village finance was intended to be adjusted with the revenues from the land, the house and the business profit taxes. It was so arranged that both the land tax and the house tax should be turned over to the districts in which they had been collected. This plan is particularly interesting in that it combines the idea of the transfer of the house tax to the national treasury and that of the transfer of the land tax to the local treasuries.

Lastly, under this plan, of the total expenditure for the pay of city, town and village primary school teachers, ¥85,000,000 was to be borne by the national treasury and the remainder by the prefectures, so that the cities, towns and villages might be relieved entirely of the burden of this expenditure. The value of this method lies in the fact that the State subsidy for the compulsory education expenditure, having been divested of the collateral object of the adjustment of local finance, was included in the system of grants for the adjustment of local finance, with its object confined to the payment of the compulsory education expenditure. Thus, through the adoption of this plan, the long-outstanding issue of the defrayal of the entire compulsory education expenditure was to be solved, though in a somewhat altered form.

Let me now summarise the contents of the fund for the adjustment of local finance.

(a) The total amount of the fund and the source of revenue. The total annual amount to be ¥140,000,000 each

for the prefectures and for the cities, towns and villages. The revenues from the tax on interest on capital, the special tax on bonds in foreign currencies and the income surtax to be employed as a fund for the adjustment of prefectural finance, while the revenues from the land tax, the house tax and the business profit tax to be used as a fund for the adjustment of city, town and village finance.

(b) The fund for the adjustment of prefectural finance.

(1) A-class adjustment fund — One half of the budgeted fund for the adjustment of prefectural finance.

(2) B-class adjustment fund — The other half of the budgeted fund for the adjustment of prefectural finance.

(c) The fund for the adjustment of city, town and village finance.

(1) A-class adjustment fund — Land tax and house tax (in accordance with the principle of returning tax revenues to the districts in which they have been collected.).

(2) B-class adjustment fund — Consisting of three kinds of taxes including the business profit tax.

CHAPTER 3. THE FUTURE OF THE SYSTEM OF GRANTS-IN-AID FOR THE ADJUSTMENT OF LOCAL FINANCE

1. *The development of the State subsidy system*

Of the various measures hitherto evolved for the reform of local finance, the one for the transfer of the land tax to the local treasuries and that for the defrayal of the entire compulsory education expenditure out of the national treasury used to claim a particularly large share of public attention, but, for various reasons, these measures have been found impracticable. At the moment, the plan of grants-in-aid for the adjustment of local finance stands the best chance of adoption.

It is a phenomenon common to all countries that, what with the expansion of local expenditure and the scarcity of the sources of local revenue, there exists unfairness in the

incidence of financial burdens. The only way out of the difficulty is the creation of a system of State grants for the relief of local finance, side by side with the existing system of national taxes and local taxes. This State subsidy will serve as a grant-in-aid designed to equalise the burden of taxation between rich and poor districts.

In Table No. 3, the State subsidies for financial relief and subsidies for quasi-financial relief are compared.

Table No. 3.

Comparison of State subsidies for financial relief and subsidies for quasi-financial relief. (in units of ¥ 1,000,000).

| Fiscal years | Ordinary expenditure | Extraordinary expenditure | | | Total |
|--------------|---|---|--|---|-------|
| | Subsidy for pay of primary school teachers (Education Department) | Temporary subsidy for primary school expenditure (Education Department) | Temporary subsidy for town & village finance (Home Office) | Temporary subsidy for local finance (Home Office) | |
| 1921-22 | 10 | — | — | — | 10 |
| 1922-23 | 10 | — | — | — | 10 |
| 1923-24 | 40 | — | — | — | 40 |
| 1924-25 | 40 | — | — | — | 40 |
| 1925-26 | 40 | — | — | — | 40 |
| 1926-27 | 70 | — | — | — | 70 |
| 1927-28 | 75 | — | — | — | 75 |
| 1928-29 | 75 | — | — | — | 75 |
| 1929-30 | 75 | — | — | — | 75 |
| 1930-31 | 85 | — | — | — | 85 |
| 1931-32 | 85 | — | — | — | 85 |
| 1932-33 | 85 | 12 | — | — | 97 |
| 1933-34 | 85 | 12 | — | — | 97 |
| 1934-35 | 85 | 12 | — | — | 97 |
| 1935-36 | 85 | 9 | — | — | 94 |
| 1936-37 | 85 | — | 20 | — | 105 |
| 1937-38 | 85 | — | — | 100 | 185 |
| 1938-39 | 85 | — | — | 130 | 215 |

The temporary subsidy for town and village finance and the temporary subsidy for local finance in Table No. 3 are the grants for the relief of local finance, pure and simple, while the State subsidy for the pay of primary school teachers and the temporary subsidy for primary school expenditure are at once subsidies for primary school educa-

tion and a sort of grant for the relief of local finance. For this reason, I have called the latter subsidies for quasi-financial relief. There are many points calling for attention in connection with the problem of increasing the subsidies for financial relief and the subsidies for quasi-financial relief, but when it is remembered that these grants have yearly increased until from ¥10,000,000 in 1921 they had grown to ¥185,000,000 in 1937 and to ¥215,000,000 in 1938, it is imperative that some pertinent measures should be taken to solve this problem properly.

*2. The all-round reform of the taxation system,
national and local*

The reform of local finance must be effected by a combination of various methods. It cannot be achieved by a single measure, no matter how excellent that measure may be. That is to say, the reform of the local government system, the adjustment of subsidies for local finance, the settlement of the problem of the compulsory education expenditure, the supply of new sources of revenue to local public bodies, as well as other methods, must be adopted concurrently, but the final solution will, after all, largely depend on the adoption of the system of grants-in-aid for the adjustment of local finance.

The present writer is highly dissatisfied with the manner in which the Government has hitherto attempted to solve this problem, though he is not blind to the adverse financial circumstances which prevented the authorities from dealing with it in a decisive manner. The educational subsidy was created all right, but it was vitiated by the element of financial relief which unwarrantedly was allowed to enter into its composition, while the term of operation for a subsidy for financial relief, originally fixed at a single fiscal year, was extended without providing definite sources of revenue. Again, on one occasion, the Government, under the pressure of the Diet's demand, revised its plan and precipitately

increased the amount of the subsidy by ¥30,000,000. If this important problem is handled in this hazard manner hereafter, it is to be feared that the relation between national and local finance will never be adequately adjusted. The present writer does not necessarily insist on the adoption of Dr. Baba's plan in its entirety, but he does maintain that if a system of grants-in-aid for the adjustment of local finance is to be firmly established at all, it is imperative that adequate sources of revenue should be provided and that the plan worked out should be such as to cover the transfer of the house tax to the national treasury, the transfer of the land tax to the local treasuries and the defrayal of the entire compulsory education expenditure by the national treasury.

Fifty years have already elapsed since the local government system was introduced in this country, and the country has made considerable progress in the interval. It is, indeed, a matter for genuine satisfaction that Japan's enormous strength is being manifested in the present Sino-Japanese hostilities. It is sincerely to be hoped that a really adequate plan for the reform of local finance may be both drawn up and implemented at the present opportunity.