

**Minister's Summary by Minister Ota****23rd Meeting (October 24, 2006)**

- (1) On the areas of drastic reform
- (2) Intensive deliberation (1): Local reform

Hiroko Ota here. Today, the Council on Economic and Fiscal Policy (CEFP) held its 23rd meeting of the year, and we discussed the areas of drastic reform to be debated from now, and the decentralization reform as the first time agenda of intensive deliberations.

On the areas of drastic reform, expert members gave presentations based on their paper. In the last CEFP meeting, we talked about regarding the next five years as the transitional period for a new growing economy and the first two years as a takeoff period. Today, the priority agenda to be examined for this takeoff period was set. It is mentioned that intensive deliberations to be conducted from now on should give priority to items with high urgency. During the explanation of the issue, an expert member noted that, although the regulatory reform is not listed as an individual reform in the paper, it is an extremely important reform which can serve as a common thread for the whole.

The member added that it is necessary to promote discussions by establishing a research committee under the CEFP.

Then, Mr. Amari, Minister of Economy, Trade and Industry, made a statement in line with his paper to the effect that the growth strategy is important as the basic premise for expenditure and revenue reform.

A free discussion touched on the proposal in the expert members' paper requesting "examining a system together to keep the natural revenue growth from being spent for easygoing expenditure increase." There were remarks that even if natural revenue growth happens, it is necessary to determine whether it is temporary or permanent before, for example, we connect it with expenditure increase, and that therefore, revenue growth of a temporary nature is still in uncertainty. Additionally, a view was expressed about the necessity to defend the framework of expenditure since the budgetary ceiling has already been indicated. Furthermore, there was a statement that this revitalizing

economy and financial reconstruction are compatible.

At the same time, the issue of government reform described in the expert members' paper states, "the reform of government assets and debts management (to be practiced based on the Basic Policies, the existing research committee to be reorganized)." On this matter, the Basic Policies 2006 states, "that the research committee on the reform of government assets and debts management should be reorganized by adding expert members in fields such as finance from private sectors." So, I said that I would like to proceed with required preparations immediately.

On government assets and debts management, there was an opinion that the viewpoint of maximizing the assets would be important besides its simple selling.

The idea is that we can consider utilizing government assets in a way so that revenue can be created to a maximum extent.

The Prime Minister made the following statement:

It is necessary for the government to make effective use of its assets, utilize the wisdom of private sectors and make the reform as appealing as possible.

As for decentralization reform, Mr. Suga, Minister of Internal Affairs and Communications, made a proposal based on his paper, followed by expert members. There were supplemental remarks about the new comprehensive decentralization law aimed to be enacted over the next three years. They said rather than doing nothing for discussions on subsidies and transfer of tax sources until the enactment, we should conduct thorough debate on subsidies reform, transfer of tax sources and the expansion of new local allocation tax during the three years, and that subsidies reform and transfer of tax sources should be implemented step by step. Then, Mr. Omi, Minister of Finance, and Mr. Amari, Minister of Economy, Trade and Industry, made their proposals. Here, concerns were raised about the possible expansion of disparity among municipalities as decentralization is promoted, and the necessity for a system to minimize the expansion was suggested.

Specifically, if the ratio for tax revenues is set at one-to-one by promoting transfer of tax sources, gaps will widen between local areas that can increase tax revenues and the ones that cannot. It was argued that it is not desirable if the disparity between Tokyo and other areas increases in the name of decentralization, and that the system leading to a balanced increase of tax revenue is required.

Opinions were expressed, for example, that the above system should be considered with enterprise tax on corporations since the difference in tax revenue varies from region to region, and that a new system such as local consumption tax may need to be examined. Thus, it was discussed that full examination should be given on the method of transferring tax sources.

Increasing the number of municipalities that require no local allocation tax by transfer of tax sources is mentioned in the papers of both Mr. Suga and expert members. Transfer of tax sources will also increase tax revenues of municipalities which do not require allocation tax, but under the present system, once tax sources enter into the hands of those municipalities, the sources can no longer be taken away. Therefore, although the disparity among the municipalities that receive allocation tax will be narrowed, those with no allocation tax requirement will remain out of the system to correct the disparity. There was an opinion that an increase of municipalities that do not depend on allocation tax might mean reducing disparity will become impracticable.

To this, there was again an opinion that increasing municipalities which do not receive allocation tax is still a very important key for decentralization, and that we need to examine a system to prevent large expansion of disparity.

As a similar issue, the paper of expert members proposed that the ratio of reserved revenues should be raised. When calculating the standard financial revenues for allocation tax, 25% is left at municipalities and the remaining portion is included in the standard financial revenue. Without reserved revenues, local allocation tax will decrease by just that much, even if municipalities make efforts to increase their tax revenues. We still have a reserved revenues ratio of 25%, but the paper proposes to raise the percentage as an incentive for municipalities to continue such efforts. To this, concern was expressed that increasing the ratio of reserved revenues might cause the expansion of disparity, though the purpose itself is good. Briefly, intensive discussions were made on a support system of providing an incentive for the municipalities that are doing their best and on establishing a system to prevent the support from widening gaps.

Another issue addressed in the discussion was a “regional governments system (doshu-sei)”. Several members pointed out that the present system cannot be maintained forever and that the “doshu-sei” should be given serious discussions from a long-term perspective. Discussions were made that the solid handling of the issue is required under the Prime Minister's leadership by limiting the time for its realization. It was also pointed out that, in doing so, the so-called “sorting philosophy,” or sorting what the central government should do and what should be entrusted to the regional governments would be required.

If I may make one more point, one of the expert members’ proposals is aimed at full liberalization of the municipal bonds market. The proposal was met with an opinion that full liberalization of the municipal bonds market provides a system which allows the market to evaluate the credit of local governments, and that this is the final goal of decentralization, and how much this will be realized will serve as a barometer of decentralization.

Also, municipalities are currently required to pay a contribution for public works under the central government, so if municipal bonds are completely liberalized, municipalities with weak financial capability or disability to issue municipal bonds cannot afford to bear burden, even for their public works. There were discussions that several conditions should be improved in the liberalization.

As for the areas of drastic reform, the expert members’ paper includes the phrase, the “effort for regional revitalization led by private sectors.” We had some discussions that the idea of promoting private sectors’ initiative should not be forgotten, and that it will be important to change the industrial structure and create a mechanism of private sectors initiative.

I have this as my summary: the CEFPP meeting could establish a rough consensus on establishing the comprehensive decentralization law in three years and on expanding a new type of allocation tax. It was also agreed to enact legislation for local government fiscal rehabilitation within two years.

At the same time, I would like to carry over into future discussion ideas about setting the ratio for tax revenues at one-to-one by transfer of tax sources, and considering a system to prevent increase of reserved revenues, and municipalities which do not

require allocation tax from leading to the expansion of disparity.

The Prime Minister made the following statement.

In the future intensive deliberations on the areas of drastic reform, I would like the CEF to have more substantial discussions with related ministers. The result of discussions will be put into the Basic Principles of FY2007 Budget Formulation to be established at the end of November and the new medium-term policy in January. For this purpose, in-depth discussions are requested.

Decentralization is quite important because its promotion will lead to the administrative reform of local governments and this will help bring about vitalization.

To start with, the law for the promotion of decentralization reform should be enacted immediately. I request that an effective plan for the promotion of decentralization reform be established under a strong framework of examination. To promote full-fledged decentralization, I would like to submit new comprehensive decentralization bill within three years. This will be the prerequisite and an important step for the “doshu-sei”.

The “doshu-sei” has already been indicated in the manifesto and I will resolutely effort to create the system. The “doshu-sei” will vary according to what authority and responsibility will be transferred from the central government to regions, so we should promote discussions while clarifying the image about what authority and responsibility is to be transferred.

Discussions on the comprehensive decentralization bill will be an important step for the “doshu-sei” as well, so rather than thinking that discussions on the comprehensive bill are delayed due to a lumbering “doshu-sei”, we need to steadily promote discussions on both the comprehensive bill and “doshu-sei”.

For local financial reform, allocation tax, review of tax items and allocation of tax sources, subsidies reform, and municipal bonds reform should all not be left out.

I request that the CEF conduct thorough discussions on all four issues and clarify the path towards such reforms in the new medium-term policy.

Regarding the FY2007 budget, I request that expenditure reduction including unsubsidized ordinary construction expenses be thorough, based on the Basic Policies 2006.

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