

## BUDGETS AND THE BUDGETARY PROCESS IN JAPAN

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### *Abstract*

Government fiscal activity can be reported through the budget to the nation. Governments perform a number of functions. Public expenditures and taxes are used to stabilize the economy; that is, when private demand is weak, expenditures may be increased or taxes adjusted downward or both. Even if stabilization goals are satisfied, the government would have to fulfill other roles, such as resource allocation and income distribution in the economy. These roles represent themselves in the provision of certain public goods and services to society at large or to specific individuals separately. Given the multiple roles the public sector performs in the economy, how can we judge the allocation or assignment of these roles in a framework of multi-level government? Also, how can we understand the actual performance of government in the past and present? All of these can be conveyed via the budgets and the budgetary process. Each country has historically developed its own unique system of budget. It is difficult to look for any resemblance from one country's budget to another.

The budget system serves many functions to execute those roles mentioned above. Main tasks of the budgets are to control government fiscal activities, to review previous actions and to identify future government programs. In order to clarify these roles and functions assigned to the government, we must explore carefully an entire system of budgets and in turn the fiscal structure in the public sector.

This paper starts with an outline of Japan's budgetary system with special reference to alternative concepts and uses under the present system. Then it describes the budgetary process and procedures which is sometimes called "budget cycles".

### *I. Alternative Concepts and uses of the Budgets*

#### **1. The Entire System of Japan's Budget**

In Japan, there is no counterpart concept of the "unified budget" or consolidated budget in the US (see A. F. Otto 1993 ch. 3). Each budget is independent of other budgets, and is not consolidated in any unified system. At the same time, the budget system has traditionally been based on a narrower scope, not consolidated. In order to clarify the alternative concepts of

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fiscal deficits used for the analysis of budgetary policy, we must begin with the discussion of the budget system. In Japan, the government sector is stratified mainly into two levels; the national and local governments, each one having some responsibility for a particular set of public functions. Each level of governments has its own budget system, which is composed of more or less similar accounts.

Figure 1 illustrates the whole budget system, covering the entire scope of government. The national government budget contains *the general account, special accounts and the budgets of government-affiliated agencies and public corporations*. Among them, *the general account* is the most fundamental budget. In fact, almost all national tax revenues except the local transfer tax belong to *the general account*, as well as revenues of national bond issues. These revenues are appropriated to such expenditure items as is listed in Figure 1, but most of them are transfers and grants to various special accounts and to local governments. A few outlays are directly paid to the private sector from *the general account*, excluding wages and salaries of government employees.

*The general account* of the national government can greatly affect the entire system of the budget including that of local governments, although it reflects only a part of the whole budgetary system. When we simply say “budget”, it often means the *general account budget*.

*The special accounts* are established when the national government needs to manage flows of specific funds to carry out specific government activities. For instance, such activities as government enterprises, insurance, loans, etc., are managed by one of the related special accounts. Each special account has its own specific revenue source, such as contribution, charge, interests and borrowing. In addition to these revenues, transfers from *the general account* is of great importance in operating the special accounts for their own functions.

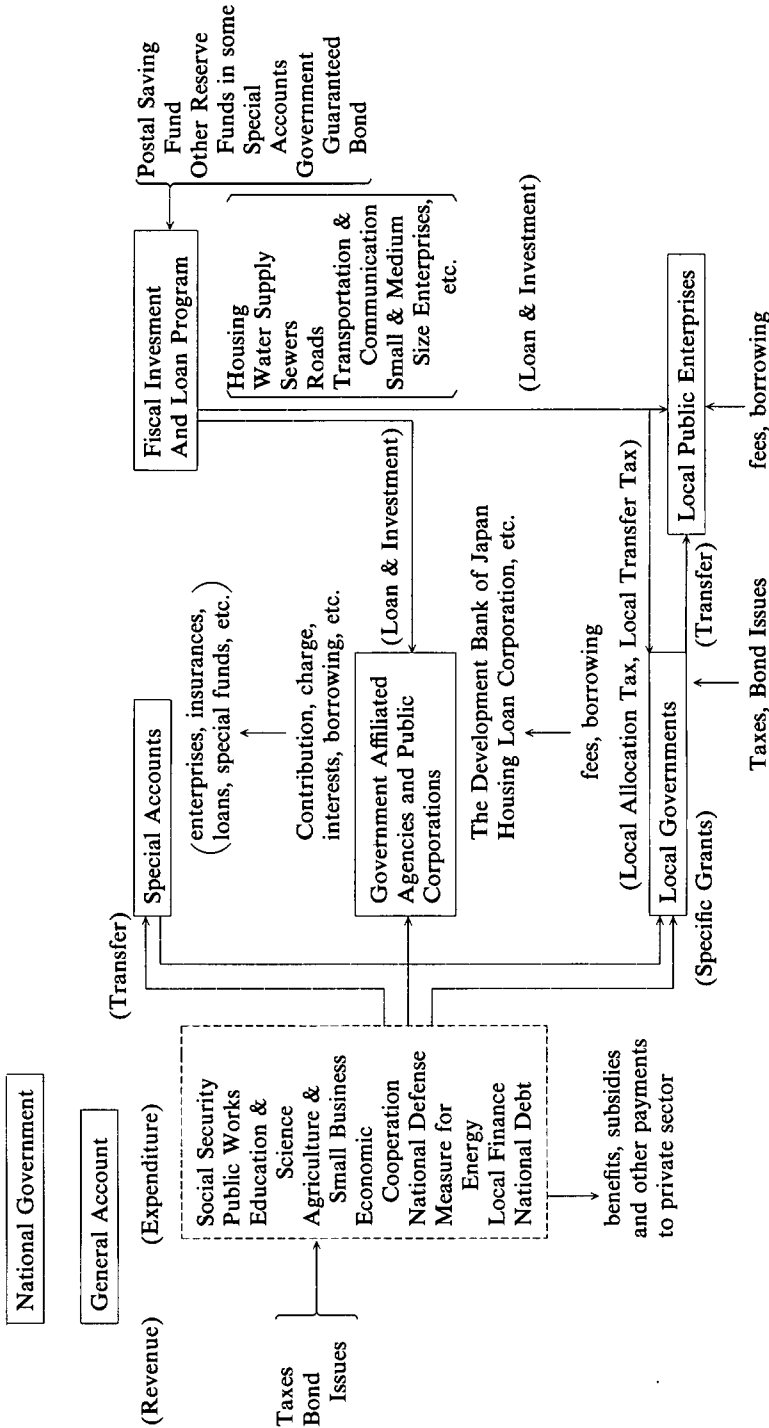
*Government-affiliated agencies* that are granted special legal status from the government also have their own budgets. The number of government-affiliated agencies are 11, including the Development Bank of Japan, Housing Loan Corporation and so on. Since their activities are closely related to government policies, their budgets are included as a part of the national budget system. Thus, they must be submitted to the Diet for approval together with other budgets. Furthermore, there are a number of public corporations, mainly consisting of the Urban Development and Housing Corporation, the Japan Highway Corporation and the like.

Similarly, special note should be paid to the function of the Fiscal Investment and Loan Program (FILP). This is not a budget item, but a program of various investments and loans used by the national government. Mainly financed by the postal saving and public pension funds, loans are made to the activities of housing, water supply, roads and so on. The budget system of each local government is also constituted by both the ordinary accounts and the public enterprise accounts. At the sub-national level, each is relevant to general administration and enterprise activities.

## 2. The National Budget Concept

Among three different budgets, of most importance is no doubt *the general account* which is the basic account of the government. The expenditure side of *the general account* contains major government programmes of social security, public works, defense, education and the like, as listed in Figure 1. On the other hand, all national taxes are included in the revenue of *the general account*, as noted before, except earmarked taxes appropriated to certain special

FIGURE 1. A BIRD-EYE SKETCH OF JAPAN'S BUDGETARY SYSTEM



Source: Ministry of Finance, *The Budget in Brief*, 1985.

accounts.

*The general account* budget (hereafter simply referred to as the general account) has two basic principles for fiscal actions. First of all, every item of public expenditures or revenues must be represented in the budget for each fiscal year (from April 1 to March 31). The expenditures for each fiscal year must basically be financed by revenues in that year except carried-over expenses, continued expenses, contract authorization, etc.. This principle is usually called the "single-year budget principle", in which each fiscal year should be treated independently of another fiscal year. This is to be contrasted with the multiple-year budget in the US. Behind this single-year treatment, the revenue side of the budget are defined, including national bonds in addition to taxes. Thus, the total amount of revenues in the budget is constantly equivalent to expenditures in each fiscal year.

Second, certain limit is set in the budget when national bonds are issued as a supplemental revenue source to make up for shortfalls of taxes. In principle, the total amount of bond floatings must be restricted within the limit of issuing construction bonds that are appropriated for capital expenditures in the current budget. This is the so-called principle of "construction bonds". Of course, another form of "debt-covering bonds" can be issued by a special authorization law when revenue shortages are too enormous to be covered only by construction bonds. Obviously, these two budgetary principles in Japan are different from those of many other advanced countries, presenting its unique features in the budgetary system.

Shifting our attention to other types of budgets, to begin with, let us explore in more detail what *the special account budgets* look like. When the government needs to undertake special projects, to control specific funds, and to perform specific function separate from the general fiscal activity, the special accounts might be more effective for administering their related budget presentations. Thus, *the special account budgets* are established by legislation for this purpose on the basis of non-unified concept. Table 1 tabulates the current system of 38 special accounts in 1995, classified into seven sub-groups. Each special account basically has its distinctive source of revenue like social insurance contributions, interest receipts from loans, revenues from government enterprises and so on. For instance, the insurance special accounts which consist of the largest group are established for handling the benefits and contributions in social insurance, reinsurance and pensions financially supported by tax revenues of *the general account*. Main tasks for other special accounts are those as presented in Table 1.

In general, both *the general and special account budgets* comprise the on-budget activity as the national budget. On the other hand, the government has so far extended its functions beyond the on-budget scope of general activities to perform them with greater flexibility and efficiency in view of management and accounting, separate from *the general and specific accounts* mentioned above. Therefore, *government-affiliated agencies* were established under special laws as the so-called "special corporation" in the form of a corporate style of management. All of them are fully capitalized by the government, and as of 1996 there are eleven special corporations, consisting of nine public finance corporations and two banks, as noted above. Since they function in relation to government fiscal activity, their budgets must be approved together with other budgets by the Diet. Also, the *government-affiliated agencies* are deeply involved in the Fiscal Investment and Loan Program.

When we analyze government behaviors or define fiscal deficits, the scope of *the general account* is quite commonly used in Japan [see. for general discussion, Ishi (1986)]. For one thing, *the general account* can be thought of as representing the entire picture of Japan's fiscal

TABLE 1. THE SYSTEM OF SPECIAL ACCOUNTS

Type	Number	Explanation	Examples
The enterprise special accounts	5	To manage specific enterprises that the government administers.	<ul style="list-style-type: none"> <li>• Mint Bureau</li> <li>• Printing Bureau</li> <li>• Postal Service</li> </ul>
The insurance special accounts	11	Special insurance, reinsurance, and social insurance that are difficult for the private sector to provide (A) as well as insurance plans comparable to those provided by private insurance companies (B)	(A) <ul style="list-style-type: none"> <li>• Welfare Insurance</li> <li>• National Insurance</li> <li>• Labour Insurance</li> </ul> (B) <ul style="list-style-type: none"> <li>• Postal Life Insurance</li> <li>• Forest Insurance</li> </ul>
The special accounts for public investment	5	To conduct specific public works.	<ul style="list-style-type: none"> <li>• Port Improvement</li> <li>• Road Improvement</li> <li>• Flood Control</li> </ul>
The special accounts for administrative business	9	To manage administrative business except for insurance, public works and loan.	<ul style="list-style-type: none"> <li>• National schools</li> <li>• National hospitals</li> <li>• Foodstuff (especially rice) Control</li> </ul>
The special accounts for loans	2	To administer the loan program to the public corporations for specific purposes.	<ul style="list-style-type: none"> <li>• Industrial Investment</li> <li>• Urban Development Loan</li> </ul>
The special accounts for fund management	2	To manage public funds established for specific purposes.	<ul style="list-style-type: none"> <li>• Trust Funds Bureau Fund</li> <li>• Foreign Exchange Fund (for sales and purchases of foreign exchange)</li> </ul>
The consolidated funds special accounts	4	To consolidate the revenues and expenditures for specific purposes so as to make their accounting clear.	<ul style="list-style-type: none"> <li>• National Debt Consolidation Fund</li> <li>• Local Allocation and Local Transfer Tax</li> </ul>

activities, although it merely occupies the narrowest scope in the public sector. The other is that fiscal data are much more abundant and available to us than any other budgets. Ideally, like the US, the unified budget should be employed for budget presentation of the national government, combining the general account budget and other two budgets.

Since such a unified budget has not been prepared for our analysis, we have to rely on the budget concept of *the general account*. Apparently, we must take careful note of the conceptual discrepancy of budget between Japan and other countries. For example, social security contributions<sup>1</sup> (i.e., payroll tax in the US) are not included in *general account* revenues. As was seen in Figure 1, only transfers to social insurance special accounts appear on the expenditure

<sup>1</sup> The social insurance system in Japan contains programs in relation to health insurance, public pensions and unemployment compensation. The system is so complicated that it is a bit hard to explain briefly the mechanism of each program. For instance, in the case of public pensions, different groups of employees belong to different pension schemes; that is, employees of private companies belong to the Employees' Pension (*Kosei Nenkin*), government employees to the Mutual Aid Association Pension (*Kyosai Nenkin*) and the self-employed to the National Pension (*Kokumin Nenkin*).

budget of *the general account*. Consequently, *the general account* deficit is different from fiscal deficit in the US federal budget in which total expenditures and revenues of social security programs are included. To seek a US counterpart figure, we must include total outlays and revenues of social insurance special accounts.

### 3. Local Public Finance Programme

Local governments in Japan have equally their own budgetary system. On the sub-national level, Japan's local governments are composed of the so-called two-tier system; i.e., prefectures and municipalities. The total number in 1994 was 3282, consisting of 47 prefectures and 3235 municipalities (i.e., 663 cities and 2572 towns-villages).

Each local government has its own budgeting account which compiles the revenues and expenditures necessary for its activities. There are two types of accounts. One is *the ordinary account* for general administrative services, such as education, fire, police, and so on. The other is *the public enterprise account* for such services as housing, sewerage, and public transport. This budgeting system provides a common framework for comparing the financial situation among various local governments. These accounts must be reported to the Ministry of Home Affairs (MOHA) where they are statistically compiled each year and are utilized for the analysis of local public finance.

However, it usually takes a couple of years to compile and publish fiscal data on a national basis with the full coverage of more than 3000 local governments. Thus, any appropriate method is needed to make an all-inclusive form of total local budgets more promptly, because both national and local budgets must be prepared simultaneously.

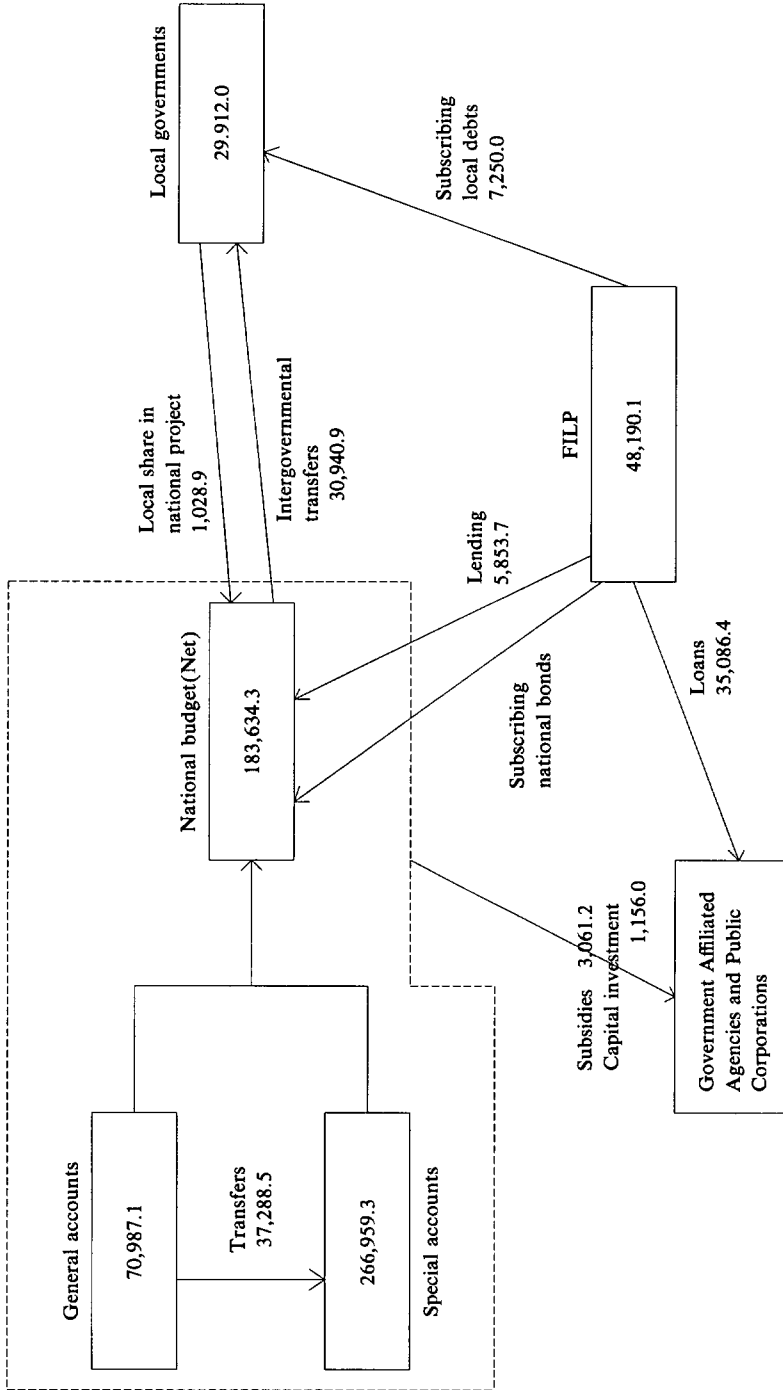
Before the beginning of each fiscal year, the national government has to review the general situation of local governments in order to allocate revenue sources and to form basic fiscal policies among multiple levels of governments. For this purpose, the MOHA is compelled by law to make official estimates of the total expected expenditures and revenues of all the local governments. Using this estimate as a basis, the MOHA is then expected to guarantee sufficient financial resources for each local government. The estimate and the revenue-sharing methods are consolidated into the Local Public Finance Programme (LPFP). This is an "aggregated local public finance budget compiled of the annual budgets of more than 3000 local public bodies". It is considered to be comparable to the country's national budget [see, Ishi (1993)].

### 4. The Position of the General Account in the Entire Budgetary System

Given the entire budget system described above, what is the relative importance of *the general account* in quantitative terms within a whole framework of budget? Figure 2 is prepared for this purpose to indicate the interactions between *the general account* and other budgets by using the 1996 initial budget figures. Total expenditure of *the general account* amounts to ¥70,987.1 billion, more than half of which is transferred into *the special accounts*, mainly those of local allocation and local transfer taxes, national debt consolidation fund, welfare insurance and so on. The remainder is directly paid to the private sector. Removing the overlap of *general and special accounts*, the net amount of ¥183,634.3 billion in the national budget is channeled into three directions to other budgetary accounts.

First of all, the national budget transfers ¥30,940.9 billion into local governments

FIGURE 2. FLOWS OF FINANCIAL FUND FROM THE GENERAL ACCOUNT TO OTHER BUDGETS (¥ billion)



Notes: All figures are based on those of the initial budget and local public finance program in 1995.

through intergovernmental transfers, such as local allocation tax, local transfer tax and national grant-in-aids. Conversely, local governments have to pay back ¥1,028.9 billion to the national government as the local government share in national direct projects. The second channel is concerned with *government affiliated agencies and public corporations* in terms of subsidies (¥3,061.2 billion) and capital investment (¥1,156.0 billion) from the national budget. In addition, these agencies and corporations are granted loans in large amount by the FILP (¥35,086.4 billion). Third, the national budget is closely related to the FILP, which is mainly financed by postal savings and public pensions. The FILP lends ¥5,853.7 billion to the national budget and subscribes substantial part of national bonds.

## 5. The Government Sector in the System of National Accounts

Another concept of the budget can be considered to make up for the narrow scope of *the general account*. This concept covers the entire coverage of the government in the economy and depends on the concept of SNA (the System of National Accounts) framework. The government sector in the SNA corresponds conceptually to a system of double-entry accounts used by the EPA to estimate current productive activity in Japan according to the international standard of calculation in the United Nations. When the SNA measures the market values of the currently produced final output of goods and services, classified by type of expenditures, there is public expenditure which explicitly appears as government purchases of goods and services, as well as personal consumer expenditures, gross private domestic investment and net exports. The total amount of these items become the Gross Domestic Products (GDP<sup>2</sup>), but government transfer payments do not appear conceptually in public expenditure.

In Figure 3, the government sector as defined in the SNA is illustrated in contrast to *the general account* of the national government. Grossly speaking, the government sector in the SNA framework is divided into two sectors; the general government and public enterprise within central and local governments, respectively. The scope of the general government corresponding to the general account concept has three major components; i.e., (a) central government, (b) local government and (c) social security fund. As evident from Figure 3, the general government not only includes the general account of the national budget, but also local ordinary accounts, non-enterprise special accounts and social insurance special accounts (i.e., social security fund).

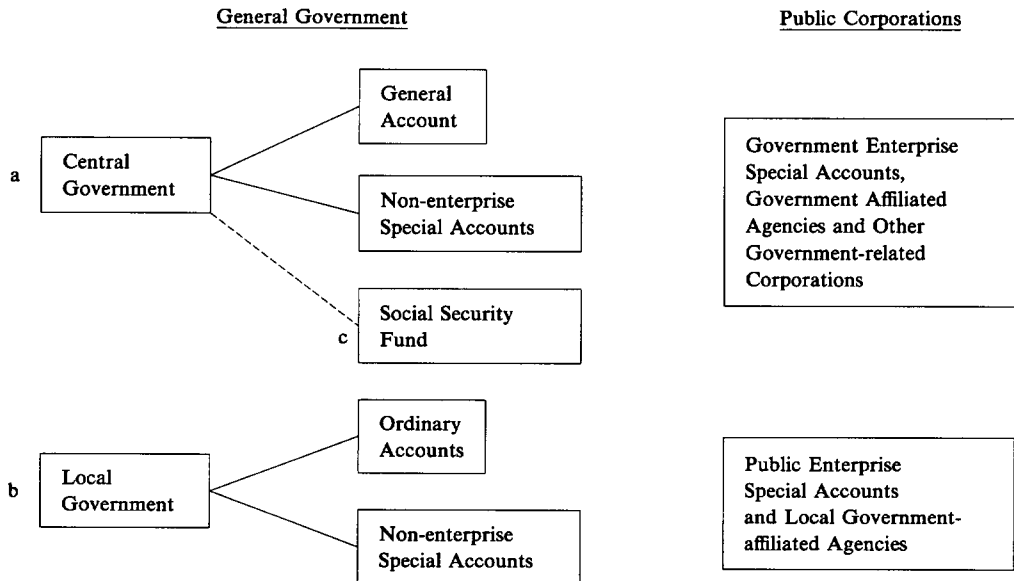
The government sector in the SNA is not a budget in the sense that it is not a fiscal plan for controlling, administering or proposing the activities of the government. It should be considered as a conceptual design of the government sector in the consistent framework of SNA common to the international community. Of course, the SNA's treatment of government activity differs from that of the budget primarily in two ways, reflecting the difference between national income concept and fiscal operations. To begin with, transfers in the budget, including those to other accounts, interest payments or grants to local governments, are excluded from government expenditure in the SNA as a result of netting out when all sectors are consolidated into a summary account for the government and the nation as a whole. Only government purchases of goods and services are included in the SNA concept, because only a part of final

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<sup>2</sup> In 1992, the GNP concept was replaced by GDP in Japan as a measure of national products and income in accordance with international treatment.



FIGURE 3. THE GOVERNMENT SECTOR IN THE SNA



Source: Economic Planning Agency, *Annual Report on National Accounts, 1995*.

output ought to be included.

Next, lending and financial activities are treated differently between the budget and the SNA. The budget includes financial transactions of the government such as granting loans, loan repayments and land asset purchases while the SNA excludes them because they produce no current output or income. For instance, the purchase of a land for public works is counted as a payment in the budget but is omitted from the SNA. Likewise, direct lending by government-affiliated agencies is excluded from the SNA since none of these transactions generate purchases of final output.

For economic analysis of fiscal policy, the SNA concept is preferred to *the general account*. By excluding such items as purely financial transactions (e.g., those involving the dealing assets), the SNA concept provides a better measure of fiscal activities than does *the general account*. The most important reason for the preference of the SNA concept would perhaps be the need for consistency when relating relevant data to the economy as a whole. As noted earlier, it is important to stress that the SNA concept does correspond to the system of national accounts used to measure GDP while *the general account* does not. The framework of GDP is commonly employed as a yardstick of the level of economic activity in economic analysis. Thus, it is desirable to use a data series which is in concept consistent with the estimates of SNA as an indicator of fiscal policy. This being the case, it would be better to see how changes in fiscal decisions influence the level of economic activity.

Furthermore, the SNA concept has more advantages in attempting international comparisons, because each country follows the common framework of measuring data. However, most of the SNA data become available only after 1970 in the international context, and in addition they are usually lacking in detailed information of fiscal data. Thus, it is difficult to

use the SNA concept in analyzing the behaviors of fiscal authority in detail. By contrast, the general account is often more useful for discussion of fiscal policy because of data availability. Thus, both should be treated as complementary, not exclusively.

Table 2 explores the relation of *the general account* to the SNA concept. In accordance with each item in Figure 3, it is possible to obtain relevant data in both final consumption expenditures and capital formation in the government sector in 1993 (see, EPA 1995). The relative share of *the general account* in the SNA framework shows merely 17.3 percent in final consumption expenditures and 1.6 percent in capital formation. Obviously, nearly 75 percent of both expenditures are occupied by local governments, given the current fiscal structure. Since transfer payments that occupy substantial share in total government expenditures are included in the private sector, *the general account* only plays minor role quantitatively in government fiscal activities as a whole. However, as seen in Figure 1, *the general account* takes the initiative in controlling overall fiscal actions through transfers to other budgets, such as *the special accounts* and local governments. Accordingly, it is likely to be considered as a representative of total budgetary activity.

## II. *The Budgetary Process*

### 1. Main Features of Japan Budgeting<sup>3</sup>

Fiscal policy can be executed in practice through budgeting, in which the levels and composition of taxes and expenditures should be set to achieve certain policy goals. Therefore, it is crucial in any discussion of fiscal policy to understand the budgetary system, consisting of both the executive and the legislative process through which taxes and expenditures are actually determined every fiscal year.

Generally speaking, the making of a nation's budget initially rests with the executive branch of the government. Then the legislative process approves the budget submitted by the executive at the Diet. In a parliament system, the legislative power to alter the budget at the executive level is usually very limited. In fact, under the parliamentary system of Japan, as well as the UK, German and Canada, the government budget is commonly accepted without any serious amendment or modifications. This implies that a single budget initially formulated by the executive plays a vital role in the budgetary process.

Budgeting is a continuous process, generating several steps in the budgetary process. Among them, in Japan, the following three steps are very important; (1) budget preparation and transmittal, (2) congressional action, and (3) execution and settlement of the budget with audit. This process is by and large common to many other countries. Needless to say, the first step is of most importance, because there are no customs of amending it at the Diet level, as noted above.

In Japan, the Ministry of Finance (MOF) has been given general jurisdiction over the whole process of making the budget. Within the MOF, the Budget Bureau is chiefly charged with the draft of each budget. Although the MOF is practically prepared for the budget at the

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<sup>3</sup> In what follows, focus is largely upon the national budget.

TABLE 2. RELATION OF THE GENERAL ACCOUNT  
TO THE SNA CONCEPT: 1993

Items in the SNA	Amount ¥billion	Percent distribution %
1. Final consumption expenditure in the general government	44,987.1	100.0
(1) Central	10,459.0	23.2
a. <u>General account</u>	<u>7,769.3</u>	<u>(17.3)</u>
b. Non-enterprise special accounts	1,920.5	( 4.2)
c. Jigyodan	769.3	( 1.7)
(2) Local	33,650.2	74.8
(3) Social security fund	877.8	2.0
2. Government Capital Formation	40,944.9	100.0
(1) Fixed investment	41,126.5	
a. Central	10,480.2	25.6
① General government	5,382.6	(13.1)
(i) <u>General account</u>	<u>658.2</u>	<u>( 1.6)</u>
(ii) Non-enterprise special account	4,347.4	(10.6)
(iii) Jigyodan	376.9	( 0.9)
② Public enterprises	5,097.7	(12.5)
b. Local	30,491.6	74.5
c. Social security fund	154.7	0.4
(2) Increases in inventory	-181.6	-0.4
<b>Total</b>	<b>85,932.0</b>	

Source: Economic Planning Agency, *Annual Report on National Accounts*, 1995, pp. 240-41.

initial stage, the Cabinet is solely responsible to transmit it to the Diet after accepting the budget draft from the MOF and adding to it minor modifications.

There are three points worth noting as the marked features in Japan's budgeting. First, revenue budget is equally compiled, separated from expenditure budget. Thus, unlike many other countries, Japan's budget to be submitted to the Diet is composed of both sides of the budget, respectively. Revenue budget is formulated to clarify the resource needs of budget programmes in the form of taxes, debt and non-tax revenues in relation to the economic outlook and prospective revenues. For this purpose, at the end of every calendar year, *Economic Outlook and Basic Policy Stance on Economic Management* is published by the government for budget preparation of the upcoming fiscal year. The growth rate of nominal GDP and other important data, which are indispensable to estimate tax revenues, are all included in this document in connection with current and projected economic conditions. As a consequence, the simultaneous considerations of both sides of revenues and expenditures are made in general.<sup>4</sup>

Second, such provisions as continued expenses, approved carried-over expenses and contract authorization are submitted to the Diet in order to seek its approval. All of them are important as exceptional provisions of single-year-budget principle, whose outlays can be extended over a stretch of multi-years (i.e., the maximum limit is five years). To begin with,

<sup>4</sup> Before publishing such official data, the Tax Bureau Staffs at the MOF begin to estimate tax revenues on an informal basis by using their own procedures.

continued expenses contains items which the government have to make payments over a period of several years ; e.g., the construction of large-scale guard ships and submarine for defense purpose. Also, the Diet may allow the carry over of some expenditures in the subsequent fiscal year under the scheme of approved carried-over expenses. When an expenditure item is not anticipated to be exhausted within the current fiscal year, the carry-over treatment is permitted by Diet approval in advance. Moreover, the contract authorization scheme allows the government to contract certain projects on a multiple year basis. All or part of necessary outlays are made within a given fiscal year or in subsequent several years by prior approval of the Diet.

Third, one cycle of budget starts from April 1 to end March 31 every year; i.e., fiscal year in Japan. With the exception of these three expenses noted above, outlays in the regular budget of each fiscal year must be made in that relevant time period. However, when the Cabinet expects that the regular budget cannot be approved by April 1 mostly for political reasons (e. g., general election), a provisional budget is specially compiled for a specific period from the beginning of fiscal year, and submitted to the Diet. Since the provisional budget is replaced by the regular budget once it is approved with time-lag, expenditures in the provisional budgets must be limited to the minimum requirement payments (i.e., wage and salary of government employees) consistent with the upcoming regular budget. Furthermore, a supplementary budget is prepared for and submitted to the Diet when a shortage of revenue sources or special needs for expenditures occurs during the current fiscal year. The supplementary budgets usually emerge a couple of times in a year for a variety of reasons such as the necessity of recovering natural disasters, wage hike for government employees proposed by the recommendation of the National Personal Authority<sup>5</sup> and so on.

## 2. Budget Preparation and Transmittal

The making of a budget usually begins with the preparation for budget requests in the period of June-August at the level of ministries and agencies every year (eight to ten months before the next fiscal year begins on April 1). The appropriate time sequence at each stage of budget preparation is illustrated in Figure 4 in the case of the 1995 budget formulation (see, for general discussion, MOF 1995). There are the two-way flows of decisions up from ministries and agencies and then back down from the MOF.

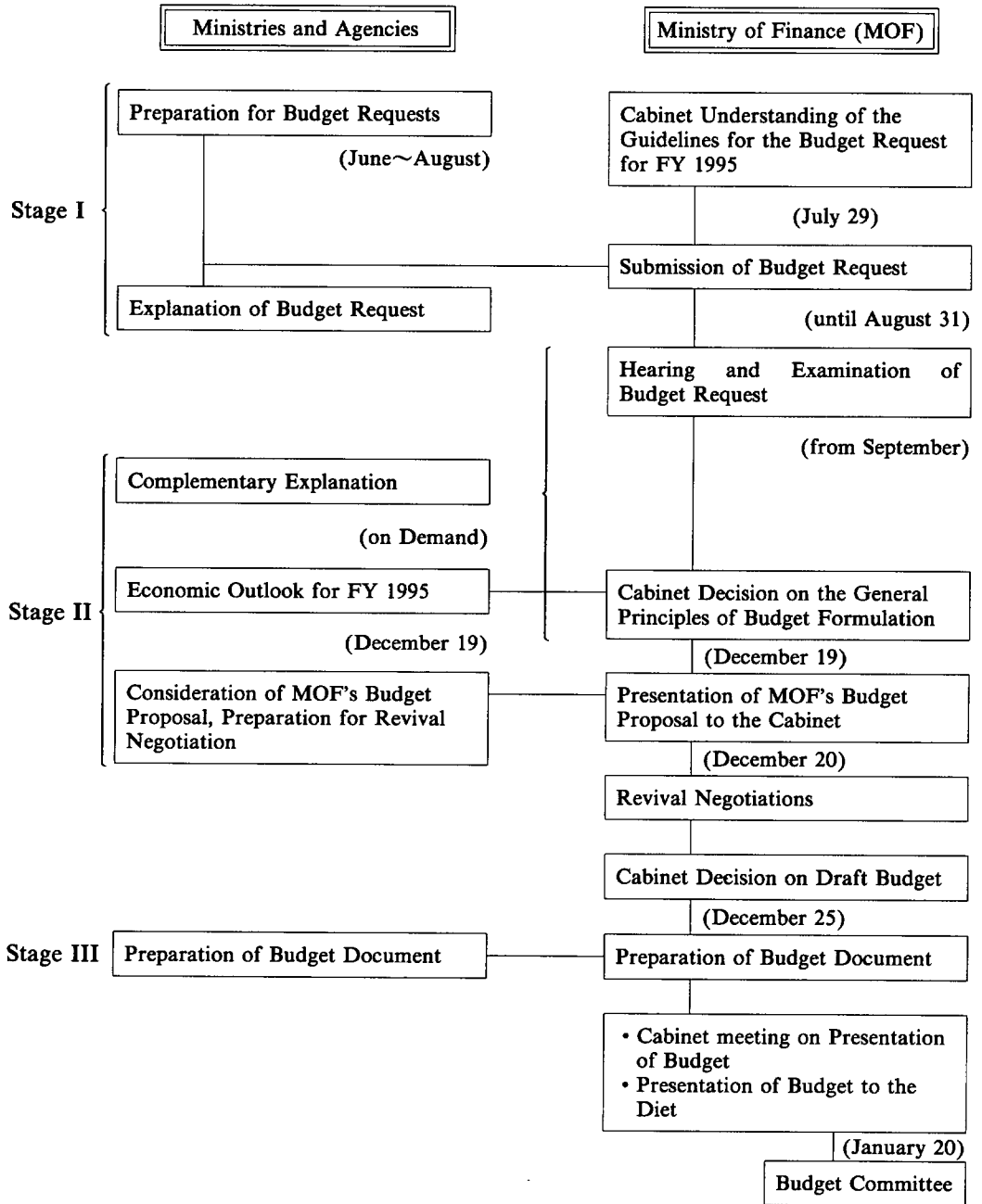
Budget preparation begins at the level of ministries and agencies. By August or earlier in some cases the individual units in all ministries and agencies have to make plans for their expenditures and programs. For this purpose, they review current operations and issues, program objectives and future plans pertinent to the upcoming budget. Budget offices within each organization finally set up their own budget requests to be submitted to the MOF after making adjustment for intra-ministry review.

In parallel with these preparations, guidelines for the requests of estimated budget are decided by the Cabinet about a month before making budget requests by individual ministries and agencies. Under the guidelines certain levels of "ceiling" are fixed relative to the expenditure increment over the budget of previous year, depending upon each category of

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<sup>5</sup> Every year the National Personal Authority has a rule of recommending wage raise for government employees to the government in order to make up for the gap between private and public sectors.

FIGURE 4. PROCESS OF BUDGET PREPARATION FOR FISCAL 1995



Source: Ministry of Finance, *The Japanese Budget in Brief*, 1995, p. 106.

current and investment expenditures except two entitled expenditures (debt service charges and local allocation tax; i.e., tax-sharing grant). Non-entitled expenditures are mainly targeted for setting such ceilings. The level and coverage of ceilings have become severer for the past decade or so.<sup>6</sup> Guidelines reflecting the basic attitude of the Cabinet for budgeting then flow back down through the MOF to ministries and agencies in the form of limiting targets to guide the preparation of the formal budget requests in August. They must modify their budget requests to fit the guidelines and give the priorities among various expenditure items by themselves before submitting them to the MOF. Therefore, these guidelines work effectively in controlling the excessive demand for expanding the budget at each ministry and agency. It would perhaps be possible to assess that they have played a substantial role in curtailing expenditure level in the past, although any critical view may be made to the guideline strategy. The first step of the budget process is over when budget requests are presented to the MOF on August 31.

Subsequently, the second stage runs from September to December. This time is spent compiling detailed estimates and negotiating between relevant ministries and the MOF on budget allocations and figures. After budget requests are transmitted, budget examiners at the Budget Bureau of MOF start a series of hearing and reviews with budget office staffs in ministries and agencies concerning the details of individual budget items. Additional supporting data and materials are requested in the hearing and review process. The budget examiners give considerable attention to the basis for each estimate of budget items, review the past performance of relevant ministries and agencies, check the accuracy of the factual information presented and take account of the future implication of expenditure programmes. In addition, the examiners identify each item of expenditures, management issues and the like to be raised for discussion with ministry and agency representatives during the hearings of the MOF. Conversely, all ministries and agencies have to defend their budget requests from one item to another in front of the examiners at these hearings, usually held from September to December.

Towards the end of December, the Cabinet issues the "General Principles of Budget Formulation" and the MOF follows this guide to complete the budget draft. For about a week after the MOF' draft is published, final negotiations are made between the MOF and ministries and agencies whose representatives attempt to justify higher amounts to the MOF staffs. The process usually continues to attain the highest level of negotiations between the Minister of Finance and relevant Ministers or Director-General of Agencies. After reaching final reconciliations among the authorities concerned, the MOF's budget draft is finalized and officially approved by the Cabinet at the end of December.

No doubt, budget making is always a political process itself, and the politics of making the budget is important in various ways. In particular, specific ministries and their "supporting politicians" frequently become advocates of increased expenditures for their own sake, backed politically by vested interest groups. It is commonly considered as natural and inevitable by the Diet and the MOF that they have a very strong power in justifying their programme decisions and securing their budget requests. In Japan, this is quite true in such specific areas as agriculture and public works. It is widely acknowledged that politicians often intervene the

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<sup>6</sup> For instance, prior to 1975 the guidelines were too generous to admit maximum 25–50 percent relative to previous fiscal years, but in the 1980s they became very strict to restrain budget request with "zero" or "minus" ceiling.

budgetary process for their own self-interests, leading to bias in fund allocation of the budgetary process.

### **3. Parliamentary Deliberation for Budgeting**

After the Cabinet transmits the draft budget to the Diet, the third stage launches in the budgetary process from the latter half of January. Of course, before its transmittal, a series of budget documents have to be prepared by the MOF staffs. In Japan's budgetary system, however, we can say that almost the whole process of budgeting is de facto ended by the second stage of budget preparation. Indeed, no serious amendment or modification has so far been made in the past performance of budgeting in the deliberation of parliament with minor exceptions in fiscal 1972, 1977, 1991 and 1996. This is to be sharply contrasted with congressional budgeting activity in the US.

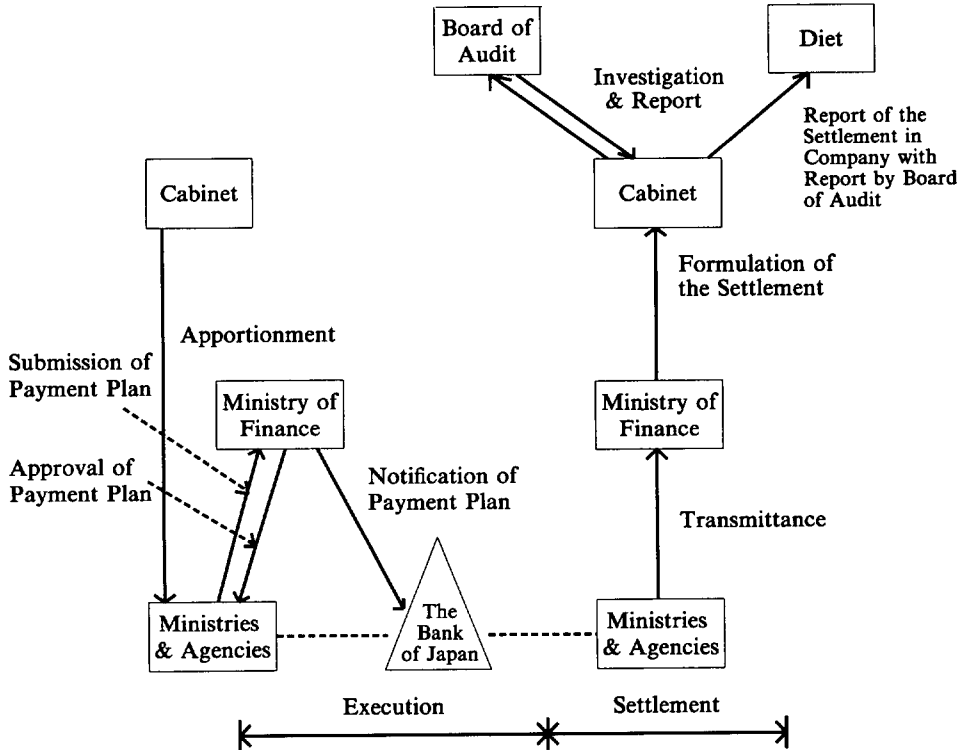
The Japanese constitution stipulates that the House of Representatives (Lower House) should be given the first priority over the deliberations concerning the draft budget presented by the Cabinet. In the plenary parliament, the Minister of Finance makes a budget speech in which he outlines basic nature and structure of the upcoming budget with the government's stance of fiscal and monetary policies. On the same day, his budget speech is also repeated in the House of Councilors (Upper House). In both Houses, the Budget Committee is organized to deliberate the draft budget intensively, but given the automatic approval of the budget, most of the deliberations tend to be a mere formality without any meaningful debates among members of parliaments. During the deliberations of the draft budget, public hearings are required by law, and each public attendants are selected by each political party.

After the approval by the Budget Committee in the House of Representatives, the draft budget is formally put to a vote at the plenary session of that House, and thereafter it is sent to the House of Councilors. The same procedure is taken at the Budget Committee to deliberate the budget and it is approved by vote. After being passed by the House of Councilors, the budget becomes effective from April 1. If the House of Councilors does not pass the draft budget within 30 days after being transmitted, the budget is automatically approved in accordance with the decision of the House of Representatives. Moreover, if the decision differs from one House to another, a joint committee comprising several members selected from both houses is convened to enter into the reconciliation process. It is generally difficult to come to a common conclusion. In such situations, the decision of the House of Representatives is given priority. Evident from these facts, it is guaranteed by the Constitution that the House of Representatives has an upper hand in budget deliberation in order not to retard the budgetary process.

### **4. Execution and Settlement of the Budget**

Normally a new budget starts from April 1, and thereafter the budget turns into the execution process. As shown in Figure 5, the Cabinet apportions necessary fund of the expenditure budget to relevant ministries and agencies for enforcement. Overall responsibility of executing the expenditure budget is made to the heads of each ministry and agency, who cannot use other purposes than those appropriated for the respective budgetary items. Based upon the appropriated budget, they have to prepare for payment plans on a quarterly basis in

FIGURE 5. EXECUTION AND SETTLEMENT OF THE BUDGET



Source: The same as in Figure 4, p. 113.

which required disbursements must be clarified by each spending officer. After submitting them, approval should be made by the MOF, which notifies payment plans to the Bank of Japan (BOJ). Actual payments of the expenditure budget are made by issuing cheques drawn on the BOJ.

Every fiscal year ends on March 31, but provision is made for additional disbursement period for a couple of weeks. After the close of the fiscal year, each ministry and agency has to transmit the statement of accounts for its expenditures to the MOF by the end of July which in turn carries out the settlement of accounts for total revenues and expenditures to cover all related budgets. Formulation of the settlement made by the MOF must be authorized by the Cabinet, and is sent to the Board of Audit by the end of November. The Board of Audit is charged with inspecting the settlement of accounts, independently of the Cabinet, as stipulated by the Constitution.

The results of inspection by the Board are returned to the Cabinet in form of reports, with which the settlement reports are equally presented to the Diet by the Cabinet around December. In both Houses, the Settlement of Accounts Committees are open to deliberate on these reports to seek possible responsibility of relevant ministries and agencies in cases of injustice or misuse in the disbursement of budgetary items.

As a consequence of settlement, fiscal surplus is usually generated to some extent which



is called "carryover-surplus". According to a rule of the Public Finance Law, not less than half of carryover-surplus must be appropriated to redeem national bonds within two years under consideration. Such surplus is transferred into the Settlement Adjustment Fund. Conversely, when revenue shortages are incurred in the settlement of *the general account* during recessions, the Fund is allowed to compensate for these revenue shortages. When the Fund does not contain enough outstanding balance for this purpose, certain financial sources are transferred from the National Bonds Consolidation Fund to the Settlement Adjustment Fund to make up for such shortfall. However, they are required to be paid back from *the general account* by the end of next fiscal year.

## 5. Budget Process in Local Governments

Apart from the preparation of national budget, let us investigate briefly the budgetary process in local governments. Since the total number of local governments is more than 3000, it is impossible to explore the budgets of prefectural and municipal governments in each regions separately. Therefore, in what follows we shall focus on the single case of Tokyo (i.e., the Tokyo Metropolitan Government), because Tokyo can be thought of as a representative example to study the budgetary process applicable to other governments at the local level.

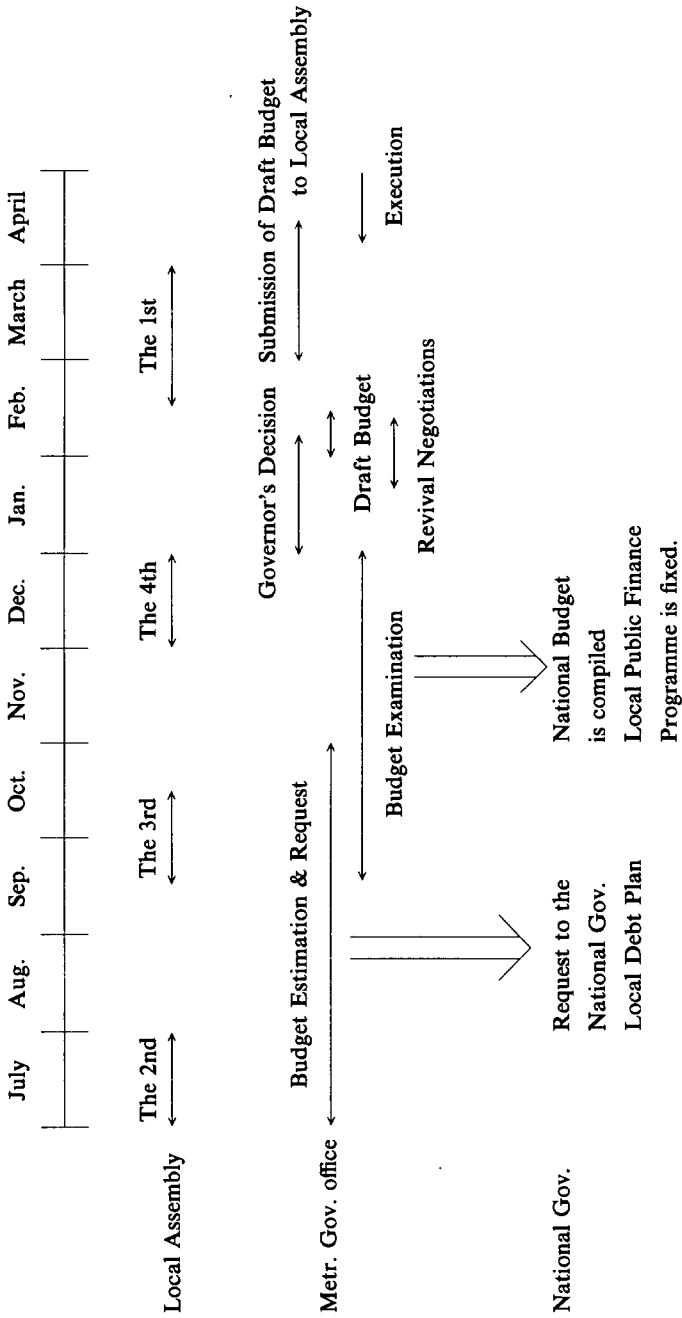
Figure 6 depicts a summary of budget process in a typical year. Budget preparation begins with estimates in individual units of each bureau at the Metropolitan Government, and budget estimates are submitted under the limit of ceiling by late August. From late September to late October, budget requests are presented to the Budget Bureau, dividing between the 1st request and the 2nd request, while the Budget Bureau staffs examine them step by step with hearings from demanders of relevant budget items. Budget examination usually continues until early January within the Budget Bureau. Meanwhile, the Metropolitan Government makes any requests for preparing the upcoming budget to the national government ; say the MOHA or other ministries, and local debt issuance program is published by the MOHA. Generally speaking, since local budgets are affected by the national budget through the share of revenue sources and national grant-in-aids to a considerable extent, great importance is attached to review the process of compiling the national budget around the close of the calendar year.

Before ending the process of budget preparation, municipal governments including the 23 wards in the Tokyo Metropolitan area also submit their requests for budgeting to the Metropolitan Government. At the final stage, the Governor's decision is made in early January to determine any significant budget items which are very difficult to be decided at the level of budget examiners and are equally necessary to stress the importance in view of specific policy issues. After including such decision from the Governor, the draft budget is published around late January, and thereafter budget negotiations are begun to reach the final budget plan.

The local assembly is regularly held four times a year; March, June, October and December. The budget plan is transmitted to the 1st meeting of local assembly to be held every March and is deliberated mainly in the Special Budget Committee. After passing the budget plan at the local assembly by the end of March, it comes into enforcement.

In sum, it seems that the budgetary process is more or less alike between the national and local governments, although time schedule is a bit different from each case.

FIGURE 6. BUDGET PROCESS FOR THE TOKYO METROPOLITAN GOVERNMENT



Note: Tabulated by data from the Tokyo Metropolitan Government

### III. *Concluding Remarks*

In this paper, we have investigated institutionally the basic features of Japan's budgetary system and process. The scope of our discussion is not so ambitious, and more importance is simply placed on clarifying the fundamental framework of budgeting, in particular for the sake of foreign readers. One may criticize the present budget system in Japan in the following three points. The first is concerned with the "single-year budget principle" which might be replaced by the multiple-year one in view of allocative efficiency in budgetary fund. The second point is directed to the establishment of current and capital budgets each in order to control relevant expenditure and revenue in a separate account. Third, the unified budget, like the US one, might be constructed on a consolidated basis to make the narrower scope of present budget system broader and clearer, avoiding overlapping transactions and double accountings.

We would like to examine further these points as the future task. In spite of such criticism, it seems that Japan budgeting system and process are working at present with no serious problem.

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