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The Politics of Budgeting in Japan

How Much Do Institutions Matter?

ABSTRACT

In the past decade, the Japanese government has revamped its budget institutions twice. This paper examines how these changes have changed the configuration of power among the actors in the budget process. It also explores the implications of these changes for the management of the nation's finances.

KEYWORDS: Japanese politics, budget politics, fiscal policy, budget institutions, public spending

INTRODUCTION

In the past decade, the Japanese government has undertaken two systematic efforts to reform its budget institutions and budget process. First, in 2001, the government established a new body, the Council on Economic and Fiscal Policy (CEFP), charged with overseeing budget and economic policy. With the historic victory by the Democratic Party of Japan (DPJ) in 2009, the new government immediately set to work overhauling the budget process for the coming fiscal year (FY), creating two new budget institutions. These efforts to reform Japan's budget process have implications both for how the government manages its finances and the nature of political control over budget making. This paper asks: What impact has Japan's budget reform had, if any, and what impact is it likely to have in the future?

WHY BUDGET INSTITUTIONS MATTER

The issue of Japan's budget institutions is one of both real-world and theoretical significance. Since 1991, the budget has been in deficit every FY, and

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the nation now faces net public debt of over 100% of gross domestic product (GDP). This figure will rise considerably as a consequence of the global financial crisis that began in 2008. These deficits and high public debt are daunting national political challenges that threaten Japan's future economic prosperity. Servicing its public debt consumes a growing share of its limited budgetary resources and will leave a large fiscal burden for future generations to bear. For 2010 (FY), bond issuances will total a staggering 48% of the budget, exceeding tax revenues for the first time in Japan's postwar history. As the country's population ages, social security expenditures continue to rise while the base of workers paying taxes and social insurance declines. The government has been helped by low interest rates, but this is unlikely to continue indefinitely.

As research has shown, budget deficits are a problem rooted in the nature of the costs and benefits of public spending. Budget deficits can arise as a result of the rational calculations of political actors.¹ Because tax revenues are a common resource, the problem of a "common pool" arises. The benefits accruing from the use of tax revenue are typically highly concentrated, e.g., targeted toward a specific region or group, while the costs of higher budget deficits are widely dispersed, i.e., paid for by a common pool tax base. This produces a systematic bias toward budget deficits because there is an asymmetry between the benefits and costs, with some groups or regions capturing benefits while bearing only a fraction of the cost. Research on this problem has demonstrated, however, that a variety of factors, such as strong budget institutions that force actors to internalize the costs of budget deficits, can alleviate the common pool problem.² As von Hagen and Hallerberg argue, when a government delegates authority to a centralized budget apparatus, it will have an incentive to mitigate budget deficits, as this will be one of the criteria by which its success will be measured.³ Hahm, Kamlet, and Mowery have reached a similar conclusion based on their empirical analysis showing that stronger fiscal bureaucracies produce lower fiscal deficits.⁴ Budget institutions matter because they shape fiscal performance.

1. James M. Poterba and Jurgen von Hagen, "Introduction," in *Fiscal Institutions and Fiscal Performance*, James M. Poterba and Jurgen von Hagen, eds. (Chicago, Ill.: University of Chicago Press, 1999).

2. Ibid.

3. Jurgen von Hagen and Mark Hallerberg, "Electoral Institutions, Cabinet Negotiations, and Budget Deficits within the European Union," in *ibid.*, Poterba and von Hagen, eds., pp. 214–15.

4. Sung Deuk Hahm, Mark S. Kamlet, and David Mowery, "The Political Economy of Deficit Spending in Nine Industrialized Parliamentary Democracies," *Comparative Political Studies* 29:1 (1996).

Budget institutions also matter because they structure the relative influence of various actors over the budget process. This has been an issue of keen interest in Japan, because the movement to reform the country's budget institutions has been largely motivated by the goal of increasing the role of the executive in the budget process. Strengthening budget institutions, along with other administrative reforms, would remove the ills of disconnected, bottom-up policy making (*tatewari gyōsei*), an overly powerful bureaucracy, and political interference from party backbenchers. This was true of the Liberal Democratic Party's (LDP) creation of the CEF, and even more so for the DPJ's current reform. The extent to which the CEF strengthened the cabinet has been debated among Japan scholars. Some have found that the CEF has in fact tipped the balance of power from party backbenchers and the bureaucracy in favor of the prime minister and cabinet.⁵ Mulgan, however, has argued that the CEF has not fundamentally changed the balance of power.⁶ This study will not definitively settle this debate, but the issue of budgeting is particularly germane to the discussion because greater budget control has been a central goal of reforms to enhance political leadership.

THE BUDGET PROCESS PRIOR TO 2001

As in all countries, the budget process has several layers of budget decisions. First, governments must determine the overall budget size, level of deficit financing, and overall fiscal stance. Second, governments make decisions regarding the allocation of funds to broad areas such as defense or social security. Finally, there are thousands of micro-level decisions regarding the funding of specific policies and projects.⁷ In the Japanese context, prior to 2001 this process typically proceeded from June until March of the following year (Japan's FY runs from April 1 to the subsequent end of March). Figure 1 illustrates the key steps in the process. The old budget process began in June with a determination of the overall size of the budget. After considering a number of factors, such as the state of the economy, projected revenues, debt

5. Mitsuo Hosen, "Acceleration of Economic Reform in Japan and the Role of the Council on Economic and Fiscal Policy," in *Microeconomic Foundations of Economic Performance in East Asia* (Manila: East Asian Bureau of Economic Research, 2006).

6. Aurelia George Mulgan, *Japan's Failed Revolution: Koizumi and the Politics of Economic Reform* (Canberra: Asia Pacific Press, 2002), pp. 213–31.

7. The author would like to thank an anonymous reviewer for suggesting this framework for analyzing the budget process.

FIGURE 1. The Old Budget Process



SOURCE: By author.

levels, and so forth, the government issued the budget request guideline, sometimes referred to as the budget ceiling, which sets a numerical target for the coming FY that was not to be exceeded. The purpose of the budget request guideline was to provide a baseline for ministries to use in compiling their formal budget requests for the coming FY.

The setting of the budget guideline was one of the most important stages in budget negotiations because it determined how large the pie would be. During the 1990s, the budget guideline also indicated at least very roughly the government's priorities, specifying funding levels for certain sectors such as social security and public works. Under normal circumstances, the government typically adhered to the budget guideline, although it was not binding. In later stages of budget negotiations, the government could revise target budget totals depending on a variety of factors such as macroeconomic conditions or other pressing needs. If a severe economic downturn occurred, for instance, the government might increase the budget total in order to stimulate the economy or, as happened during the first Gulf War, the government increased spending to finance the war effort.

The MOF compiled the budget request guideline, but it was the product of intense political negotiation. Typically, backbenchers from the longtime ruling LDP and the spending ministries (i.e., all those other than the MOF) attempted to increase their allocations. LDP politicians were particularly

interested in increasing spending in areas that would help them channel support to their constituents (e.g., public works) or for other policies in which they had a particular interest. The spending ministries maneuvered to raise their totals or avoid cuts. *Zoku* (politicians with specific policy expertise) Diet members and spending ministries often collaborated. *Zoku* interceded on behalf of spending ministries, and the latter responded to requests from *zoku*. During these negotiations, MOF, which consistently advocated fiscal discipline, attempted to keep the budget request guideline as low as possible. But the ministry was constrained by the need to secure the approval of the LDP, the prime minister, and the cabinet. MOF was in constant communication with all of these groups throughout the entire budget process, attempting to gauge what was politically feasible.⁸ The ruling party and government signaled to MOF its priorities through these channels of communication, but these interactions also provided an opportunity for MOF to convince the political leadership of the need to limit spending. The bulk of the negotiations occurred through these informal, behind-the-scenes channels, but in cases where there was persistent disagreement, the government and LDP leadership brokered settlements.

Both the government—the prime minister and cabinet—and the ruling party played active roles in the budget process. Formally, the prime minister and cabinet approved the budget request guidelines and submitted a budget bill to the Diet, but behind the scenes, the LDP participated in the budget process. Whether the ruling party or the government was the ultimate arbiter is difficult to determine. Mulgan argues that the LDP, not the government, called the shots, a situation that she dubs an “un-Westminster system.”⁹ There is some degree of truth to this in the case of the budget process, but it is also true that some prime ministers were able to override internal party opposition, as in the 1980s, when Prime Minister Nakasone Yasuhiro imposed zero-growth budget ceilings.

The budget request guideline served as the basis for formal budget requests made by spending ministries. At this point, budget negotiations were largely over the distribution of the total amount of funds: it was understood that the requests would not exceed the budget request guideline, barring some kind of significant change in circumstances (e.g., onset of a recession).

8. Maurice Wright, *Japan's Fiscal Crisis: The Ministry of Finance and the Politics of Public Spending, 1975–2000* (New York: Oxford University Press, 2002), pp. 275–311.

9. Mulgan, *Japan's Failed Revolution*.

Spending ministry bureaucrats, *zoku* Diet members, and MOF were the key actors that determined the composition of the spending within this guideline at the micro level. The process was largely bottom-up. Spending ministry bureaucrats took the lead role, and in some cases bureaucrats cooperated with the *zoku* Diet members, who interceded to win funding for public works projects or other policy areas they deemed important. MOF, specifically its budget examiners, reviewed specific spending requests, attempting to cut unnecessary spending in order to keep requests as low as possible. The allocation for public works and public investment was particularly contentious because both were important to LDP politicians who wanted to deliver concrete goods to their constituents. In rare cases when disputes could not be reconciled, the issue moved up the hierarchy, advancing to the deputy director of the Budget Bureau. Only occasionally did an issue reach the administrative vice minister, the highest civil service position in MOF, and even less frequently the minister of finance. The party leadership and government intervened to settle only the most intractable disputes.¹⁰

After the spending ministries and MOF agreed on their spending requests, MOF compiled a draft, the so-called “MOF budget.” From this stage forward, most of the big political issues had already been settled through prior negotiation (some exceptions are discussed below), although *zoku* Diet members and spending ministries did attempt to make minor changes such as restoring funding for specific projects. After completion of the MOF budget, a final round, the “revival negotiations,” opened, allowing for minor changes. This final stage was partly political theater, because the amount of funds set aside by MOF for these negotiations was already determined and known by all the key parties. During these negotiations, concessions were made in Japan’s so-called “second budget,” the Fiscal Investment Loan Program (FILP).¹¹

The final changes were then incorporated into a cabinet budget plan. The cabinet voted on the official budget plan, which at this point was largely a formality. The budget bill was then submitted to the House of Representatives, the lower house, for deliberation and a vote. The House of Councilors, the upper chamber of the Diet, also considers the budget, although its role is inferior to that of the House of Representatives. In cases where there is disagreement between the two houses that cannot be resolved, or if the

10. Author interview with MOF official, Tokyo, June 27, 2008.

11. Gene Park, *Spending without Taxation: FILP and the Politics of Public Finance in Japan* (Palo Alto, Calif.: Stanford University Press, forthcoming 2011).

upper house has not acted within 30 days after receipt of the budget passed by the House of Representatives, the latter's decision stands, as stipulated in Article 60 of the Constitution. In practice, though, with a few exceptions the passage through both houses was largely a formality because the political negotiations within the ruling party or coalition had already occurred.

In addition to the initial government budget described above, there were two other important sources of public spending: supplementary budgets and the FILP Plan. The supplementary budget was a mid-year adjustment: the government might have passed a supplementary budget because of changes during the relevant FY. For instance, economic growth might have produced more revenue than expected, pressures from the U.S. government to stimulate domestic demand might have increased, or a recession might have indicated the use of fiscal stimulus. In some cases, the supplementary budget also became an extension of the political negotiations over the initial budget. If funding could not be found for certain programs or policies during the initial budget negotiations, deals were sometimes cut with the understanding that the government would pass a mid-year supplementary budget to provide funds for them.¹² Whatever the motivation, supplementary budgets became very common and a significant source of budget indiscipline.

FILP was, and still is, a system for mobilizing savings for government-directed loans and investments that serve a public policy function. The government used FILP to pay for a significant portion of its public works and also to provide subsidized loans for housing, small and medium enterprise, and other users. Every year the government drew up a FILP Plan, which specified the overall level of funding for the coming FY and the specific allocation levels to the public and quasi-public bodies that invest or lend the funds. The process of drawing up the FILP Plan ran parallel to that of the formal budget. During budget negotiations, the FILP Plan served as a tool to broker compromises. Since FILP did not draw on limited tax revenues, MOF often preferred that spending ministries use FILP funds.¹³

THE CEFP

In early 2001, with the establishment of the CEFP, a new player was added to the budget process. The CEFP was housed within a new cabinet office

12. Author interview with MOF official, Tokyo, June 24, 2008.

13. Park, *Spending without Taxation*.

intended to set and coordinate the direction of policy. The creation of the CEFPP and more specifically the attempt to give the cabinet a larger role in fiscal policy were the culmination of a number of political currents. Proposals to transfer budget authority from MOF to the cabinet surfaced numerous times throughout the postwar period. Specifically, some argued that the Budget Bureau of MOF should be moved to the cabinet, giving the executive the capacity to draft the budget. MOF vigorously opposed such an idea. Within MOF, the Budget Bureau has been the most powerful bureau, and budgeting its most valued function. Given MOF's perceived success in managing the economy and its extensive networks within the LDP,¹⁴ the ministry was able to thwart such reform plans, at least until the 1990s.

In the 1990s, the political situation of MOF changed dramatically, as Grimes, Amyx, and others have recounted.¹⁵ First, MOF's reputation as an effective steward of economic policy came into question. As Japan's economic bubble collapsed and the economy entered a period of prolonged stagnation and financial crisis, MOF bore much of the blame, in some cases justifiably and in others not, for Japan's weak economy. Second, a steady stream of misdeeds and corruption by MOF officials provoked a public backlash against the ministry. Third, LDP support for MOF decreased. Bashing bureaucrats became an effective and popular electoral strategy, for the opposition as well as the LDP. MOF's easy cooperation with the first coalition government that excluded the LDP, from 1993 to 1994, also produced a resentment of the ministry within the party.¹⁶

All of these factors made MOF an obvious political target as Hashimoto Ryūtarō's administration embarked upon an ambitious reform to reorganize the bureaucracy and change the policymaking process. As the reform agenda advanced, MOF faced the threat of a full dismemberment. Various proposals suggested removing banking and securities regulation from MOF control—as well as its budgeting function. In the end, MOF suffered a severe defeat. The government transferred banking and securities regulation to two newly created entities. A revision to the Bank of Japan Law, which gave the central

14. Jennifer A. Amyx, *Japan's Financial Crisis, Institutional Rigidity, and Reluctant Change* (Princeton, N. J.: Princeton University Press, 2004), pp. 49–55.

15. *Ibid.*; and William W. Grimes, *Unmaking the Japanese Miracle: Macroeconomic Politics, 1985–2000* (Ithaca, N. Y.: Cornell University Press, 2001).

16. Masaru Mabuchi, *Okūnashō Wa Naze Oitsumerareta No Ka: Seikan Kankei No Henbō* [Why is the Ministry of Finance always under attack? The transformation of political-bureaucratic relations] (Tokyo: Chūō Kōronsha, 1997).

bank greater autonomy, also reduced MOF influence over monetary policy. The only silver lining for MOF was that it managed to preserve its budgetary function.¹⁷ As part of Hashimoto's Central Ministries and Agencies Reform Basic Law, the law that established the newly restructured MOF in fact reiterated the ministry's responsibility for planning, drafting, and executing the budget (Article 4).¹⁸

Although MOF kept the Budget Bureau intact, the political struggle over the budget was not finished. In order to strengthen the executive with more power and resources, the government created a new Cabinet Secretariat and a new Cabinet Office. As part of this reform, the government passed the Cabinet Office Establishment Law in 1999, which provided for creation of the CEFP within the Cabinet Office. In the lead-up to passage, MOF attempted to weaken the new body's role in the budget process, even seeking to eliminate "fiscal" from its name.¹⁹

The CEFP and the Budget Process

The CEFP was charged with drafting the basic policy direction for management of the whole economy, including fiscal policy and budget formulation.²⁰ The prime minister headed the CEFP, which indeed became part of the Cabinet Office. Other members included the chief cabinet secretary, minister of Finance, minister of Economic and Fiscal Policy, minister of Internal Affairs and Communications, and minister of Economic Trade and Industry. Also on the council were four private-sector members appointed by the prime minister. The staff of the CEFP was a combination of civil servants in the Cabinet Office (the largest number), civil servants seconded from other ministries, and private staff who accompanied the private sector members of the CEFP. MOF seconded only a few staff and reportedly had limited influence via this channel.²¹

17. Grimes, *Unmaking the Japanese Miracle*, p. 208.

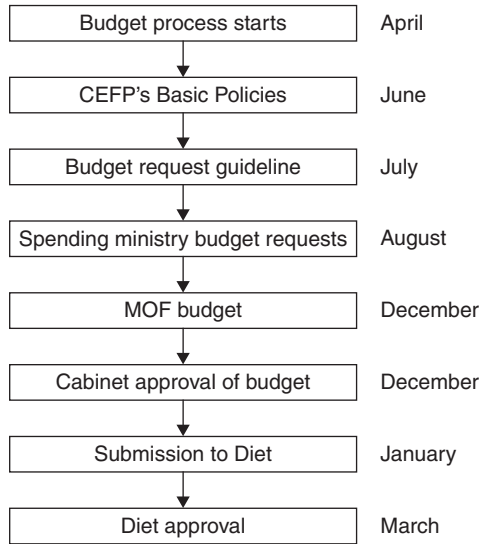
18. Akira Okada, "Keizai Zaisei Shimon Kaigi, Tokumei Tantō Daijin" [Minister in charge of special assignments, Council on Economic and Fiscal Policy], in *Chūō Shōchō Kaikaku, Hashimoto Kaikakuga Mezashita 'Kono Kuni No Katachi'* [Central government reform, the kind of government Hashimoto wanted to create], Akira Okada and Kazuaki Tanaka, eds. (Tokyo: Nihon hyōron sha, 2000), p. 126.

19. *Ibid.*, pp. 125–26.

20. Prime Minister's Office of Japan, August 20, 2009, <http://www.kantei.go.jp/foreign/policy/keizai/index_e.html>.

21. MOF official, June 24, 2008, interview.

FIGURE 2. The CEFP and the Budget Process



SOURCE: By author.

The CEFP was not only a new player in the budget process, it was also the starting point (see Figure 2). Under the pre-reform process, the first major step was drafting the budget request guideline outlined above. After the establishment of the CEFP, it kicked off the budget process by deliberating its basic approach to the budget for the coming FY, starting with a review of the key numbers such as GDP growth forecast and expected tax revenues. The process began as early as April. On the basis of its discussions, the CEFP drafted a document called the “Basic Policies for Economic and Fiscal Policy Management and Structural Reform” (hereafter, Basic Policies), setting out the basic principles for the coming budget; it was then submitted to the cabinet for approval. The cabinet-approved Basic Policies stated the broad policy direction of the government and how this should be reflected in the upcoming budget. Thus, the CEFP was intended to give the government greater control in setting overall fiscal policy—how it would relate to overarching macroeconomic policies—and influence over how the budget would reflect government priorities. These would be articulated publicly and more specifically than in the past.

Although the Basic Policies typically did not include any specific numbers, they were a critical, highly contested part of the budget process because

they served as the basis for subsequent budget request guidelines and could constrain or enable requests for spending.

After the Basic Policies were drafted, the remainder of the budget process followed a path very similar to the previous one. One exception was the items that the CEFP decided to continue deliberating. Such items typically included large spending areas such as social security or public works. CEFP deliberations could last through the fall; once outstanding issues were settled, these would be reflected in the budget. Finally, it is important to note that the CEFP did not deliberate tax issues.

THE CEFP: QUESTIONS OF EFFICACY

The creation of the new Cabinet Office and the CEFP within it was intended to strengthen the executive, centralize policymaking, and enhance control over the bureaucracy. This section considers whether the CEFP and its new role in the budget process in fact produced these changes.

Did the CEFP strengthen the executive's role in the budget process and alter the balance of power between the key actors? Who called the shots? And in cases where there were disagreements, who prevailed? According to those touting the reforms, the strengthening of the cabinet and creation of the CEFP would prevent fragmented, bottom-up policymaking. Such policies resulted from initiatives making their way up vertically separated bureaus and ministries (*tatewari gyōsei*), and from efforts to shift the policymaking initiative from the bureaucracy to the cabinet. The reform was intended to enhance the power of the executive at the expense of the ruling party, which often prevented effective government leadership. This meant the executive would use the CEFP to take charge of the budget process while diminishing the influence of bureaucrats and ruling party backbenchers. As one LDP member involved in the reform, Ishihara Nobuteru, commented, "We need a system that allows the prime minister to direct and supervise the most important parts of the budget, its basic features, mechanisms, scale and so forth."²²

A review of how the new budget process functioned, in particular how it shaped the interactions among key actors, is presented below. The discussion is organized into sections on individual prime ministers because each had different priorities and leadership styles. The following focuses primarily on

22. Okada, "Keizai Zaisei Shimon Kaigi," p. 122.

the early stages of the budget negotiations because this is the part of the budget process that changed. The analysis pays particular attention to the politics around the drafting and approval of the Basic Policies.

Koizumi Junichirō

Although the CEFP was established during the end of Prime Minister Mori Yoshirō's brief tenure, Prime Minister Koizumi was the first to have the CEFP at his disposal for annual budget negotiations, in 2001. In this case, assessing the relationship with the ruling party is straightforward because Koizumi's priorities created visible opposition. Koizumi, who had committed to "destroying" the LDP, wanted to change the entire policymaking process, removing the influence of pork-barrel-driven backbenchers. Regarding the budget process specifically, the CEFP helped Koizumi pursue his agenda, although his leadership was essential to helping him overcome opposition from his own party.

Under Koizumi, who oversaw five Basic Policies for the FYs between 2002 and 2007, the CEFP evolved into an important locus of budget negotiations and a body through which the prime minister directed the budget process. Chairing the CEFP and staffing it with those sympathetic to his agenda largely closed the body to the influence of LDP backbenchers. This allowed Koizumi to include proposals that would run against the preferences of many within his own party, such as calls to limit budget expenditures, bond issuance, and controversial items such as public works. Koizumi included in the Basic Policies specific language that would dictate the subsequent drafting of the budget, thus reducing the scope for backroom maneuvering by *zoku* Diet members and bureaucrats.

The CEFP did not solve all of Koizumi's political problems: ultimately, it was only an advisory board. He still had to contend with opposition from his own party, and the Basic Policies required cabinet approval. Koizumi faced intense opposition from his own party because of the large cuts that he proposed, particularly in social security and public works. The prime minister did not and could not avoid this opposition, a situation that the CEFP ultimately did not change, and he was often forced to make concessions during consultations with the LDP. But even with these concessions, the Basic Policies heavily reflected Koizumi's priorities. Koizumi was able to include language that called for limiting the growth of budget expenditures and bond issues. His hawkish approach to the budget intensified during his time

in office as the economy began to recover. For the 2006 and 2007 Basic Policies, Koizumi succeeded in including the controversial phrase that the government would make the maximum possible reductions in expenditures (*saidaigen no saishutsu sakugen*).

The CEFP also faced opposition initially from MOF, which saw the body as encroaching on its budget authority. The critical question was how specific the CEFP would make its Basic Policies. MOF wanted to keep the guidelines as vague as possible, allowing it greater discretion in later stages of the budget process. MOF also viewed the inclusion of special policy priority areas with some degree of concern because any mention of them in the Basic Policies was seen as empowering the spending ministries during later negotiations. As discussed below, this became a significant problem for MOF under subsequent leaders far less sympathetic to its goal of limiting budget expenditures. MOF argued that the Basic Policies should not include specific numerical targets. Finance Minister Miyazawa Kiichi argued that the outline should be broad, and he coined the term “big-boned” policy to refer to the Basic Policies.²³ In practice, the Basic Policies did not include detailed numerical targets, although they provided specific targets such as not having bond issuances or expenditures exceed those of a certain year. One significant exception was Koizumi’s final Basic Policies document for FY 2007, which included detailed targets as part of his Integrated Revenue and Expenditure Reform (IRER). The IRER was an ambitious plan for fiscal consolidation that Koizumi hoped, ultimately unsuccessfully, would commit his successors to fiscal discipline.

Although MOF did not like the encroachment of the CEFP, it is difficult to assess the degree to which the CEFP influenced relations between Koizumi and MOF. This is because Koizumi’s goals—cutting spending and slashing public works—largely aligned with those of MOF. Koizumi appointed fiscal hawks and reformists to the CEFP, and his hawkish fiscal stance was viewed favorably within the ministry.²⁴ Koizumi’s Basic Policies documents helped MOF in subsequent budget negotiations to deflect spending requests.

Abe Shinzō

Abe Shinzō was a transitional figure as prime minister, owing his position in part to his vow to continue Koizumi’s reforms, but in reality facilitating a

23. “Big-Boned Policies May Face Uncertain Future,” *Daily Yomiuri*, June 30, 2005.

24. MOF official, June 27, 2008, interview.

reconstitution of the old style of policy making. Abe, whose administration developed the Basic Policies in 2007 for the FY 2008, invited back some of the old-guard rebels that Koizumi had kicked out of the party.²⁵ In terms of policy making, Abe never really controlled the agenda of the CEFP, and under Abe, the influence of the *zoku* Diet members and the spending ministries returned. It is difficult to determine what exactly Abe's policy preferences were since he sounded more or less reformist at different times. He was also undoubtedly influenced by the approaching House of Councilors election in July 2007, which ultimately led to a large loss of LDP seats, the results of which were viewed as a reaction to Koizumi's neo-liberal policies. Regardless of Abe's preferences, though, it is clear that under his administration the new CEFP did not function as it did under Koizumi.

Under Abe, the *zoku* and spending ministries exercised greater influence on the CEFP agenda and what was ultimately included in the Basic Policies. In the Basic Policies, Abe seemed to demonstrate policy initiative by including two new areas, education and the environment. In reality, the education proposals were a repackaging of ideas supported by the education *zoku*, and the relevant spending ministries had backed the environmental proposals. Abe included in the Basic Policies language that committed the government to achieving the largest budget expenditure cuts possible, a carryover from Koizumi and one unpopular with the party. But LDP backbenchers and spending ministries partly circumvented this by having their priorities included in the Basic Policies, which would help them make budget claims in later negotiations. This situation alarmed Ota Hiroko, minister of state for Economic and Fiscal Policy.²⁶ As a result, the section of the Basic Policies describing the government's priorities, i.e., areas that should receive preferential budget treatment, expanded. On the other hand, the part dealing with the specifics of the budget, which Koizumi had used to help restrain spending, were minimalist and vague.

Fukuda Yasuo

Under Fukuda Yasuo, the regressive trend that began with Abe's administration continued. The Basic Policies were highly contested, but the CEFP did

25. Koizumi expelled members of his own party who opposed the privatization of the postal system, one of his signature reforms, in 2005.

26. "Honebuto Genan Koutai Minkan Teian, Kage Usuku" [Big-boned policies draft, retreat from private members' proposal, weakening influence], *Asahi Shimbun* [Asahi News], June 10, 2007.

not function as an effective instrument of the executive. This was in part because Fukuda did not have a clearly articulated vision like Koizumi. Fukuda did not take the lead in setting the CEFPP agenda and allowed LDP backbenchers and spending ministries to influence the process. Both appeared to be emboldened after years on the defensive, and at one point, LDP Diet members attempted to remove language that had become a pillar of the Basic Policies since Koizumi. Specifically, under both Koizumi and Abe, the Basic Policies asserted that the government would make the maximum possible reductions in budget expenditures. Opponents of cuts in the LDP lobbied to change the wording to state that the government would make an “effort” to carry out the maximum possible reductions. Although initially accepted, MOF fought back, and the original language was restored.²⁷ Even though Fukuda backed MOF, it was clear that neither he nor the CEFPP was setting the agenda.

In response to LDP opposition, including some entire sections within the party’s Policy Research Council, Fukuda also retreated on specific proposals. Specifically, the government revised a draft of the Basic Policies in response to LDP pressure to include language giving priority to social security and education.²⁸ Other sensitive issues were not settled and were left to be resolved at a later date, underscoring the diminished role of the CEFPP and the role of the Basic Policies in setting the tone for subsequent budget negotiations. One area where Fukuda did clearly take up a new issue against widespread opposition from his own party was the gasoline tax, which has been a dedicated source of revenue for road construction. Fukuda included in the Basic Policies a provision that would abolish the earmark for road construction. Still, even this provision was largely a rearguard action in response to proposals by the opposition DPJ.

Asō Taro

With Prime Minister Asō, the government’s commitment to fiscal reconstruction, begun under Koizumi and at least respected in word by Abe and Fukuda, was delayed indefinitely, in part because of the global financial

27. “Kaikaku No Hata, Gyakufu Tsuyoshi ‘Honebuto No Hoshin 08’ Genan” [The reform flag, the big-boned policies for 2008 face strong resistance], *ibid.*, June 24, 2008.

28. “Honebuto09 Kakugi Kettei Saishutsu Sakugenhe Hidane Kiezu” [Cabinet decision on the big-boned policies for 2009, trying to keep alive the momentum for expenditure cuts], *ibid.*, June 28, 2008.

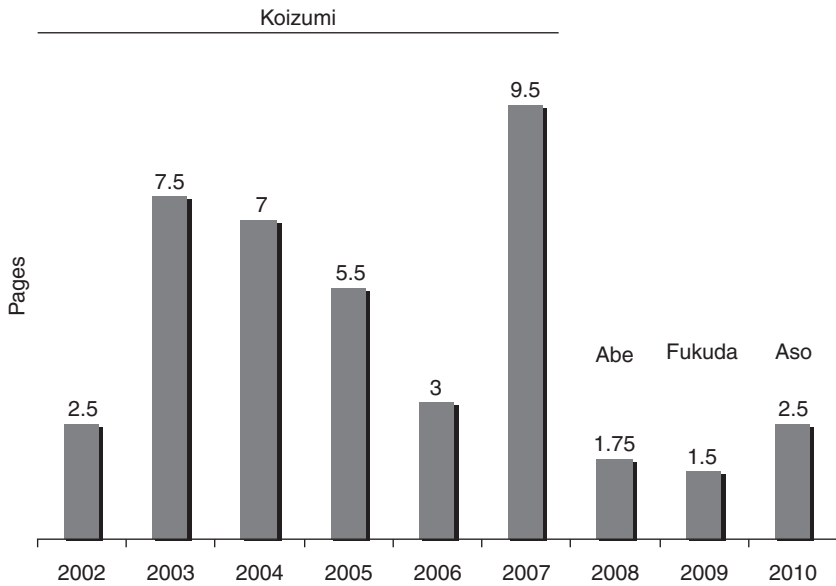
crisis and Japan's sharp economic deterioration. With the shift to fiscal stimulus, many of the tensions between the government and the ruling party disappeared, although the effort exacerbated tensions with fiscal hawks, in particular MOF. Even though the goals of the Asō cabinet and LDP backbenchers converged with fiscal stimulus, the ruling party reclaimed its role in the budget process. With pressure from the LDP and little resistance from Prime Minister Asō, the government dispensed with many of the targets that had been set for trimming expenditure growth, including social security. The LDP also succeeded in removing key language urging fiscal restraint, and the phrase "limiting budget expenditures to the maximum extent possible" was removed entirely. Moreover, for the 2010 FY budget, the sections in the Basic Policies that described the budget policy, which under Koizumi were quite specific, were spare, leaving much wider scope for future negotiations. Regarding the role of MOF, it is fairly clear that the government (and party) called the shots. This, however, had little to do with the CEFPP and new budget process, but rather represents a general trend from the 1990s.²⁹

General Trends

The foregoing discussion demonstrates a number of general points about how the creation of the CEFPP and the new budget process shaped the politics of budget spending. First, it is clear that drafting the Basic Policies became a highly contested part of budget negotiations. All of the key actors viewed the Basic Policies as a new and significant stage in the overall budget process, and consequently exerted considerable effort to shape the outcome. The wording of the document, whether numerical targets would be included (they were typically not), and how extensive the instructions would be regarding the future budget were all disputed. In this sense, the reform changed the budget process, moving up the calendar and opening up new avenues of influence. Depending on who was prime minister, however, influence ran both ways. The CEFPP functioned only as an advisory council, and ultimately, its recommendations had to be approved by the cabinet. Whether a prime minister could craft controversial Basic Policies and win cabinet approval depended on his leadership; the CEFPP did little to enhance the power of the executive headed by a passive or weak leader.

29. Grimes, *Unmaking the Japanese Miracle*.

FIGURE 3. Length of Section on Budget in the Basic Policies for the Coming Fiscal Year Budget



SOURCE: Cabinet Office, *Basic Policies for Macroeconomic Management* [Kongo no keizai zaisei oyobi keizaishakai no kouzou ni kansuru kihon houshin ni tsuite], 2002–10, <www.cao.go.jp>, accessed August 20, 2009.

NOTE: 2007 data include pages from the Appendix, which is part of Koizumi's IRER fiscal consolidation plan. It includes very detailed guidelines for the budget.

Koizumi is the exception that proves the rule. While Koizumi wielded the CEFP quite effectively to influence budget negotiations, he could do so because of his popularity with the electorate, which was enhanced by his image as a reformer. Although the CEFP was a useful instrument, Koizumi's leadership was a necessary factor that allowed him to pass his budgets. After Koizumi, under the weaker leadership of subsequent prime ministers, the executive played less of a leading role in the budget making process. Spending ministries, *zoku* Diet members, and the leadership of the LDP flexed their influence muscles during the formulation of the Basic Policies, with the CEFP playing less and less of an independent role. One manifestation of the declining influence of the CEFP was the declining specificity of the Basic Policies. Under Koizumi, the Basic Policies contained much more detailed guidelines for drafting the budget. After Koizumi, the section on the budget became much more vague and shrank considerably, as Figure 3 illustrates.

The relationship among the executive, the LDP, spending ministries, and MOF changed, but only slightly. MOF still drafted the budget request guidelines, but it had to follow the new Basic Policies when it did so. The budget guideline itself was the product of government, LDP, and MOF negotiations, similar to the old process. One difference, however, was that the new budget process made it easier in some cases for the spending ministries and LDP backbenchers to tie the hands of MOF at an earlier stage by having their programs or initiatives included as priorities in the Basic Policies. In this regard, the new approach made it more difficult for MOF to control the budget process.³⁰

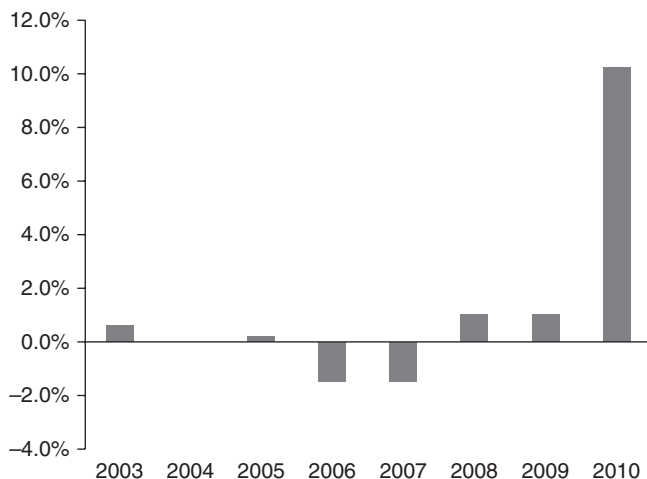
The CEFP did improve transparency. The deliberations of the CEFP were published on the Web. Thus, the negotiations and contending viewpoints were public, whereas in the past, negotiations took place largely behind the closed doors of the LDP. Any revision or deviation from the CEFP proposals were thus exposed to public scrutiny. This change appeared to have affected the media coverage of the budget process. For instance, in cases where proposals of reformist or fiscally conservative private members of the CEFP were ignored, newspapers widely criticized the LDP for backtracking.

Assessing the impact of the CEFP on Japan's fiscal performance is difficult. There have been a number of extraordinary events since the 1990s, including a series of domestic economic recessions, Japan's banking crisis, the Asian Financial Crisis, the collapse of the dot.com bubble, the terrorist attacks on 9/11, and the global financial meltdown of 2008. Thus, any trends in the data should be considered tentative and at this point impressionistic.

Figure 4 shows the change in the budget request guideline total from the previous year. Koizumi succeeded in keeping the ceiling growth low or reducing it. Under Abe (FY 2008) and Fukuda (FY 2009), the ceiling increased slightly. In the case of Asō (FY 2010), the ceiling increased sharply, which is understandable given Japan's rapid economic slowdown with the onset of the global financial crisis. Considering the impact of the financial crisis in 2008, which shaped the FY 2009 budget request guideline, the overall picture is one of relative spending constraint. This picture draws further support from the fact that the ceilings actually held all the way through the budget process, aside from the budget for FY 2009 and FY 2010. During the later stages of drafting the 2009 budget, the onset of the global financial crisis became

30. MOF official, June 27, 2008, interview.

FIGURE 4. Budget Request Guideline, Change from Previous Fiscal Year



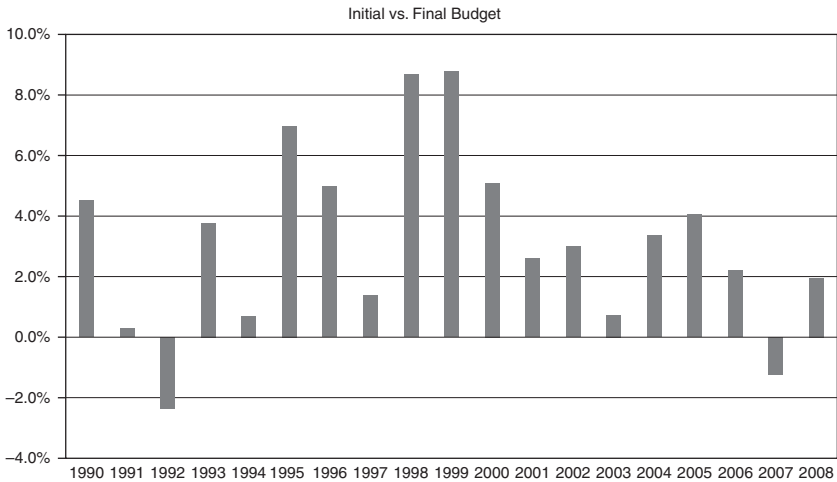
SOURCE: Japanese Ministry of Finance, *Basic Request Guideline* [Ippan saishutsu no gaisan youkyuu kijun no kangekata], 2003–10, <www.mof.go.jp>, accessed August 20, 2009.

clear, and the initial ceiling was abandoned. It should be noted, as discussed earlier, that even prior to creation of the CEFP, budget ceilings were largely observed for the remainder of the budget process.

One cannot draw the conclusion from the previous data that the CEFP enhanced the government's ability to limit budget growth, for several reasons. Most important, the budget request guideline only covers a share of total budget spending, about 60%. The budget request guideline excludes debt servicing costs and the Local Allocation Tax, which is distributed to local governments by formula. Both are treated as fixed expenditures. Additionally, the actual budget submitted to and passed by the Diet can be altered mid-year through the passage of supplementary budgets. Thus, any restraint imposed during the budget negotiations can be overridden during the execution of the budget, with Diet approval. In practice, supplementary budgets are passed, in some cases multiple times, virtually every FY. These increases can be quite large, as in the late 1990s, when they exceeded 8% of the initial budget (see Figure 5, which shows the extent to which supplementary budgets increased budget expenditures from the initial budget).

The CEFP played no significant role in determining the amount of supplementary budgets, which have been widely criticized as being arrived at by

FIGURE 5. Change from Initial to Final Budget



SOURCE: Japanese MOF, *Expenditures and Revenue from the Start of Meiji* [Meiji shonen ikou ippan kaikei sainyuu saishutsu gaisan], 1990–2008, <www.mof.go.jp>, accessed August 20, 2009.

political considerations.³¹ Thus, the Basic Policies, which is one of the distinguishing features of the new budget process, failed to exert much influence over a significant share of budget expenditures. Moreover, the CEFP's Basic Policies did not specify in any meaningful way how Japan's second budget, the FILP Plan, should be drafted.

BUDGET REFORM DPJ-STYLE

Since coming to power in September 2009, the new DPJ government, as pledged during its election campaign, has embarked on a second overhaul of Japan's budget institutions. The new government established the Government Revitalization Unit (GRU) to vet specific budget requests. It also established the much-anticipated National Policy Unit, which effectively superseded the now defunct CEFP, to guide economic and fiscal policy.

Although not much time has passed since the creation of Japan's budget institutions, they have already played a role in helping the new government control the budget process. Both the Hatoyama Yukio and Kan Naoto administrations have taken a much more hands-on approach to spending decisions.

31. MOF official, June 24, 2008, interview.

Thus far the GRU, rather than the National Policy Unit (NPU), has had the highest-visibility impact on changing the budget process. The Hatoyama cabinet created the GRU in September 2009 to review government projects, making decisions on whether or not they should be reduced or abolished. The prime minister is the chair of the GRU; the state minister of government revitalization, a cabinet appointment without portfolio, is the vice chair. The prime minister also names several outside members. The staff of the GRU is composed primarily of bureaucrats from various ministries.

In a series of meetings, which were publicly broadcast on the Web, the GRU reviewed specific spending proposals. The Hatoyama administration's decision to make the proceedings of the GRU open to the public has been highly significant. First, the move has been very popular with both the media and public. Second, the increased transparency has closed off the back-door channels that lobbyists, party backbenchers, and spending ministries used in the past to influence the budget. Consequently, the GRU has helped the government push through spending cuts that would have been more difficult, if not impossible, under the old budget process. While the CEFP also increased transparency, the GRU has gone much further. The CEFP published its proceedings, but budget proceedings were limited to discussion over general policy direction. In the case of GRU, the public proceedings covered deliberation over specific spending items, discussions that directly impacted specific political and bureaucratic interests.

The new budget process has also empowered MOF. Rather than view GRU as a competitor, MOF has attempted to take advantage of the opportunity it has provided. MOF has seconded three of its staff to GRU, all fiscal hawks with experience in the ministry's Budget Bureau. The bureau has also played a key supporting role, providing the technical expertise to review government projects. MOF has been very happy with this arrangement because GRU and the new DPJ administrations have provided the backing to make politically difficult reductions.³² Other parties, however, have been less enthusiastic about the new process. Spending ministries have been thrown into a defensive position, and there is a perception that the new process has actually given too much influence to MOF.³³ The cuts also engendered a political backlash from localities that will lose public works projects.

32. Author interview with MOF official, Tokyo, December 11, 2009.

33. Author interview with Ministry of Economy, Trade, and Industry official, Tokyo, December 11, 2009.

The DPJ administrations have also provided better political insulation for MOF. The Hatoyama administration banned lobbyists and local government officials from directly appealing to MOF, a practice common under the old budget process. Previously, each December the halls were busy with ministry officials meeting with local government officials, LDP politicians, and lobbyists. Under the DPJ, the MOF building has become relatively quiet. Under Prime Minister Hatoyama, lobbying was required to go directly through the DPJ headquarters, specifically party General Secretary Ozawa Ichirō and the vice general secretary, who then conveyed information to the cabinet. Although the party and cabinet have taken a hawkish stance toward public works spending, the arrangement raised the question of how the relationship between the two will evolve. Ozawa had no formal cabinet role, but he is one of the most influential members of the party. He is an elections expert who helped mastermind the DPJ's political landslide that brought it to power, and many newly elected DPJ Diet members owe their success to him. His recent resignation, and the appointment to Prime Minister Kan Naoto's cabinet of members critical of Ozawa, seemed to suggest that his influence waned. Ozawa also lost a bid to unseat Kan as president of the LDP, and by extension prime minister, in September 2010, although the results show that he has strong support among other DPJ Diet members. Ozawa no longer acts as the key interface between the party and lobbyists. Instead, the DPJ has revived its Policy Research Council (PRC) to play this role.

The NPU focuses on broader fiscal issues. The national policy minister, senior vice minister for the economy, and Cabinet Office economy secretary occupy the key leadership positions. As of June 2009, the NPU staff included 18 bureaucrats and 13 members seconded from the private sector. The NPU, as with the CEF, sets overall direction of economic and fiscal policy. Additionally, the NPU, as with the CEF, discusses specific issues such as further reform of the budget process, the absorption of Japan's government bonds, pension reform, the tax system, etc.

Because the DPJ took power in the middle of the budget process for FY 2010, the NPU did not have time to have a decisive role in shaping the budget, which led to some media criticism of the NPU's effectiveness. Still, the DPJ attempted to use the NPU to take a more-complete view of budget spending. Whereas the CEF's role was weakened by its inability to control supplementary budgets, the FILP, and other sources of spending, the NPU approached spending comprehensively. The NPU also proposed moving to

a three-year budget, which would constrain the government's use of politically motivated supplementary budgets, and the NPU as well as the GRU have begun to look more closely at Japan's special accounts. The NPU also started to build capacity to monitor the execution of the budget throughout the course of the FY, a significant departure from the CEFP.

Initially, the NPU as well as the GRU were created as provisional bodies. Hatoyama intended to upgrade the NPU to a formal government bureau, the National Policy Bureau (NPB), with greater authority over the budget. Because the GRU proved to be popular, Hatoyama decided to make it permanent as well. These measures were to be included in a bill to enhance the political leadership (*seiji shudō kakuritu an*). After Hatoyama's resignation in June 2010, Prime Minister Kan did not have time to pass the bill prior to upper house elections in July 2010. The election produced a large loss for the DPJ, which had held only the most tenuous control over the upper house. Unable to form a coalition large enough to pass legislation in the upper house, the DPJ lost the ability to pass legislation that would upgrade the NPU and make the GRU permanent. Consequently, Kan has downgraded the NPU, opening up the question once again of who will take the lead in the budget process.

Still, the NPU and GRU reflect the DPJ's preferences for greater transparency, centralization, and control over the execution of the budget. Thus far, both bodies have the potential to help the government gain greater control over the budget, including in areas neglected by the CEFP, although the future of both is now uncertain. The different approach of the DPJ to budget reform, however, is a reminder that while budget institutions can have an independent causal effect, such institutions are also endogenous, reflecting the preferences of the government in power. Many of the changes in the budget process under the Hatoyama and Kan cabinets are primarily the result of the different priorities of the new party in power, not institutions.

Thus far, the government has effectively created and wielded budget institutions to significant effect, but the question remains whether or not these institutions will be durable. Hypothetically, if the LDP or some other coalition comes to power, a new government could change Japan's budget institutions yet again. These new institutions could in turn reflect the new government's preferences. The failure of the DPJ to pass legislation making the new budget institutions permanent will make it much easier for future administrations to abandon the NPU and GRU. That said, there is likely to

be some lock-in effect. Any administration would likely face public criticism if attempts were made to undo the reforms. Increased transparency, in particular, has been highly popular, and efforts to reduce transparency are likely to carry real political costs.

If the DPJ can better institutionalize its new budget process, the budgeting game will be significantly different. Already, the executive is playing a more direct role in the budget from start to finish. Such centralization and increased transparency are likely to increase incentives for the government to take responsibility for its budget choices and give it enhanced control over the process.

CONCLUSION

From the previous discussion, it is clear that both the LDP's and DPJ's budget reforms have been consequential, although in what way varies greatly. The CEFP gave the executive a new forum for formulating budget policy, one that in principle would allow it to work in greater isolation from bureaucratic and party backbencher pressure. But in practice, while the new CEFP drafted the Basic Policies, its degree of autonomy from the ruling party and bureaucracy depended largely on the leadership of the prime minister, his willingness to use the body, and the political standing needed to overcome internal party opposition. While Prime Minister Koizumi effectively used the CEFP, subsequent prime ministers used a more decentralized process of drafting the Basic Policies that differed only a little from the pre-reform process. Moreover, the CEFP exerted much less influence over the later stages of the budget drafting process and its execution.

Although the DPJ's budget reforms are still a work in progress, they may go further in centralizing budget-making authority in the executive. Like the CEFP, the NPU set overarching budget policy. Although its future is now uncertain, the DPJ is still clearly committed to assert greater executive control over the budget process from drafting to execution, an important departure from the CEFP. The GRU allows the government to vet micro-level spending choices that had been largely left to bureaucrats and *zoku* politicians. Forbidding lobbying directly to spending ministries and backbenchers also has reduced their influence.

The question remains whether the DPJ's budget reform will help the Japanese government better cover the costs of their spending decisions and

maintain greater fiscal discipline in the future. *Ceteris paribus*, the answer appears to be yes. The government now has better mechanisms to control spending throughout the process. But budget institutions are only one factor influencing fiscal outcomes. While the DPJ has taken measures to strengthen Japan's budget-making institutions, its domestic campaign platform promised large spending increases while offering only vague commitments to increase revenue. With Japan's fiscal situation deteriorating, the DPJ has embraced a new fiscal consolidation agenda. With budget institutions that will help the executive set budget allocation priorities, vet micro-level spending decisions, and control more firmly the entire budget throughout its drafting and execution, the government will have a greater ability to implement its choices. It remains to be seen, however, how durable Japan's new emerging budget institutions will be.