A COMPARISON OF FISCAL FEDERALISM UNDER THE SUB NATIONAL GOVERNMENT SYSTEM IN SRI LANKA AND JAPAN: A SPECIAL REFERENCE OF REVENUE RAISING POWER DEVOLUTION

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1. Introduction

This study attempts to analyze with some of the strengths and weaknesses pertaining to fiscal decentralization in provincial and local governments/ authorities in Sri Lanka and to compare it with Japanese system. Sri Lanka is a small developing country that follows the Westminster model of cabinet government with a French-style Executive President at the top and a system of regional governments at the middle with underneath local governments. This system has been developing gradually from independence basically where a regional government system initiated in 1987 with modifications of local governments system. The political system is highly adversarial, which have alternated in power since Independence.　Specially, this power decentralization from top to down has adopted as a conflict management strategy in Sri Lanka. Such decentralized political systems are an abundant characteristic in the world, it has been adopted many countries in their political administrative processes and have responded to the changing conditions and circumstances despite their strong centralized tendency. By present, many of such countries function effectively in these power decentralized systems. Similarly, Japan is also executing this system for many decades. Japan is 6 times bigger than Sri Lanka and a developed country. The Government runs under the framework established by the Constitution of Japan, adopted in 1947. Politics of Japan are conducted in a framework of a dominant-party bicameral parliamentary constitutional monarchy, in which the emperor is the head of state, and the Prime Minister is the head of government and the head of the Cabinet, which directs the executive branch. The Cabinet has the executive power and is formed by the Prime Minister, he is designated by the National Diet and appointed to office by the emperor. In Japan, the system of local self-governments has been guaranteed by the Constitution of 1947, provides for directly elected governors, mayors, and assembly members. At the local-government level, authorities have a wide range of functions and fiscal responsibilities; a fusion of responsibility and finance exists, with two-thirds of all government expenditure being local; and there is a tradition of frequent personnel shifts at the executive level (Furukawa, 1999). As the Unitary States, the Central governments of both countries have been handling their functions, responsibilities, and public administrative powers in a sharing system or sharing a percentage of power with sub national and local governments for more than five decades.

The theory of fiscal federalism[1] assumes that a federal system of government can be efficient and effective at solving problems governments face today, such as just distribution of income, efficient and

[1] The term "fiscal federalism" was introduced by the German-born, American economist Richard Musgrave in 1959. Fiscal federalism refers to how central, state, and local governments share funding responsibilities.

effective allocation of resources, and economic stability. Federalism is the sharing of power between national and state/ local governments[2]. Fiscal federalism attempts to define the division of governmental functions, and the financial relationship between, different levels of government (usually how federal or central governments fund state and local governments)[3]. The principles of fiscal federalism are concerned with the design of fiscal constitutions, that is, how taxing, spending, and regulatory functions are allocated among governments and how intergovernmental transfers are structured. Both in the industrialized and in the developing world, nations are turning to such a devolution to improve the performance of their public sectors. The hope of this federalism is that state and local governments, being closer to the people, will be more responsive to the preferences of their constituencies and will be able to find new and better ways to provide the services. Focusing on such a role, both Sri Lanka and Japan have shared their functional and financial powers to Sub National Governments (SNGs)[4]. Under this devolution frameworks, considerable number of functional responsibilities are assigned to the lower-level units/ governments. The consequence of this is the inadequacy of financial capacity of SNGs as it is directly related with financial autonomy pertaining to revenue raising power.

2. Background of the Study

Under federalism / power decentralization, functions are devolved from center to SNGs giving opportunities to provide services and engage in development activities in their territories. The Functional devolution mostly followed the general trend of allocating matters of national importance to the Central Government and those of regional or local interest to regional or local governments and such functions are divided on a legitimate framework while there are some shared works in a concurrent list. Ministries or institutions are formed in each level to manage, implement, and monitor these functions. Matters regarding how these institutions are financed in order function effectively, efficiently, responsively, and accountably, should be addressed from the outset, because the operational success of public institutions depend on adequate financing. In a federal/ decentralized system, fiscal autonomy should have to be constitutionally defined and guaranteed and given a real meaning to the notion of self-rule particularly.

However, the most vital part of fiscal federalism is revenue raising power and how its power is delegated to lower-level governments. Fiscal and financial arrangements, hence, are pivotal in a federal system in that they determine the nature and meaning of shared rule and self-rule in practice. Especially, to carry out functions successfully, various levels of government require a specific fiscal autonomy and a

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[2] For an economist, nearly all public sectors are federal in the sense of having different levels of government that provide public services and have some scope for de facto decision-making authority (irrespective of the formal constitution) (Oates, 1999).

[3] There are different meaning of fiscal freedom, fiscal devolution, and fiscal federalism. Fiscal freedom is a broader suite of local taxes and restoration of certain grant funds, fiscal devolution is same local taxes but devolution of some central taxes and fiscal federalism is locally determined tax regimes (Local Government Association, 2020).

[4] Sub-national governance can be defined in general, as a process of exercising administrative, legislative, economic, and political authority and powers by provincially elected bodies functioning within their respective legally recognized territorial jurisdictions (Sivakuma, 2013).

revenue raising authority. However, this is a critical part and hence it may not have been successfully delegated or given financial devolution is weak when it comes to lower level of governments. Indeed, there are some questions relating to the allocation of expenditure responsibilities, the assignment of revenue raising powers, a system for fiscal equalization, and regional borrowing. In relation to this, a considerable number of cases in the world have recorded that the power of revenue generation in lower-level governments are not successful and or there are some inabilities to do that in constitutional barriers. Nonetheless, the availability of revenue sources, particularly in imposing taxes, is limited in jurisdiction, and existing sources are not feasible in their fertility. This is directly connected with the amount which they spend on service provision and development activities of lower-level governments.

There are two types of lower-level governments or SNGs below the Central Government in Sri Lanka. Rationale for such federalizing in Sri Lanka is the accommodation of multiple identities within one viable state. This entails regional autonomy over some spheres of government, whilst the Centre retains responsibility over others. The lower-level governments are namely 'Provincial Councils/ governments (PCs) and local governments (LGs) including municipalities. The local governments or authorities such as Municipal, Urban, Town and Village councils were introduced to local administration in 1930s and 1940s (Laitan, 1986) and formed within a different structure under the 13th Amendment of 1987 with the Provincial Council system. The Thirteenth Amendment to the Constitution certified on 14th November 1987, paved the way for the creation of Provincial Councils under Section 154A of the Constitution and enacted under the Provincial Councils Act No. 42 of 1987. This was an attempt made for the first time for the effective decentralization of administration by a process of devolution giving powers to the PCs to plan, execute and manage the totality of selected functions. However, prior to Independence the system of LGs[5] was essentially established depending on the central government and even after Independence what continued to prevail was administrative decentralization with the main authority being the Central Government[6]. The functions of the LGs are limited local tasks such as garbage collection, maintenance of streetlights, and paving of footpaths etc. and some minor development works beyond that are belonged to the Provincial governments. Meantime, there are government institutions that are provincial, others central and some institutions which are shared for the delivery of public goods and services under a concurrent list. Under the fiscal federalism, both types of governments have constitutional provisions in revenue raising in their territories subject to the supervision of the Central Government.

The local government system (local government entities) in Japan consists of two tiers as the

[5] Local authorities are divided into three different groups: municipal councils, urban councils and divisional councils (Pradeshiya Sabha or Pradesha Sabhai).

[6] Initially, the Local Government Ordinance No. 11 of 1920 created three types of local authorities: Urban District Councils (UDC), Rural District Councils and General Councils. This was changed later and thereafter the local authorities are functioned under the Urban Councils Ordinance 1939, the Municipal Councils Ordinance 1947 and the Pradeshiya Sabha Act (No. 15 of 1987).

Prefectures[7] (regions or territories in large geographical areas or remote islands) and the Municipalities. The Prefectures and Municipalities are both local public entities of equal status and cooperate in local administration according to their share of duties. As Ikawa states (2008), the greater part of expenditure which is directly related to people's lives is carried out by LGs. In Japan, above two tiers system exists under the unitary government structure led by the Central Government as such and the functional responsibilities of many of the subnational units stretch beyond those ordinarily performed by local councils to include primary and secondary education, water supply, firefighting services, city planning, environmental management, and so forth. However, there is no clear-cut separation between the responsibilities of the Prefectures and Municipalities. The Prefectures have considerably stronger administrative powers than the Municipalities. Each local government has an assembly as the highest decision-making body whose members are directly elected by its citizens. The Prefectures are responsible for a range of functions in the fields of economic development, public infrastructure (roads, some national highways, rivers, and harbors), public housing, education (secondary schools), social assistance policies, public health, agriculture, environment, and employment. The Municipalities also have extensive responsibilities for urban planning, local roads, local harbors, public housing, education (pre and primary schools), social welfare (child welfare, elderly, national health insurance, and ageing insurance), water, waste, and firefighting under their jurisdiction. In Japan, SNGs operation are under a centralized structure that affords them significant legal and financial autonomy and very little room for initiative and innovation. Japan's unitary system of government requires SNGs to comply with central laws, bureaucratic directives, and other forms of tight central control, especially financial (Jain, 2011). According to the historical information of the local administrative system in Japan, the system of cities and of towns and villages has established in 1888, and a system of prefectures in 1890. This kind of Japanese local autonomy system has greatly changed by a reform after the end of World War II, aiming at a decentralized, democratic system of local autonomous bodies. (Ikawa, 2008). However, in operation, the SNGs system is more similar in both Sri Lanka and Japan though there are some differences in revenue raising authority.

3. Problem Statement

Though there are more similarities in operation of SNGs in both countries, Sri Lanka and Japan, effectiveness of operation can be questionable due to their inherent constrains, particularly, this situation would arise with limitation on financial autonomy. Though there is an ability to work for local interests, if financial capacity is on a weak or inadequate position, it is difficult to execute functional responsibilities. Therefore, each level of government needs financial resources that can broadly match its expenditure requirements. In other words, devolution should ensure adequate financial resources in

[7] Prefectures are regional authorities comprising municipalities and are in charge of broader regional administration. Municipalities are local public entities that have a strong and direct relationship with local residents and handle affairs directly related to the residents. Prefectures as local government bodies that cover a wider area than that of municipalities, carry out a large number of different tasks (Ikawa, 2008).

relation to its expenditure responsibilities which can be usually done either by assigning adequate tax raising powers to each level. There are many cases in the world that have shown such a mismatch of revenue collection and excess expenditures compared to level of revenue. This would be a result of unsuccessful financial devolutions with power devolution as it is based on many reasons. One clear example for such unsuccessful fiscal devolution is Sri Lanka. As Waidyasekara (2005) stated the main fiscal weakness in the provincial council system is the paucity of revenue in relation to its expenditure, both in terms of volume and diversity. The existing framework for the devolution of power under the 13th Amendment, even though largely meaningless in practice, provides an inescapable context to the debate about more meaningful power-sharing between the Centre, and regions. Meantime, there is an argument in relation to Provincial council system that they are not working efficiently and effectively (Lakshman et al., 1998). The main reason behind the weaknesses of financial base of the system and financial resources mobilization and revenue raising autonomy at the regional level is a conflict issue. Hence, some of the regressive features of the 13th Amendment framework for financing devolution have been preserving. Similarly, in Japan, there are some issues of financial autonomy and as Ikawa (2008) mentions "Local taxes account for about one-third of gross local government expenditure and income, so advocates of decentralization emphasize that in order to secure a guarantee of autonomous financial management, it is necessary for central government to transfer tax revenue sources to local governments and increase local tax revenue".

4. Objective of the Study

The broad objective of the research is to study the financial autonomy and financial strength of sub-national government systems in Sri Lanka and Japan.

The specific objectives are:

1. To compare the administrative structure of sub-national government systems in Sri Lanka and Japan.
2. To review the functional devolution of sub-national government systems of Sri Lanka and Japan
3. To examine the strength of financial autonomy in revenue generation given under the constitutional provision.
4. To examine revenue generation constraints and bottlenecks impeding the maximization of revenue.

5. Data and Methodology

The overall methodology of study was critically investigated, described, and analyzed the fiscal federalism/decentralization with a special reference of revenue raising power devolution in Sri Lanka and Japan under the sub- national government systems. The research relied substantially on secondary data and information from the Ministry of Local government and provincial government of Sri Lanka, the Finance Commission of Sri Lanka and Ministry of Finance, Gazettes of government of Sri Lanka, Central Bank of Sri Lanka, Department of Census and Statistics and Ministry of Planning and implementation. In addition, to review the coordination structure of financial, financial mobilization structure, allocation mechanism, financial capability descriptive information was collected from documents such as reports, acts and articles. Similarly, Japanese data and information were collected from relevant documents, reports of Ministry of information and Communications, Statistical Handbooks of MIC, Reports of National Tax Agency, other regionalized reports, research articles and acts which are relevant to sub-national government system in Japan.

The proposer of this study was completed reviewing partly the literature collecting information of sub-national government system in Sri Lanka by having interviews with experts of local governments/ members of Provincial Councils, members of Prefectures/ Municipalities and other relevant officials. For actualizing the comparative part, the proposer selected a sample of Prefectures/ Municipalities nearest to the Senshu University in Japan and collected information about the operation of the system carrying out interviews with subject experts/ officers/ members of Prefectures/ Municipalities.

6. Rationale of the Study

The decentralized administrative and financial mechanism has been in relation to the development for more than three decades in Sri Lanka. This strategy is used to maximize regional attention and to provide a fair service and benefit at regional and local level and used as a political peace-making process of the country. Meantime, the devolution of administrative and financial power in regional and local level was introduced as a solution of ethnic crisis in Sri Lanka, particularly to shift the decision-making power in development into regionalized administrative structure. However, the unsuccessful operation of this system has been a major problem on expectations as it is becoming a political issue. The main cause of this critic is that the financial limitation of the provincial/ regional governments disrupts the service provision and activities of the regions. Relatively, Japanese SNG system is much better in a regional-wise service provision and development works as it is justified by many studies. Nevertheless, the SNG system in both countries is more similar in operation. Therefore, it is useful to compare the SNG systems in both countries and which enables policy makers to reorganize the systems and to find solutions for imperfect parts of power devolutions.

7. Theory of Fiscal Federalism

The literature on intergovernmental fiscal relations has been expanding rapidly in last two decades, in line with a growing worldwide trend toward fiscal decentralization. Fiscal federalism[8] studies how to share responsibilities (including finances) among federal, state, regional and local governments to

[8] Federal systems are seen to provide safeguards against the threat of centralized exploitation as well as decentralized opportunistic behavior while bringing decision makers closer to the people.

improve economic efficiency and achieve various public policy objectives. It is assumed in the theory of fiscal federalism that distribution of tax and expenditure powers between different vertical levels of government takes place though informally in country even with system of 'unitary' form of government. It has often been argued that a decentralized fiscal arrangement improves the allocation of resources because the decentralization of fiscal decisions implies that the package of spending and taxing tends to better reflect the wishes of the local voters. Fiscal federalism helps governmental organization to realize cost efficiency by economies of scale in providing public services, which correspond most closely to the preference of the people. The principles of fiscal federalism are concerned with the design of fiscal constitutions – that is, how taxing, spending, and regulatory functions are allocated among governments and how intergovernmental transfers are structured. These arrangements are of fundamental importance to the efficient and equitable provision of public services. The basic concepts of federalism are constitutional divisions of powers among various orders of government fall into three categories: unitary, federal, and confederal of government having some independent as well as shared decision-making responsibilities (Shah, 2006)[9].

Until the early 1990s, fiscal federalism was a largely unexplored area of fiscal policy. But over the last decade, a clear world-wide trend towards fiscal decentralization has emerged. The first-generation theory (FGT) of fiscal federalism is associated with decentralization of expenditure responsibilities and centralization of revenue responsibilities for the purpose of achieving 'efficiency' and 'equity' in the federation. It emphasizes the importance of transfers for addressing the problems of vertical and horizontal imbalances. It is largely normative and assumes that federal and sub-national decision-makers are 'benevolent' and maximizes the social welfare. The second-generation theory (SGT), especially the theory of market-preserving federalism assumes that public officials have goals induced by political institutions that often systematically diverge from maximizing citizen's welfare. Unlike the FGT which emphasizes the importance of transfers for mitigating vertical and horizontal imbalances, the SGT gives more importance to incentives generated by sub-national tax collection for fostering economic prosperity. The SGT has had significant implications for the design of transfer systems so that equalization goals can be achieved without diminishing the incentives of public officials to foster thriving sub-national economies. In brief, the SGT is in favor of decentralization of both expenditure and revenue responsibilities; and it gives minimal role to revenue-sharing and inter-governmental transfers (Jha,

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[9] A unitary form of government facilitates centralized decision making to further national unity. It places a greater premium on uniformity and equal access to public services than it does on diversity. An overwhelming majority of countries (148 of 193 countries in 2006) have a unitary form of government. The city-states of Singapore and Monaco are single-tiered unitary governments. China, Egypt, France, Indonesia, Italy, Japan, Korea, New Zealand, Norway, the Philippines, Portugal, Sweden, Turkey, and the United Kingdom have multi-tiered governments based on unitary constitutions. As a result, some unitary countries (e.g., China, Denmark, Norway, and Sweden) are more fiscally decentralized than are some federal countries, such as Australia and India. A unitary country has a single or multi-tiered government in which effective control of all government functions rests with the central government. A federal form of government has a multi-order structure, with all orders A federal form of government has a multi-order structure, with all orders of government having some independent as well as shared decision-making responsibilities. In a confederal system, the general government serves as the agent of the member units, usually without independent taxing and spending powers.

2012).

7.1 Purpose of Fiscal Federalism

For a successful decentralization, national governments need to design and supervise clear fiscal arrangements that support local service delivery. At the same time, regional and local authorities/ governments are challenged to strengthen their financial capacities and use their limited resources in an effective and efficient way. Oates (1972) argues that fiscal autonomy induces a better match between public services delivery and citizens' preferences and willingness to pay, incentivizing transparency and accountability, thus increasing efficiency. Baldwin and Krugman (2004) also argue that fiscal autonomy can act as a powerful instrument against agglomeration forces as it introduces mechanisms for peripheral jurisdictions to compete with the "center". There is a wide variety of international experiences in fiscal federalism based on: 1) the division of functions among different tiers of government; 2) the design of fiscal transfers; 3) principles of assessment; and 4) institutional arrangements. Furthermore, intergovernmental fiscal transfers are either constitutionally or legally mandated (Singh, 2020). Furthermore, the goal of modern fiscal federalism is not just to ensure the efficient allocation of resources, but also to protect liberty and restrain the power of government, to share legislative and fiscal competencies, to foster political participation and preserve markets.

7.2 Principles of Fiscal Federalism

The principles of fiscal federalism are concerned with the design of fiscal constitutions – that is, how taxing, spending, and regulatory functions are allocated among governments and how Intergovernmental transfers are structured. These arrangements are of fundamental importance to the efficient and equitable provision of public services. As Singh (2020) stated, there are important Principles for a fiscal federalism (Table No 01).

Table No 01: BROAD PRINCIPLES ASSOCIATED WITH FISCAL FEDERALISM

Fiscal equivalency	Decentralization theorem	Principle of subsidiarity
The principle of "fiscal equivalency" requires a separate jurisdiction for each public service. Wallace Oates proposes a related idea, the so-called "correspondence principle". According to this principle, the jurisdiction determining the order of provision of each public good should include the set of individuals that consume it. This generally requires a large number of overlapping jurisdictions.	According to the "decentralization theorem" advanced by Oates, "each public service should be provided by the jurisdiction having control over the minimum geographic area that would internalize the benefits and costs of such provision." Unlike the general prediction, a higher degree of spillovers may reduce the difference in the utility of centralization and decentralization.	The "subsidiarity principle" states that functions should be performed at the lowest level of government. The principle, if not explicitly but implicitly, implies hierarchy. The deeper questions that arise are who will decide, and for whom, coupled with which functions will be assigned to which level.

Source: Singh (2020)

8. Structure of Sub-national Governments in Sri Lanka and Japan

There are two types of lower-level governments or SNGs below the Central Government in Sri Lanka. Rationale for such federalizing in Sri Lanka is the accommodation of multiple identities within one viable state. As shows in figure No 01, the lower-level governments are namely 'Provincial governments or Provincial Councils (PCs) and local governments (LGs) including municipalities'[10]. PCs constitute the intermediate level of government that was established within the existing governmental system which provided for a set of structures and positions with authority to exercise powers and functions at the provincial level. LGs are elected councils for the local level and its main role is the delivering required services to the locals in which public service responsibilities are shared between deconcentrated line agencies at the district and divisional level and local governments at the rural/urban level. The local governments system in Japan consists of two tiers as the Prefectures (regions or territories in large geographical areas or remote islands) and the Municipalities. The Prefectures and Municipalities are mutually independent. As Aoki (2008) stated that the Prefectures, having a wider regional viewpoint, can give various guidance and advice to Municipalities. The important role played by such LGs as the level of public administration closest to the people has only grown with the dynamic changes in social systems brought about by ongoing rapid development of information technology and the growing diversity of people's values (CLAIR, 2012)[11]. The Prefectures and Municipalities are both local public entities of equal status, act as comprehensive administrative bodies and cooperate in local administration according to their share of duties. However, local public entities in Japan have the character of being self-governing 'governments' of the inhabitants of a certain area, and at the same time, they are the bodies that execute the administrative tasks of the Central Government.

The Provincial Council is an autonomous body being constituted in terms of the Constitution and hence does not come under the purview of any Ministry. The members of Provincial Council of Sri Lanka are elected in accordance with the law relating Provincial Council elections. The Governor, who is the head of the Provincial Council, is appointed by the President and holds office during the pleasure of the President. Each Provincial Council has such a Governor appointed by the President for a five-year term, exercising provincial executive power and responsible for executing the policies of the provincial council through a board of ministers headed by a Chief Minister and comprising no more than four other ministers. Similarly, the electing members of a local government/ authority in Sri Lanka are from wards and from a list. The Local Authorities Election (Amendment) Act gives the percentages of above representation as onward basis 60% and on proportional basis 40%. The Mayer/ Chairman is selected from members elected of local authority.

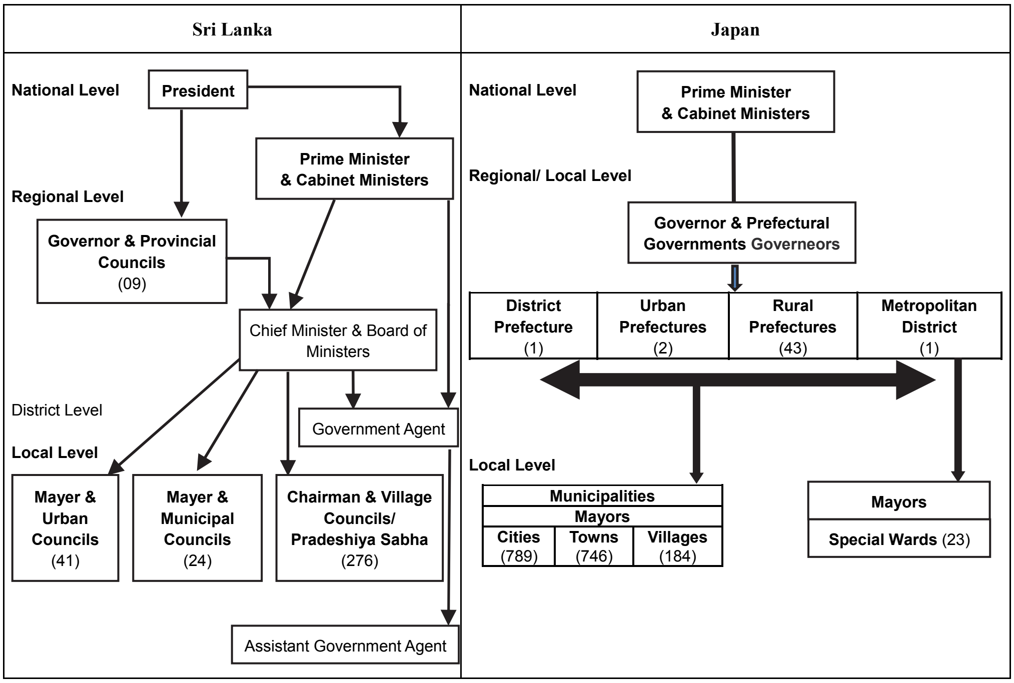
With a similar procedure, the number of local assembly members of Japan is determined by the

[10] With the introduction of universal franchise in 1931 that elected local authorities of four types - Municipal Councils, Urban Councils, Town Councils and Village Councils were established (Leitan, 2001) and the Provincial Councils were established under the Thirteenth Amendment to the Constitution, which came into effect on 14 November 1987 (Wickramaratne, 2010).

[11] The 'main purpose of local self-government' is interpreted as consisting of collective self-government and resident self-government (Constitution).

Ordinance in Japan. The 2011 revision of the Local Autonomy Act eliminates limits by population size (Sakaki, 2014). Candidates for election of assembly members must be residents and at least 25 years old. Governor of Prefecture or Mayer of Municipality is the Chief Executive, elect from the same election and an elected member to be a Governor or Mayer, he/she must be at least 30 years old for a Governor of a Prefecture and 25 years old for a Mayer of a municipality. The Prefectures and Municipalities do not simply denote administrative units of the national government. Nor are they merely agents of the national government. They are independent incorporated entities based in their respective regions[12] and comprised of their residents, which serve to carry out local public administration within their jurisdictions. Japan's local autonomy is based on the Constitution of Japan, which was adopted in 1946 and took effect in the following year. It regards local autonomy as indispensable to democracy, clearly placing local governments within the national government structure and guaranteeing their autonomy. This Local Autonomy Law provides for basic matters relating to the organization and operation of local

Figure No 1: STRUCTURE OF PUBLIC ADMINISTRATION IN SRI LANKA AND JAPAN



Note: In government system of Japan, Central Government, Prefecture Governments, Municipalities, and special Wards have equal statues by level (Statistical Handbook, 2019). In Sri Lanka, Provincial Councils are intermediate level of governments that were established with authority to exercise powers and functions at the provincial level and Local governments have established for delivering required services to the locals with deconcentrated line agencies.

[12] The Prefectures and Municipalities are mutually independent local government entities, with no hierarchical relationships between them in terms of their administrative systems. However, their different natures give rise to different functions. While Prefectures are wide-area local governments encompassing municipalities, Municipalities are basic local governments closely connected to residents' daily lives. Prefectures do give guidance and advice to Municipalities from their more regional perspectives on a variety of issues, and they perform various licensing and permit functions (CLAIR, 2016).

governments such as their types, powers, residents, legislative assemblies, and agencies and financial affairs. It also specifies the relationship between the National and local governments, and the relationship among local governments (CLAIR, 2020).
There are some differences within the systems of both countries, while the similarities of regional governments/ local governments structures. Firstly, there is a difference about autonomy of regional/ local governments in both countries. Japan's local autonomy is based on the Constitution of Japan. It regards the local autonomy as indispensable to democracy, clearly placing local governments within the national government structure and guaranteeing their autonomy. In Sri Lanka, the PCs are autonomous regional governments to a particular region, but the executive power of the President is imposed by the Governor of Provincial Council, he/she is the representative of the Executive President. Functions assigned to the Governor seek to ensure that devolved powers are exercised within the framework of the law. Governor's role responsibilities are the implementation of executive powers regarding matters on which the Provincial Council has power to make statutes, either, directly, or through Ministers of the Board of Ministers, or through subordinate officers. Generally, with the advice of the Board of Ministers, except where he is required to act in his own discretion, which is usually under instructions from the President (Welikala, 2016). As well as, under the devolution subjects of the concurrent list, the Provincial Council can exercise power regarding the subjects in this list. However, before the Provincial Council should pass a statute on such subject, it should consult the Parliament of Central Government for its opinions on the provisions contained in such statute. Where the Parliament desires to pass an Act on a subject in this list it can do so provided however that it would consult the Provincial Councils about the provisions of such Act.

Second basic difference of the structure of Japan is that all governments below the National Government are recognized as LGs. Though the Prefecture governments seem to be the regional governments as these represent a large area, it is considered as LGs. However, there are many similarities of Prefecture governments of Japan and PCs of Sri Lanka. The difference is that the Governor is the Head of the Provincial government of Sri Lanka, he/she is appointed by the Executive President, and holds office during the pleasure of the President. Governor is not an elected member of the Provincial government. The Governor is performed the President's executive mandate in the Provincial government. In Japan, the Governor of a Prefecture is also the Chief Executive officer of the Prefecture government, and he/she is an elected member of relevant election. Governors are appointed with the consent of their assemblies.

LGs are the third and lowest level of governments in Sri Lanka. The local government bodies are collectively known as local authorities. Local authorities don't derive their powers from an individual source but from numerous Acts and Ordinances. The Ministry of Local Governments and Provincial Councils is responsible for policy and legislation at the national level, while the provincial ministers of local government are responsible for administration and supervision at the local level. The national-level minister has powers to create, reconstitute or upgrade a local authority based on the recommendations of a committee established for these purposes. Furthermore, the powers are somewhat curtailed by the fact that they are subordinate to the Central Government and its line ministry and Provincial Councils. The line ministry of the Central Government is intervened in activities of the local governments through the divisional Secretary. The Divisional Secretary works under the village council or 'Pradeshiya Sabha' as its Chief Administrative Officer. He is assisted by a team of staff officers dealing with functions devolved to the Pradeshiya Sabha as well as the functions decentralized from the district level and/ or from the Centre. Meantime, the Provincial Council is also intervened in the Pradeshiya Sabha and hence the Divisional Secretary is supervised the functions of the Pradeshiya Sabha under the power vested in the Provincial Minister of local government and Provincial Commissioner of local government delegated to him. In addition, the Provincial Minister for LGs has oversight responsibility, with authority being delegated to the Provincial Commissioner of LGs. The power to dissolve a council is also exercised at the provincial level and there have been cases of Mayors/ Chairpersons being suspended due to charges of mismanagement and malpractice. Furthermore, Local authorities are accountable to the auditor general for funds transferred to them by the Central Government through PCs.

8.1 Power Decentralization Vs Federalist System

Japan is a unitary state, containing forty-seven administrative divisions, with the Emperor as its Head of State. Sri Lanka is also a unitary state, and the President is the Head of the State. This has been accredited by the Constitutions of both countries. In a unitary state power resides in a centralized government, in contrast to a federal state and central government *is the supreme authority*. As unitary form of governments, the national governments in both countries have all the powers. Any constitutional powers given to the regions or locals of the country are dependent on the national governments, which can withdraw from them at any time. Federalism refers to an organization of government where powers and responsibilities are both divided and shared between the national government and the "constituent unit" which may be state, province, regional or local governments[13]. Sri Lanka is functioning in such a partial power devolution/ sharing structure where the transfer of authority to subordinate levels of government, called Provincial Councils. Local level in Sri Lanka has established the local governments which have been functioning since many decades for local administrative and public services purposes. In these definitions, political decentralization involves devolution whereas administrative decentralization involves de-concentration and delegation of powers to the periphery. In the Sri Lankan context, decentralization involves de-concentration, devolution, and the privatization. Contrary, Japan is implementing a city devolution model in the power decentralization structure. Japan's cities have a strong tradition of devolution and are uniform in their organization and competences, particularly in respect of the so named 'designated cities'. The powers of the designated cities are widespread, being delegated many of the functions normally performed by prefectural governments. Prefectures are regional authorities comprising municipalities and Prefectures and municipalities are both local public entities of equal status and cooperate in local administration according to their share of duties.

[13] Federal state is a political entity characterized by a union of partially self-governing provinces, states, or other regions under a central federal government (https://en.wikipedia.org).

8.2 Sub National Government System in Sri Lanka

As a Unitary Democratic Republic, Sri Lanka is governed by a semi-presidential system, with a mixture of a presidential system and a Parliamentary system. The Parliament of Sri Lanka is a unicameral 225-member legislature with 196 members elected in multi-seat constituencies and 29 elected by proportional representation. Members are elected by universal suffrage for a five-year term. The parliament reserves the power to make all laws. The president's deputy, the Prime Minister, leads the ruling party in parliament and shares many executive responsibilities, mainly in domestic affairs.

The Sri Lankan governance system is divided into three tiers: central, provincial, and local. There are 9 provincial governments, and the local governments are divided into three types of local councils. The local councils include 23 municipal councils, which cover cities and larger urban areas; 41 urban councils, which cover smaller towns, and 271 rural/ village councils, which are also called Pradeshiya Sabha. Local government enshrined in and recognized as subordinate level of government under the direct purview of provincial councils, the 13th Amendment to the Constitution, which states 'Local authorities will have the powers vested in them under existing law, the Municipal Councils Ordinance, and the Urban Councils Ordinance. Pradeshiya Sabhas will have the powers vested in them under existing law (Table No 02). It will be open to the provincial council to confer additional powers on local authorities but not to take away their powers'.

8.3 Sub National Government System in Japan

The Government of Japan consists of legislative, executive and judiciary branches and is based on popular sovereignty. The Government runs under the framework established by the Constitution of Japan, adopted in 1947. The Executive branch of Japan is headed by the Prime Minister. The Prime Minister is the head of the Cabinet, and is designated by the legislative organ, the National policy. Japan administration has also an equal three tier governmental structure[14]. The first tier is the national government. Next are the two tiers of local government − 47 prefectures and 1741 municipalities[15,16]. Meanwhile, as main Prefecture and the metropolitan district with largest inhabitants, Tokyo has 23 special wards. Under the second tire, Japan is divided into forty-seven administrative divisions, it is called 'Prefectures'. The Prefectures are regional authorities and in charge of broader regional administration. Municipalities are named cities (at least 50000 inhabitants), towns, or villages, according to population size. This full structure below the Central Government is identified as Local government system in Japan.

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[14] In Japan, local governments are a part of the governing system for the entire nation, and a "fusion type" system has been adopted in which the central and local administrative entities are in a mutually dependent and mutually complementary relationship.

[15] In addition to such as prefectures and municipalities, there are special local public entities that have been established for specific objectives relating to local government. These include special wards, cooperatives, and public property districts.

[16] Article 1-3 of the Local Government Act: 'Local public entities shall be ordinary local public entities and special local public entities. 'Ordinary local public entities shall be prefectures and municipalities. Special local public entities shall be special wards, associations of local public entities and property districts.

Table No 02: FRAMEWORK OF FUNCTIONAL ALLOCATION AND POWER ENUMERATING OF SNGs

Govt. Category	Country	The Legislative Process	Allocation of Subjects
Central Government	**Sri Lanka**	1978, Constitution of Democratic Socialist Republic in Sri Lanka	- National Policy on all Subjects and Functions - Defense - international relations - currency and customs - national development - National highways and roads - forests, water resources, irrigation, non-renewable natural resources
	Japan	1947, Constitution of Japan	- Expressways - National roads (designated sections) - Universities (national university corporations) - Defense - Diplomacy - Currency
Regional/ Local Governments	**Sri Lanka (Provincial Councils)**	1987, 13th Amendment to the Constitution which enacted by the Provincial Councils Act, No. 42 of 1987 & features amended by Act No. 27 of 1990 and Act No. 28 of 1990	- Internal Law and Order and Police - regional economic plans - provincial education - Housing - Provincial roads - health, rural development - Agriculture - land use and development - cooperative development - Local government
	Japan (Prefectures)	the Constitution of 1947, Article 92, the 1999 Omnibus Law of Local Autonomy	- National roads (other sections) - Prefectural roads - High schools - Management of elementary & junior high school personnel - Public health centers - Police
Local Governments	**Sri Lanka (Municipal, & Urban councils and Pradeshiya Sabha)**	Municipal Council Ordinance No. 29 of 1947, the Urban Councils Ordinance No. 61 of 1939 and Pradeshiya Sabha Act No. 15 of 1987 & six amendment Acts passed in 2016/17*	- local public services - Local roads - sanitation and drains - housing - libraries, public parks and recreational
	Japan (Municipalities-Cities, Town, Village, and special wards)	Local Government, Chapter 8 of the Constitution, Articles 92, 93, 94	- Urban planning, etc. - Municipal roads - Elementary & junior high schools - Kindergartens & day care - Garbage disposal – Care & welfare - Fire services - Resident registry

Source: 1987, 13th Amendment to the Constitution of Sri Lanka, Shun'ichi (2003), Council of Local Authorities for International Relations (CLAIR) (2012)

Note: The demarcation of the spheres of national and provincial competence of Sri Lanka is laid out through three lists of subjects under the Ninth Schedule to the Constitution, a Provincial Councils List, a Reserved List, and a Concurrent List.

* Local Authorities Elections (Amendment) Act (No. 31 of 2017), Local Authorities Filling of Vacancies (Special Provisions) (Amendment) Acts (Nos. 34, 35, 36 and 37 of 2014), Municipal Council (Amendment) Act (No. 34 of 2014, Urban Council (Amendment) Act (No. 35 of 2014), Pradeshiya Sabha (Amendment) Act (No. 36 of 2014).

The Prefectures in Japan are comprised from one Metropolitan district (Tokyo), two urban Prefectures (Kyoto and Osaka), 43 rural Prefectures and one district (Hokaido). The Prefectures are local public entities of equal status and cooperate in local administration according to their share of duties. Both prefectures and municipalities have assemblies whose members, elected every four years by the population, have the power to approve the budget and submit bills and ordinances. According to Article 92 of the Constitution, the local governments of Japan are local public entities whose body and functions are defined by law in accordance with the principle of local autonomy. The main law that defines them is the Local Autonomy Law[17]. They are given limited executive and legislative powers by the Constitution (Table No 02).

9. Fiscal and Financial Foundation of SNGs

9.1 Fiscal/ Financial Devolution

Availability of sufficient financial resource is an important aspect of devolution of powers. Especially, the fiscal power of sub national governments is a most important part in power devolution packages. Because meaningful decentralization is a pre-requisite for effective and efficient exercise of authority and powers by sub-national government. Nonetheless, the distribution of taxing and spending powers between central and sub national governments affects the implementation of economic policies and ultimately their outcome in terms of growth and regional inequality. The decentralization is basically compatible with the supporting for the bottom level participation in the governance process. It has the idea of founding local autonomy by allocating power and resources from the center to the localities (Sivakumar, 2013). As stated in SNGWOFI (2019), subnational governments are governed by political bodies (deliberative assemblies and executive bodies) and have their own assets and administrative staff. They can raise own-source revenues, such as taxes, fees and user charges and they manage their own budget. In other words, it is said that without fiscal decentralization[18], political and administrative decentralization are meaningless. The distribution of powers, responsibilities and resources should be carefully considered to maximize the chances of success of a decentralization process. On the other hand, sharing revenue raised by one order of government with others, as well as the feature of equalization transfers, represent the element of unity and interdependence. In this way, the symbiosis of unity and diversity inherent to the federal idea is reproduced in the fiscal relationship between Centre and regions in federations.

Nevertheless, when the practical situation is considered in Sri Lanka and Japan, each level of government needs financial resources that broadly match its expenditure responsibilities. Specially, with increase of functions and role under the devolved responsibilities, the required amount money that they

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[17] Law for the Improvement of Relevant Laws for the Promotion of Decentralization enacted in July 1999 (the Omnibus Local Autonomy Law)

[18] Fiscal decentralization involves delegating taxing and spending responsibilities to subnational tiers of government. In this case, the degree of decentralization depends on both the number of resources delegated and the autonomy in managing such resources (SNGWOFI, 2019).

need annually is also increased. Furthermore, the money is required to run their own administrative setup of relevant regions and wards and to pay their salaries, provide day today logistic requirements. It can be large with size of responsibilities, geographical area, service delivery, and with national policies and programs carried out by local governments. The existing amounts of expenditure have been recorded in different reports with regards to Sri Lanka and Japan. For example, since 1987 spending by sub-national governments in Sri Lanka has accounted for only 10% of total public sector expenditure; on average 8% for Provincial Councils and slightly more than 2% for local governments (Cartier, Ayer, and Saravanamuttu, 2005). In Japan, the fiscal year 2013, net total expenditure by the national government and local governments amounted to 69.1 trillion yen and 96.6 yen, respectively. The scale of expenditure by local governments reached approximately 1.4 times that of the national government; this figure shows how extensive role local governments play in the public administration of Japan (Tokyo Metropolitan Government, 2006-2018). To meet these, expenditures, necessary funds should be available in SNGs and therefore ensuring that each level of government has adequate financial resources in relation to its expenditure responsibilities is usually done either by assigning adequate tax raising powers to each level, or by creating a system, ideally with a framework in the Constitution, through which the proceeds of taxation raised by one government (most commonly the central government) are allocated between all levels of government. Indeed, if there are weak local tax raising base, restricted possibilities for service fee income and the low level of transfers from central government have kept SNGs in penury.

9.2 The Legal Framework of Fiscal/ Financial Devolution of the PCs in Sri Lanka

The Thirteen Amendment in 1987 and Act no 42 and its part III explains the financial matters of the Provincial Council system. The revenue sources devolved to the provinces are enumerated in Sections 33 and 36.1 to 36.20 of List 1 of the Ninth Schedule to the Thirteenth Amendment. There are twenty sources of revenue currently allocated to the provinces under Item 36 of the Provincial List. While at first glance these sources appear formidable, a closer scrutiny reveals that the main sources consist only of the turnover taxes and stamp duties while license taxes, motor vehicle license fees and court fines are the other substantial revenue sources. However, implementation of Turnover taxes on wholesale and retail sales (paragraph 36.1), motor vehicle license fees (paragraph 36.4), and taxes on mineral rights (paragraph 36.18) are within some limits and subject to such exemptions as may be prescribed by law made by Central Parliament. Taxes on lands and buildings including the property of the state (paragraph 36.17), and other taxes within the province in order to raise revenue for provincial purposes (paragraph 36.20) are permitted only to the extent permitted by law made by Parliament (Welikala, 2016).

Of these main sources of revenue, the Turnover Tax had replaced with the Nation Building Tax in 2010 through a government circular. It was recommended that Provincial Councils be allowed to directly collect turnover taxes. It was further recommended that procedures and limitations be established in the constitution to limit the central government's ability to control the taxation powers devolved to the provinces. Section 2 of the Provincial Councils Turnover Taxes (Limits and Exceptions) Act No. 25 of

1995 imposes restrictions on the turnover taxable by a provincial council in the following ways: the rate of tax imposed by a provincial council shall not exceed five percent of the turnover, and provincial councils must mandatorily exempt wholesale or retail sales by the manufacturer of goods, wholesale or retail sales by co-operative societies, or wholesale or retail sales to buyers outside Sri Lanka (*vide* s.2 (3) read with the schedule to the Act) taxes on lands and buildings including the property of the state (paragraph 36.17), and other taxes within the province in order to raise revenue for provincial purposes (paragraph 36.20) are permitted only to the extent permitted by law made by Parliament (Waidyasekera, 2005, Welikala, 2016).

Text Box: 01

Revenue Source-wise

The revenue sources of Provincial Councils can be divided into three broad categories.
a) Taxes on Production and Expenditure.
b) Receipts from Property and Investment.
c) Sales and Charges.

a) Taxes on Production and Expenditure consist mainly of the turnover taxes on wholesale and retail sales, license fees on liquor, betting taxes, taxes on lotteries and prize competitions, arrack and toddy tavern rents, stamp duties, motor vehicle license fees and fines.
b) Receipts from Property and Investment consist largely of rents from land and buildings, interest and dividends.
c) Sales and Charges include profits from commercial activities, court fees and fines, fees under the Motor Traffic Act and the Omnibus Act and the Registrar of Companies. Such sales also consist of sales of capital goods.
Provincial revenue could also be classified into two types: i) those that are collected by the Provincial Council and credited to the Provincial Fund itself, and ii) those that are collected by the Councils and not credited to the Fund but distributed to local bodies.
The base of the tax is limited by three factors.

i) Exemption of certain commodities and items gazette.
ii) It is limited to wholesale and retail sales and precludes other activities such as manufacturing and services.
iii) It is subject to the limitations and exemptions prescribed by Parliament and legislated under the Provincial Councils' Turnover Tax (Limits and Exemptions) Act No. 25 of 1995.

Furthermore, enabling legislation in the form of Financial Statutes have been passed by the respective Provincial Councils with effect from January 1, 1991, to empower them to recover the relevant taxes and fees, e.g., Western Province Statute No.6 of 1990, Southern Province No.9 of 1990 and North Central Province No.13 of 1990 etc. To achieve uniformity of application, the substantive as well as the procedural law in all provinces is basically the same.

With limited tax raising powers of Provincial Councils in Sri Lanka under the 13th Amendment, they are considerably dependent on transfers from the Central Government[19]. Sri Lanka has a Finance Commission established under Article 154R of the 13th Amendment, which is somewhat similar to the Finance Commission of India, although the latter's mandate appears to be far wider than its Sri Lankan

[19] Transfers come as Block Grants, Criteria Based Grants and Development Grants.

counterpart's constitutional sphere of activity. The Finance Commission is charged with the duty of recommending to the President the principles to be employed in allocating funds to provinces and for the due apportionment of such funds between the provinces. The Constitution states that the commission must consider "the need, progressively, to reduce social and economic disparities" (154R (5) (c)). Thus, it was recommended that the constitution make provisions concerning the amount of funds to be transferred to the provinces by the Centre, particularly in ensuring that amounts transferred are commensurate to the responsibilities devolved to the provinces under the constitution (Ganeshathasan & Mendis, 2015). Such transfer procedures from Central Government to local governments are common characteristic in a federal system which ensured adequate financial resources in relation to expenditure responsibilities to each level of governments, ideally with a framework in the Constitution, through which the proceeds of taxation raised by one government (most commonly the central government) are allocated between all levels of government.

Under the 13th Amendment provincial councils may only borrow from the central government to the extent allowed by Parliament (*vide* s. 19 (1) (c) of the Provincial Councils Act No. 42 of 1987 and paragraphs 35 and 31 of the Provincial List). In other words, the province should be given the implementation authority in respect of foreign-funded projects related to provincial subject matter. External resources were always channeled through central institutions, and a limited form of intergovernmental relations. This borrowing ability, however, has its limitations both legal and commercial. The legal limitation is partly inherent in item 35 itself where the borrowing power is available only to the extent permitted by or under any law made by Parliament. Further, foreign borrowing is specifically precluded under List II and foreign aid through loans under Section 22 of the Provincial Councils Act No. 42 of 1987 must be channeled through the Central Government and would be project oriented. The commercial and practical considerations would be the performance and creditworthiness of the Provincial Council, as well as the viability of the projects concerned both for government guarantees and/or acceptance of collateral by banks (Waidyasekera, 2005).

9.3 Fiscal/ Financial Power of Local Governments in Sri Lanka

The powers and functions of the local authorities are mainly derived from the relevant legislations i.e., the Municipal Council Ordinance No. 29 of 1947, the Urban Council Ordinance No 61 of 1939 and the Pradeshiya Sabha Act No 15 of 1987. Financial arrangement for local governments has also noted in the Municipal Council Ordinance No. 29 of 1947, the Urban Council Ordinance No 61 of 1939 and the Pradeshiya Sabha Act No 15 of 1987. As the third tier, local authorities are responsible for collection of local taxes and user fees, as well as other sources of revenue such as property rates and assessments, revenue grants for salary and rents. Locally raised taxes must be levied within limits prescribed by national government. Every local government, for its general financial purposes has a local fund. All receipts come from taxes, duties, fees, and other charges levied under the authority of this Ordinance must be payable into the local fund[20]. Grants are provided from both provincial and national government. National government provides financial transfers to cover salaries in whole or in part and to meet the monthly allowance payable to councilors. In the Pradeshiya Sabhas, the whole salary bill is covered, whereas in the smaller urban authorities it is closer to 70%. In Colombo Municipal Council it is about 50%. There is no formal policy of revenue sharing and grant decisions are made on a case-by-case basis by the Finance Commission. The Local Loan and Development Fund is a statutory body providing over LKR100m of loans per year to local government at below-market rates, with a focus on infrastructure development.

In addition, loans shall be lawful for a local governments subject to the approval of the Minister, to borrow from the Sri Lanka Government, or an any person or person or body of persons, whether incorporated or not, such sum or sums of money as may be necessary for any of the purpose of the local government, provided that the approval of the Minister shall not be necessary for borrowing any such sum if the amount outstanding in respect of all loans already raised by such local government does not exceed the total income received by such local government during the three years immediately preceding the year in which that sum is to be borrowed[21]. Meanwhile, the Government of Sri Lanka has established a Local Loans and development Fund for the local governments. The Local Loans and Development Fund (LLDF) is the statutory body established under the Local Loans and Development Ordinance No.22 of 1916. Initially the objective of the fund was to provide loans to any local authority. The fund functions under the minister in charge of local government. The LLDF is managed by a Board of Commissioners (BoC), comprising seven chief secretaries, two provincial commissioners, one member nominated by the Minister of Finance and three persons nominated by the Minister in charge of Local Government. The secretary to the ministry of local government is the ex-officio chairperson. The prime function of LLDF is to meet the capital investment needs of the local authorities and it provides long term loans at a concessionary rate of interest.

9.4 Legal Framework of Fiscal/ Financial Devolution of the Local Governments in Japan

Japan's local autonomy is based on the Constitution of Japan, which was adopted in 1946 and took effect in the following year. It regards local autonomy as indispensable to democracy, clearly placing local governments within the national government structure and guaranteeing their autonomy. According to Article 92 of the Constitution, the local governments of Japan are local public entities whose body and functions are defined by law in accordance with the principle of local autonomy. The main law that defines them is the Local Autonomy Law. Subsequently, these constitutional provisions strengthened time to time attaching important laws and regulations to the Local Autonomy Law e.g., the 1999 Omnibus Law of Local Autonomy.

Local governments basically have complete power over their independent financial operations, although

[20] Urban Councils Ordinance No 61 of 1939 & Municipal Councils Ordinance No 29 of 1947
[21] Pradeshiya Sabha Act, No. 15 of 1987

there are various mechanisms in place for maintaining balance with national government financial operations and for guaranteeing revenue sources. Finance is the economy of the public authority body with coercive power. Under the Article 223 of the Local Autonomy Law, Ordinary local public entities may levy and collect local taxes as prescribed by law. Further, according to the Article 3(1) of the Local Tax Law, a local body shall determine the tax items, taxable objects, tax base, tax rates and other matters concerning the levy and collection of its local taxes in accordance with the bylaws of the local body concerned. The local tax and local allocation tax (general revenue sources), national government disbursements[22] and local government bonds are the major revenue sources for local governments (MIC, 2010). In addition, there are some other financing sources which include local transfer taxes, usage charges and fees etc.
Local government revenues mainly come from local taxes. It is about 60% from the total revenues. The Local Tax Law provides for the imposition and collection of taxes by prefectures and municipalities. There are many types of local taxes in Japan, with the Local Tax Law providing for 13 types of prefecture taxes (11 types of ordinary and 2 types of earmarked taxes), and 13 types of municipal taxes (6 types of ordinary and 7 types of earmarked taxes), i.e., 26 types of local taxes in all. Main taxes of Prefecture governments are Municipal inhabitants' tax, local cooperate tax, local consumption tax, property tax, city planning tax and Municipal tobacco tax respectively. Main taxes of Municipalities are individual municipal inhabitant tax, Corporate municipal inhabitant tax, Fixed asset tax, City planning tax etc. (Sasaki, 2014, CLAIR, 2020). Also, in addition to these, local governments may create non-statutory ordinary and non-statutory earmarked taxes. The local allocation tax should be counted as local government tax revenue but is instead collected by the central government as a national tax on behalf of the local governments[23]. It is then re-distributed in accordance with prescribed standards to compensate for the imbalance in financial resources among local governments, guaranteeing financial resources so that all local governments can maintain a certain set level of administrative services.

However, utilization of local allocation tax revenue is up to the independent judgment of each local government, and the central government is prohibited from attaching conditions to or restrictions on its use. This point makes the local allocation tax essentially different from other national government grants, whose uses are specified, and a general financial resource (that can be used according to the local government's own judgment) equal in importance to local taxes. Furthermore, if revenue sources are insufficient, the national government will consider amendment of the local finance system or an increase in the local allocation tax rate to secure the necessary financial resources for local governments (CLAIR, 2020).

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[22] The National Government disbursements are allocated to local governments by the central government. However, these disbursements are earmarked for specific uses. There are three types of central government disbursements: national treasury obligations, grants, and payments for delegated functions. All of these are earmarked revenue sources allocated to specific programs and projects, and they cannot be diverted to other purposes.

[23] The local allocation tax is an intrinsic revenue resource shared by local governments in order to adjust imbalances in tax revenue among local governments and to guarantee revenue resources (Sasaki, 2014).

In addition, as mentioned above, article 5 of the Local Finance Law[24] contains the basic principle that local governments must have sources of revenue other than local bonds to cover their annual expenditures. However, this article does allow local bonds to be issued to cover expenses for things such as publicly owned corporations, disbursements, and loans, refinancing of local bonds, disaster emergency projects, and maintenance of public facilities. Hence, any local government may issue bonds anyway after reporting to its assembly, even if it cannot obtain the necessary approval. Nonetheless, Local governments may take out long-term, low interest loans of public funds after consulting with and receiving the approval of the Minister of Internal Affairs and Communications or others (Oura, 2002 & CLAIR, 2020). Most local governments borrow long-term money from financial institutions, such as commercial banks, Agricultural Co-operative Associations, and Insurance Companies (MIC, 2010).

10. Operational Status of Fiscal/ Financial Devolution

Most integral part of power devolution to sub national governments is the fiscal and financial devolution. Also, fiscal relations across different levels of government are a key determinant component of the institutional framework that can affect regional convergence and inequality across territories. If the financial devolution is not perfect, the power devolution process is weak and does not work properly. As Gulati (1994) stated “the functional decentralization will remain on paper is a corresponding financial devolution is not made will be generally accepted”. Specially, if the fiscal federalism is not perfect, in other words, if there is not a locally determined tax regime, SNGs cannot raise funds on their own requirements[25]. Therefore, allocation of functions and responsibilities to SNGs should be match with financial powers and funds are put at their disposal without too many constricting conditions. Ideally speaking, the SNGs should have adequate powers to raise matching resources of their own. It is important in this study that to explore the extent of fiscal federalism in relation to Sri Lanka and Japan.

10.1 Strength and Limitations of Fiscal/ Financial Devolution: Sri Lanka

The devolution of powers and functions on provincial councils in Sri Lanka are largely based upon the powers and functions of the States in India (Welikala, 2016). The 13th Amendment to 1978 Constitution of Sri Lanka indicates the “devolved subjects” to the provincial councils under List I, while categorizing the “reserved subjects” for the central government under List II. This specifies the reserved subjects as “national policy on all subjects and functions.” In addition, the List III specifies the “concurrent subjects” those concurrently managed by the Centre and the provinces. To execute the functions in the list I and concurrent list, Provincial governments need a considerable number of financial resources annually. Nonetheless, a significant amount of money has been paid out by the Provincial Councils annually to run the administrative mechanism of nine Provincial Councils in the country, particularly for salary

[24] the *article 5* of "*Local*. Public *Finance Law*” in Japan

[25] In devolution packages of many countries, there are fiscal freedom which is a broader suite of local taxes and restoration of certain grant funds, and fiscal devolution which is same local taxes but devolution of some central taxes, but not perfect fiscal federalism.

payments and logistics items. This annual required money does not fulfil from revenue of the PCs earned, but largely come from the Central Government allocations. Following table shows the PCs tax earning and its size compared to the Central Government earning and the GDP percentage in Sri Lanka.

TABLE NO 03: Revenues of Provincial Councils in Relation to Government Revenue 1999 - 2020 (Rs. Million)

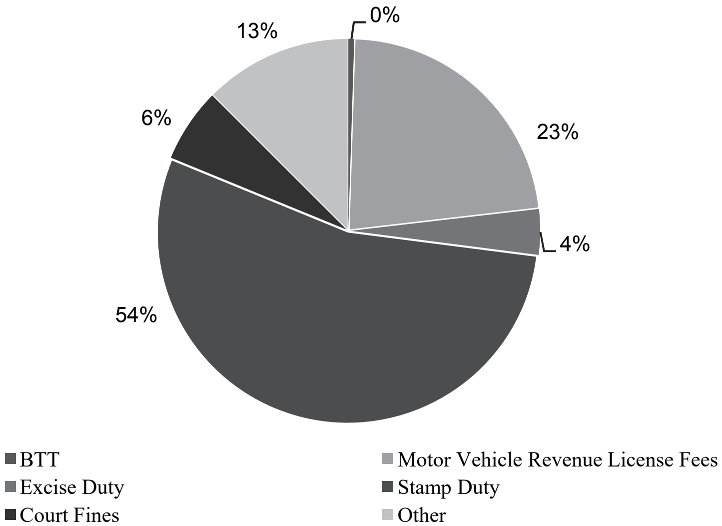
Item	2001	2004	2007	2012	2015	2018	2020
Central Government Total Revenue	234,296 (16.6)	311,437 (15.3)	565,051 (15.8)	1051,460 (13.9)	1454,878 (13.3)	1919,973 (13.4)	1367,960 (9.1)
Provincial Total Revenue	8,674 (0.6)	13,522 (0.6)	25,868 (0.7)	49,235 (0.6)	67,972 (0.6)	88,689 (0.6)	52,245 (0.3)
% of Provincial Total/ Government Total Revenue	3.7%	4.3%	4.6%	4.7%	4.7%	4.6%	3.8%
Central Government Tax Revenue	205,840 (14.6)	281,552 (13.8)	508,947 (14.2)	908,913 (12.0)	1355,779 (12.4)	1712,318 (11.9)	1216,542 (8.1)
Provincial Tax Revenu	7,539 (0.5)	11,544 (0.5)	21,473 (0.6)	41,657 (0.5)	61,476 (0.6)	82,228 (0.6)	43,096 (0.3)
% of Provincial Tax/ Government Tax Revenue	3.6%	4.1%	4.2%	4.6%	4.5%	4.8%	3.5%

Note: Figures in parenthesis denote percentage/GDP.
Source: Compiled from Central Bank of Sri Lanka Annual Reports, various years.

Above Table No 03 shows that the amount of revenues that the Provincial Councils of Sri Lanka collect from their own domains. It is demonstrated that the total revenue of all PCs as a percentage to Central Government total revenue is less than 5% and 0.6% as a percentage of GDP. The rates of tax revenues are reflected same pattern and more than 95% tax revenues collected of the country is belonged to the Central Government. Another salient feature of this revenue collection is that the Provincial Council of Western Province is collected about 45-50% from total revenue collections of nine provincial councils. In other words, size of revenue collection of Provincial Governments is relatively small except the Western Province. Further, there is an unequal revenue base in provinces. As mentioned in the Ninth Schedule to the Thirteenth Amendment and its devolution part of taxes, tax income come from the turnover taxes and stamp duties while license taxes and motor vehicle license fees and court fines are the other substantial revenue sources. From Provincial revenues, main contributors are Stamp duties and Motor vehicles license fees, which recodes about 80%. However, the power of Turnover Tax collection on wholesale and retail had been given to the Provincial Councils since 1991 and it was a largest percentage in the early years of 1990s. In 1998, introduced the Goods and Services Tax in place of Turnover Tax (abolished Goods and Services Tax in 2002 and introduced Value Added Taxes). Converting remaining amount of provincial turnover taxes into Nation Building Tax (NBT) since 2009, collection of NBT removed from the Provincial Councils and now all sales taxes are collected by the

Central government and the collection of NBT goes back to the PCs as transfers[26]. However, the collection of stamp duties in some limits are remaining and part of stamp duties are also collected from the Central Government and Transfers to the PCs. Particularly, showing an interesting characteristic in federal framework in Sri Lanka, almost all revenue is collected by the Central government whereas expenditures are highly decentralized and regional finance most of their obligations to deliver public services via transfer from the central government (a mix of conditional and unconditional transfers). Following Figure No 02 shows that revenues receiving of the PCs in different sources by present.

Figure No 02: REVENUE COLLECTED FROM DEVOLVED SOURCES OF THE PROVINCIAL COUNCILS - 2018



Source: Finance Commission, Annual Report 2018
Note: Others include rents, interests, examination fees, sale of capital assets, betting tax etc.

Furthermore, the transfers of NBT revenues and stamp duty from the central government to the PCs accounted about 40-45 per cent and 40 per cent of total tax revenue of PCs, respectively. The revenue collection from fees and charges, which accounts for around 75 per cent of total non-tax revenue of PCs. Altogether, the revenue collection of PCs is covered only about 15% of PCs' total expenditure. The largest percentage of expenditures of PCs is recurrent expenditure, which indicates more than 90%. This happens mainly due to higher expenditure on personal emoluments and the maintenance cost of roads and irrigation, the personal emoluments are recorded about 70% from total expenditures and continued to be the single largest item in the recurrent expenditure. The capital expenditures of PCs are only about

[26] National authorities such as the Commissioner General of Inland Revenue, the Director General of Customs, and the Commissioner General of Motor Traffic, has to be transferred to the provinces on the following basis: NTB 33%, Stamp Duties 100% and Vehicle Registration fees 70% (Finance Commission, 2018).

5-10%, being a considerable issue of PCs in the country in relation to development role. Of course, this can no longer be justified. Huge amount of money is spent for survival, which is in fact wasteful. Further, regular delays in disbursements of funds by the Treasury has led to greater liabilities and provincial council's inability to meet their commitments, which in turn impact their credibility and image. In certain instances, a lack of proper financial control by some of provincial councils has led to mismanagement of funds.

Table No 04: FINANCING THE EXPENDITURE OF THE PROVINCIAL COUNCILS (Rs. Millions)

Item	2000	2005	2010	2015	2020
TOTAL EXPENDITURE	37,328	73,009	145,491	269,586	337,006
TOTAL REVENUE	7,534	16,132	36,829	67,972	52,245
FINANCING THE DEFICIT					
CENTRAL GOVERNMENT TRANSFERS	31,543	59,696	107,032	201,614	284,761
1. Block grants out of Central Government transfers	76%	79%	80%	83%	93%
2. Criteria based grants out of Central Government transfers	4%	2%	2%	2%	1%
3. Specific development grants out of Central Government transfers	18%	9%	11%	7%	4%
4. Foreign grants for specific out of Central Government transfers	2%	10%	7%	8%	2%

Source: Compiled from Central Bank of Sri Lanka Annual Reports, various years.
Note: In some years, the deficit is not equal to Central Government transfers due to differences of matching grants and specific development grants.

As shows in Table No 04, transfers of Central Government to the PCs are come in different forms. They are Block Grants, Province Specific Development Grants (PSDGs) and Criteria Based Grants (CBGs). The amount of these grants is decided by the Finance Commission of Sri Lanka under the given criteria. Block grants are the major form of central government transfers to PCs, and it provides for recurrent expenditures of the PCs. As show in the above Table No 04, a largest percentage of transfers come from the Block Grants which is currently more than 90%. The transfers under PSDGs, grants for special projects and CBGs are about 4% and 1% respectively which basically come under the capital expenditures category. During the period after 2000, a share of 85 per cent of the total expenditure of PCs was financed through the Central government transfers reflecting the need to enhance the revenue collection of PCs, thereby to ease the burden on the Central government budget. Depending largely on transfers in financing the budget of PCs has in one side been lessening the taxing power of PCs further and creating of new revenue sources. Nonetheless, there is an inefficient impact on allocation financial resources, expenditure management and accountability. Regarding that, Bartolini et al. (2016) explain that subnational governments that rely on own resources, rather than transfers from the central government, tend to allocate more spending to economic rather than social areas (i.e., local policies related to investment and the business environment). Similarly, Kappeler et al. (2013) show that higher tax decentralization is associated with a shift of local spending towards investment in infrastructure and education.

10.2 Revenue Capacity and Fiscal Potential

The main fiscal weakness in the provincial council system in Sri Lanka is the paucity of revenue in relation to its expenditure, both in terms of volume and diversity. The tax base transfer has been minuscule compared to expenditure responsibilities. Meantime, inadequate financial capacity, duplication of work and lack of clarity in devolved functions hinder effective service delivery. Further, lack of effective authority over finances and human resources and lack of skills in enactment of statutes by provincial staff have contributed to weakened provincial administration and there is a lack of motivation to introduce imaginative or innovative revenue enhancing measures or schemes within the province. Nonetheless, though there are limited devolved powers in enactments of statutes for new avenues for taxes, it has been again controlled by the Centre under some limitations, prescribed by law made by Parliament and the dominance of central bureaucratic institutions, and non-implementation of the 13th Amendment to the 1978 Constitution fully. The limitation on revenue raising have prescribed for almost all the taxes imposed by the PCs. For example, Turnover taxes on wholesale and retail sales, motor vehicle license fees, and taxes on mineral rights are within such limits and subject to such exemptions as may be prescribed by law made by Parliament. Enumerated Taxes on lands and buildings including the property of the state also, and other taxes within the province to raise revenue for provincial purposes are permitted only to the extent permitted by law made by Parliament. In brief, the 13th Amendment shows that it does not allow provincial councils any serious autonomous revenue raising power, instead opting for direct grants from the Centre and a limited form of revenue sharing. Consequently, being the PCs are a 'White Elephant' in the public administration, inadequate financial and fiscal power of PCs has been a critical issue as it is huge impediment on development process.

10.3 Revenue Potentiality of PCs

Even within the limits of taxation, there are some significant avenues to initiate new taxes at regional basis. Specially, the PCs are able to introduce new taxes and also fines within devolved subject areas and usage of regional basis resources. However, this potentiality has not yet been utilized by any of the Provincial council in Sri Lanka. This situation has indicated by many studies. Regarding this, Wijesinghe (1996) stated that around half of the actual realizable revenue potential at Provincial or regional level may still be untapped. The most feasible sources for additional revenue that can be considered list out as follows:

(1). An additional tax revenue can be generated by changing rates and considering current values on land and buildings including the property of the state to the extent permitted by Parliament. Especially, rates imposed can be changed on earning capacity and yield of lands utilized for farming and buildings leased in urban areas etc.

(2). Levying taxes on Mineral Rights. Some provincial areas of Sri Lanka are rich in mineral deposits such as graphite or plumbago, gems and precious stones, ilmenite, and phosphate. This is an enormous potential lucrative revenue source for the Provincial Councils but at present seems to be mostly untapped.

(3). The stamp Duties that can be collected in regional basis on the deeds relating to the transfer of immovable property are largely undervalued and the valuation declared on the deeds is mostly less than marketable values. An acceptable method of regular and expeditious re-examination of deeds could result in considerable revenue improvement of the PCs.

(4). There is a significant potentiality for taxes and fees on other areas such as fees under the Medical Ordinance, Fauna and Flora Protection Act, Weights and Measures Ordinance, license fees on drugs and chemicals, transport, purchase & sale of intoxicating liquors, and betting in provincial areas.

(5). The PCs have further potentiality to levying taxes or fees on transportation of commodities, and parking facilities for private vehicles and an entertainment tax in utilizing of gardens, parks, rivers, lakes, and various entertainment locations.

10.4 Limitations of the Central Government Transfers

The annual gap between the revenues expenditures of PCs is financed by the Central government transfers which comes on the recommendation of the Finance Commission. The amounts of transfers given to the PCs are decided by the finance Commission to the stipulated criteria[27]. Decision over the transfers is not one and only role of the Finance Commission in relation to the PCs. It has a somewhat broader role in fiscal and financial management. In fact, the function of the Finance Commission is to maintain 'vertical fiscal imbalance', i.e., setting of revenue raising powers of PCs and the equalization of horizontal fiscal imbalances among the PCs. The horizontal equalization is the allocation of finance to regional disparities in economic development and wealth, arising from natural or geographical, economic, or political factors. Specially, the duty in financial allocation of the Finance Commission in the adjustment of the vertical fiscal imbalance is to make recommendations to the President as to the principles on which funds allocated annually by the central government budget to the provincial level should be apportioned between the various Provinces. In this situation, there is not an autonomous decision-making process to the PCs in relation to the financial transfers. It has been controlled by the Central Government allocation procedures and authorities. Nonetheless, there is neither direct provincial representation nor provincial involvement in this process which has been a major weakness in the process of financial allocation of PCs.

[27] According to the horizontal equalization, the Commission is to formulate the principles necessary to achieve balanced regional development across the country. In doing so, the Commission considers (a) the population of each Province, (b) the per capita income of each Province, (c) the need, progressively, to reduce social and economic disparities, and (d) the need, progressively, to reduce the difference between the per capita income of each Province and the highest per capita income among the provinces.

In addition, the Governor as the President's representative makes the rules governing all aspects of provincial finance, including the Provincial Fund and the Emergency Fund of the Province. Financial oversight of the provincial administration is to be carried out by the Provincial Council, and further oversight by the Governor and Parliament was deemed an unnecessary intrusion into provincial autonomy by the Centre. Meanwhile, the Governor's discretionary powers regarding provincial financial statutes are significant: all statutes involving revenue or expenditure can only be introduced, moved, or passed by the Provincial Council on the prior recommendation of such a statute by the Governor; all demands for central grants to the Provincial Council require the Governor's recommendation; the annual budget of the provincial administration is presented to the Provincial Council by the Governor[28]. All these reflect an interference of the Executive authority and the Central Parliament of the country in financial and fiscal matters of the PCs.

10.5 Autonomy of PCs on Borrowings

Borrowing authority in Sri Lanka has remained centralized. Under the 13th Amendment provincial councils may only borrow from the central government to the extent allowed by Parliament (*vide* s. 19 (1) (c) of the Provincial Councils Act No. 42 of 1987 and paragraphs 35 and 31 of the Provincial List). Regarding this Herath (2009) has stated that the Provincial Councils are allowed to maintain a provincial fund and raise loans, which somewhat offset limits on revenue generation via taxation. As well as, external resources are always channeled through central institutions, and a limited form of intergovernmental relations. Foreign funding, hence, obtained by the central government for projects falling within provincial subject matter should be directed to the provinces and international borrowings by regional administrations shall be subject to criteria and limitations specified by Parliament which requires the concurrence of the central Minister of Finance. The province should be given implementation authority in respect of foreign-funded projects related to provincial subject matter. Similarly, any agreements negotiated and entered by regional administrations regarding international grants and foreign development assistance are to be in accordance with the national policies on international aid, which are formulated by the Centre. However, the actual authority to raise funds is highly controlled by the central government, as clarified in the Eleventh Amendment. Ultimately it can interpret as Provincial Councils having the ability to borrow, but under limited circumstances and subject to central government scrutiny.

Fiscal/ Financial Power of the Local Governments of Sri Lanka: The fiscal and financial powers of the local authorities are mainly derived from the relevant legislations. The legislative clauses are clearly clarified the scope and responsibility of local authorities in provision of assigned services to the public

[28] It is regarding the procedure for fiscal and financial statutes in the Provincial Councils that the Governor's powers are most visible, and least compatible with democratic and devolution principles. The Governor makes the rules governing all aspects of provincial finance, including the Provincial Fund and the Emergency Fund of the Province. The Governor presents the annual budget of the provincial administration to the Provincial Council showing the estimates of receipts and expenditure, and he must recommend all demands for grants made to the Provincial Council. While the Provincial Council has the authority to approve the annual budget, the consequent Appropriations Statute is subject to the assent of the Governor (Walikala, 2016).

and types of local taxes and user fees that can be collected from their domain. Basically, the local government revenues are mainly come from assessment rates, rent, license fees, charges for services and capital receipts respectively. However, the local governments do not have an autonomous authority in operation of service delivery and collection of charges, which are often regulated under the rules and scrutiny of the Central government. This control has been existing for many decades, particularly from prior to the independence and after 1948, the local governments have been operating under the line ministry of the Central Government. This has been further broadened with commencement of PC system since 1987 and hence the supervision of local governments has become a devolved subject of the provincial governments under the Sri Lankan Constitution.

By present, Sri Lankan local government system does not have a strongest fiscal & financial capacity as it is not an autonomous governing structure. The local governments have limited own sources of revenue with procedural constrains for enhancement of own sources especially regarding property taxes; limited use of powers conferred to it regarding taxation. Therefore, the local governments have a high dependence on fiscal transfers of the Central Government. As Smoke (2015) stated, from a fiscal perspective, local governments in Sri Lanka are heavily dependent on central and provincial government transfers and loans. Own source revenues, which include property taxes, user fees and licensing charges, account for less than 1 percent in total public sector revenue. Of these existing revenue sources, the stamp duty on the transfer of property and court fees are largest respectively. Altogether, it is very clear with its receipts that the revenue grants including stamp duties (35%), capital receipts (14%), assessment rates (14%), license fees (11%) of the total revenues. When the revenue receipts are compared, from this total collection 40-50% is collected by the Municipal councils and 40-45% is collected by the Pradeshiya Sabhas and less than 10% is collected by the Urban councils (Ministry of Local governments, 2021). Furthermore, it is to be noted that the local government own source revenues, which include property taxes, user fees and licensing charges, account for less than 1% in total public sector revenue. As a result, from the fiscal perspective, local government in Sri Lanka are heavily dependent on central and provincial government transfers and loans. Meanwhile, the local governments are taken funds from external Sources such as funds through private sector partnerships; community level interventions; loans /local loan development fund/over drafts from banks for short term financing. Transfers are come in the form of block grants that flows to the local government from Provincial Councils.

10.6 Trends of Expenditures of the PCs and Local Governments in Sri Lanka

The revenue receipts of PCs are utilized to finance different expenditures annually. These expenditures as a percentage of GDP are annually laid between 2-4%. The largest percentage of these expenditures is utilized for recurrent expenditures and the recurrent expenditure for all provinces significantly outweighs capital expenditure annually. Personal emoluments account for more than 60% of this total recurrent expenditure (Table No 05) and the total amount of recurrent expenditures has been increasing continuously for last couple of decades mainly due to the increase in personal emoluments, which continued to be the single largest item in recurrent expenditure of PCs. The education and health sectors absorbed a major portion of the personal emoluments of PCs accounting for nearly 90 per cent of the total expenditure on personal emoluments. Moreover, the local authorities in the Western Province of the country are incurred a large expenditure of about 45% of total estimated expenditure in a year (Ministry of Provincial Councils & Local Governments, 2018). Meanwhile, a part of the revenues which comes as block grant transfers to the PCs provides to the local governments. This is one of main revenue sources of the local governments and the total which includes the national line ministry transfers and own generated incomes spend on various roles such as staff expenses, operations and maintenances, capital expenditure and recurrent expenditures related to subnational spending on roads, hospitals, and other public service utilities (World Bank, 2006). The capital expenditures of the Local Governments are mostly used for building of capital assets and the rest spends largely for repair capital assets & supply of Equipment etc.

Table No 05: EXPENDITURE CLASSIFICATION OF THE PCs IN SRI LANKA 2000 -2020

Expenditure Item	2000 %	2005 %	2010 %	2015 %	2020 %
1. RECURRENT EXPENDITURE	77	81	83	81	86
O/W Personal Emoluments	*59*	*64*	*65*	*63*	*67*
2. CAPITAL EXPENDITURE	23	19	17	19	14
Total	100	100	100	100	100

Source: Central Bank of Sri Lanka

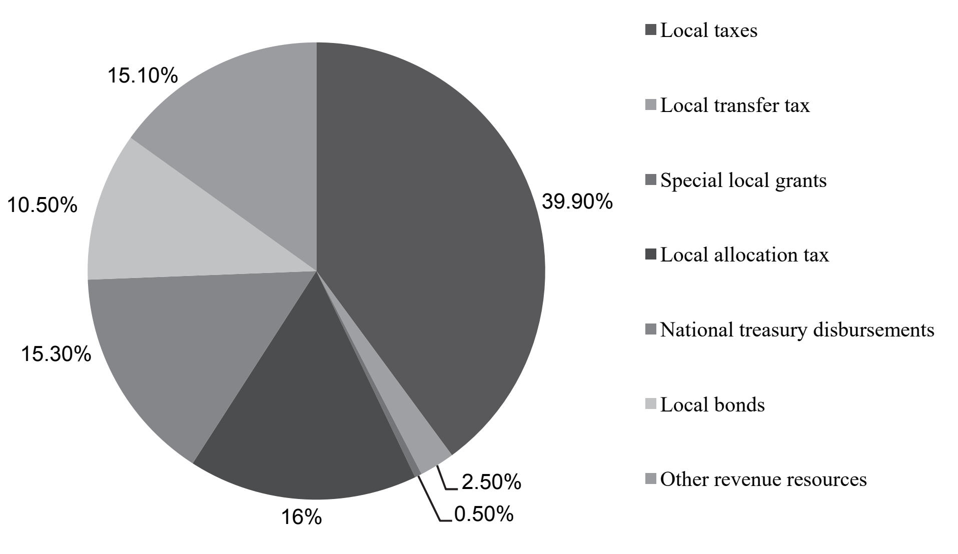
10.7 Strength and Limitations of Fiscal/ Financial Devolution: Japan

Local governments in Japan basically have complete power over their independent financial operations, although there are various mechanisms in place for maintaining balance with national government financial operations and for guaranteeing revenue sources. Indeed, Japan's local government financial affairs come under the Autonomy Law with all other basic matters relating to the organization such as operation of local governments, powers, residents, legislative assemblies, and agencies. The local government assemblies have an authority to approve financial plans/ budgets and establish ordinances within the law. The local finance plan is officially called "Estimated Total Local Public Entity Revenue and Expenditure". Article 7 of the Local Allocation Tax Law stipulates that the Cabinet is required to specify such a plan, submit it to the Diet, and announce it publicly.

The local finance plan is a system to verify whether local governments have the financial resources necessary to provide the legally prescribed level of projects and administrative services. It is arrived at by computing all local government revenues and expenditures, and then estimating their overall budget situation. If revenue sources are insufficient, the national government will consider amendment of the local finance system or an increase in the local allocation tax rate to secure the necessary financial resources for local governments. Conversely, local governments can use the local finance plan to gain an understanding of the ideal local finance situation across the nation in order to maintain consistency with national economic and fiscal policies, achieve harmonization among national government finance, local government finance and they can make it a guide for their own financial operations. In addition, under the Article 94, the local public entities shall have the right to manage their property, affairs, and administration and to enact their own regulations within the law. The power on all these is relatively high and sound compared to Sri Lanka as it enhances the autonomy and independence of local governments.

The financial resources of Japan’s central government are operated in a decentralized form, where authority and financial resources have been transferred in large measure to local governments. In this separated pattern, the central government does not carry out administrative intervention vis-à-vis a local government, which for its part, is able to implement its duties independently. It is fair to say that the relationship between central government and local governments in Japan, characterized for a long time by the existence of the “Agency Delegated Function System” also belonged to this interfused pattern of government (Ikawa, 2008). Hence, strengthening the revenue base of the local governments, the Central Government has conferred a considerable taxation power to the local governments and certified a central financial allocation to fill the budgetary gap. Relatively, financial base of local governments of Japan is hence strong as it shows a good example for the fiscal federalism. As shows in following Figure No 03, the main sources of revenues are the local tax, local allocation tax, national government disbursements and local government bonds.

Figure No 03: COMPOSITION OF THE LOCAL GOVERNMENT REVENUES - 2019

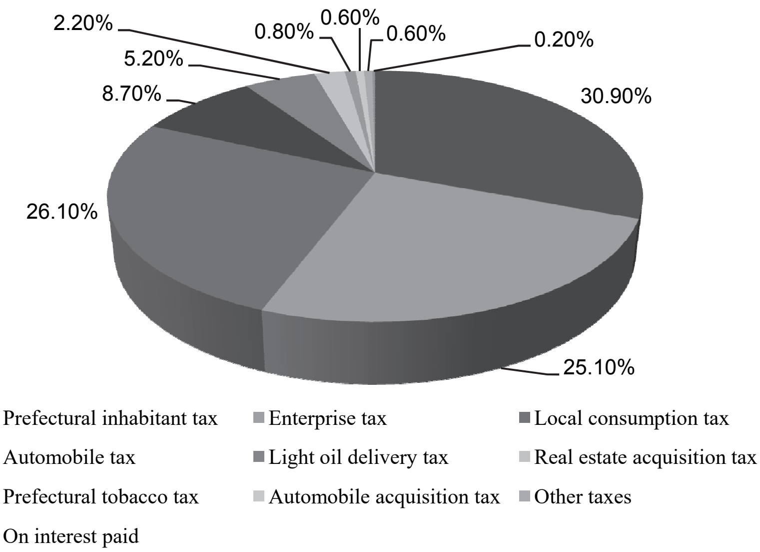


Source: MIC (2021)

As shows in the above Figure No 03, the largest percentage of local revenues are provided by the local taxes. The Local Tax Law provides for the imposition and collection of taxes by prefectures and municipalities. Allocating administrative tasks and taxation powers to local authorities through vertical fiscal coordination creates this ability to raise tax revenue from the community. As shows in the above Figure, local taxes account about 40% of total annual revenue. If it is considered separately, Prefecture taxes account about 40% of an annual average revenue for prefectures, and municipal taxes account for 35% of an annual average revenue for municipalities. As mentioned in the above, there are many types of local taxes in Japan, particularly 13 types of prefecture taxes and 13 types of municipal taxes. Following figures show the main taxes and their percentages (2019 values) of Prefecture governments and Municipality governments. Specially, the largest percentage of taxes of Prefectures and Municipalities is come from Prefecture/ Municipal inhabitants' tax. Inhabitants tax is a resident tax which levies both on individuals and businesses. According to the size of tax earnings, Tokyo prefecture is the largest tax collector and Okinawa prefecture is the lowest tax collector (CLAIR, 2020).

Meantime, local tax capacity has been strengthening further with other many taxes. As shows in following Figure No 04, main partners of these taxes are local consumption tax, enterprise tax, automobile tax etc. respectively for the Prefectures, and fixed assets (property tax on land and buildings) tax, city planning etc. tax for the Municipalities (Figure No 05). A system of local consumption taxes was instituted in 1997 as a means of increasing local government financial resources to promote local autonomy. Contribution of all these taxes to local governments' revenue base is significantly and continuous for many years.

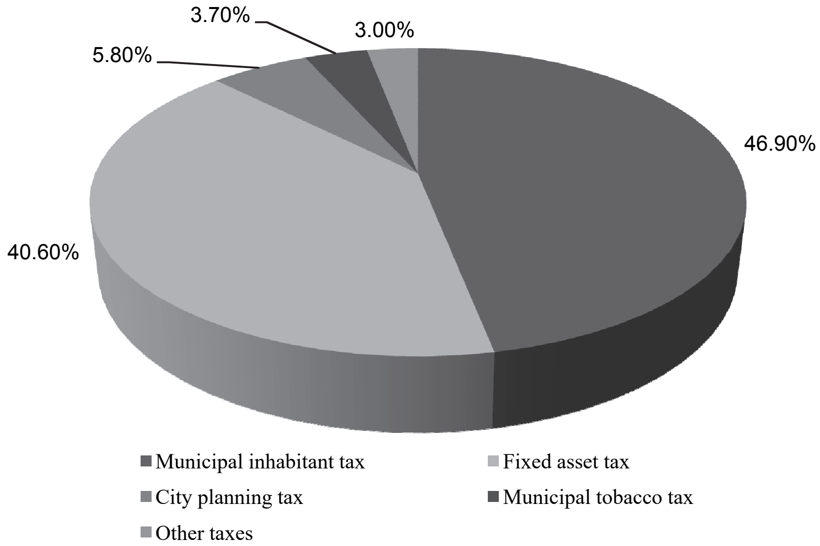
Figure No 04: COMPOSITION OF PREFECTUAL GOVERNMENTS TAXES - 2019



Source: MIC (2021)

In addition to all these tax sources, local government revenues in large come from respectively, local allocation tax about 15-20%, National treasury disbursements about 15-18%, local government bonds about 10-12% and others about 15-16% (MIC, 2021). Local allocation tax is a method by which the central government uses central government resources to correct fiscal capacity gaps between local governments (Vertical fiscal adjustment with horizontal effect). This has indeed been a considerable strength in fulfilling of local governments' expenditure capability. Nonetheless, the performance of this allocation system in Japan for past many years are relatively very successful rather than other countries who execute the power decentralization to sub national governments. Further, in the context of fiscal autonomy, the monies of allocation taxes are shared as general revenues that local governments can use as they see fit.

Figure No 05: COMPOSITION OF MUNICIPALITY TAXES -2019



Source: MIC (2021)

Following Figures No 06 & 07 show that the types of revenue of the prefecture governments and Municipalities separately. As it shows according to the 2019 estimation that most important revenue source of Prefecture governments is local taxes and for the Municipalities is other revenue sources which includes different taxes, fees, and charges. The collection of such local taxes, fees and charges have been verified giving their full authority with relevant laws and regulations. However, the Prefectures and Municipalities are not allocated taxation powers corresponding to their administrative tasks, largely depending on various allocations, transfers, and other disbursements of upper authorities in financing their annual expenditures.

Figure No 06: REVENUE BREAKDOWN OF PREFECTURE GOVERNMENTS - 2019

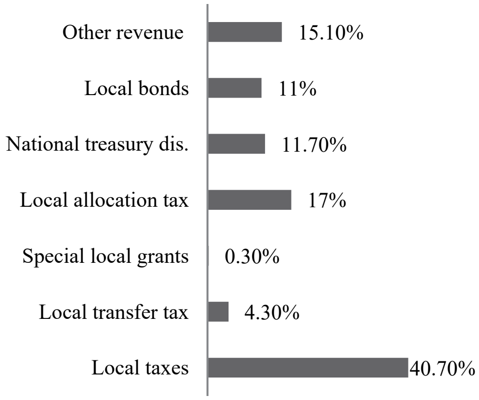
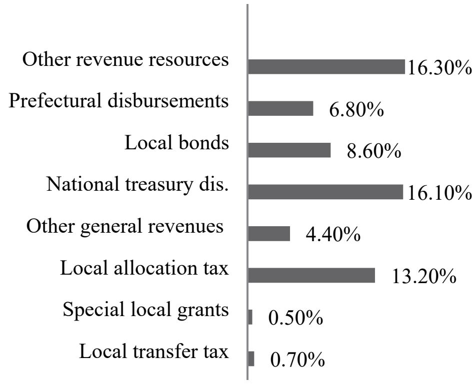


Figure No 07: REVENUE BREAKDOWN OF MUNICIPALITY GOVERNMENTS - 2019



However, there are various mechanisms and regulations in place for maintaining balance with national government financial operations, for guaranteeing revenue sources and levying taxes. Though the legislative power of taxation is held by the central government and local governments, tax object and tax base regarding levying taxes (only ordinary tax or an object tax) of local governments are determined under the national tax policy. In other words, local governments do not have the legislative power to determine the tax base, only the power to determine the tax rate. On the other hand, local total tax revenues are shared between the central government and local governments. In this context, some or all the local taxes levied by local governments are transferred to central government. Additionally, some financial procedures in central government disbursements, particularly national treasury subsidies and obligatory shares have also been imposed by the Central Government. These have been adopted mostly to regularize the financial mechanisms of local governments rather than a controlling mechanism. Further, prefectures and municipalities are given roughly a same number of financial resources and the local allocation taxes is provided in a set percentage from the certain taxes. Under this, the total amount of the local allocation tax grant is predetermined ratios of five national taxes. These are, specifically, 33.1% of income tax and corporate tax, 50% of liquor tax, 22.3% of consumption tax, 25.0% of tobacco tax and all local corporation tax revenues. Meanwhile, the local allocation tax grant is given in a divided form as the ordinary local allocation tax grant (94%) and the special local allocation tax grant (6%) (MIC, 2009). Further, regarding local bonds issuance, there are some limitations and measures. Thus, the financial law does allow local bonds to be issued to cover expenses for things such as publicly owned corporations, disbursements, and loans, refinancing of local bonds, disaster emergency projects, maintenance of public facilities etc. In principle, when issuing local bonds, prefectures must consult with the Minister of Internal Affairs and Communications and municipalities must consult with their governor. In this allocation procedure, the local finance plan is verified whether local governments have the financial resources necessary to provide the legally prescribed level of projects and administrative services.

10.8 Trends of Expenditures of Local Governments in Japan

Japan's local governments require large amounts of financial resources to meet their annual expenditures. This is fulfilled from basically own revenue sources and central allocations as it explains above. Showing a usual characteristic of shared funding system (distinctive financial resource for local governments, collected by the national government on their behalf) under a fiscal federalism, Japanese local governments are largely depended on allocated revenue sources for their annual expenditures. If it is clearly stated, with respect to the income (from taxes), the allocation of tax revenue between the central and all local governments is 3:2, with the central government receiving the greater share. In other words, as a percentage, taxes paid by the public to the national government is often large, e.g., Sakai (2014) mentioned that 55% to the National government and 45% to local governments. However, due to large scale financial transfers from the central government to local governments by means of the local tax allocation (different from other national government grants), central government disbursements (disbursements are earmarked for specific uses), ultimate total funding for all local governments exceeds total funding for the central government. Further, prefectures and municipalities are receiving roughly the same level of financial resources for their annual expenditures.

Table No 06: CLASSIFICATION OF THE LOCAL GOVERNMENT EXPENDITURE – 2019

Expenditure Item		%
1	Public Welfare	26.6
2	Education	17.6
3	Debt service	12.2
4	Civil engineering work	12.2
5	General administration	9.7
6	Sanitation	6.4
7	Commerce and industry	4.8
8	Agriculture, forestry, and fishery	3.3
9	Other	7.2

Source: MIC (2021)

Though the annual tax revenues of national government are relatively high, the level of expenditures is mostly high in the local governments, e.g., total expenditures annual: National government 42% and local government 58% (MIC, 2018). In other words, about 60% of the total expenditure of the Japanese government is used for the many tasks undertaken by local governments. As Aoki (2008) stated that compared to other developed countries, Japan's share of local government expenditures, as a percentage of gross domestic expenditure, is relatively high. If it is considered the expenditures between Prefectures and Municipalities, the scale of expenditures by prefectures and by municipalities is almost the same (Shun'ichi, 2003). According to classifying the expenses by purpose demonstrates that much of public money is appropriated for public welfare expenses and Education expenses as shows in the above Table No 06 and if it is divided into subcategories, largest percentage goes to sanitation public health and hygiene expenses, and thereafter school education expenses, and judicial, police and fire service expenses. The administrative area of local governments is also accounted a greater part of the expenses (CLAIR, 2020, MIC 2020).

On the other hand, in comparison between central and local governments expenditures, the ratio of local government expenditure is higher for government services that more directly affect residents in local areas. For instance, in terms of safe and secure region-building, local governments cover nearly 80% of police and fire expenditures (Statistical Handbook. 2021). According to classification of spends, municipalities carry out many tasks in areas of the welfare of the elderly, child welfare, and livelihood protection specially. As a result, municipal expenditures on social welfare are nearly three times than prefectures. Other expenditures with a high local government ratio include sanitation and school education, both of which are deeply connected to people's everyday lives. Furthermore, increasing social security related expenditures are inevitable with Japan's aging population. With all these expenditures of local governments, annual total expenditures are large and not be able to cover only from annual tax revenues which certainly leads to go for other sources. However, in the context of financial autonomy of local governments, local governments have a significant freedom in making expenditure decisions and especially local allocation tax revenue is used in an independent judgment of each local government, and the central government is prohibited from attaching conditions to or restrictions on its use.

11. SWOT Analysis on Improvement of Revenue Capacity

Sub national government system in Sri Lanka and Japan have been operating for last couple of decades. The role which has been done by these governments for peoples is more or less successful. Specially, while the Provincial Councils in Sri Lanka is facing to some problems in fulfilling their assign duties, local governments in Japan are relatively operating successfully in service provision to their community. Main obstacle of this unsuccessful operation of Provincial Governments in Sri Lanka is inadequate financial resources. Reason for inadequate financial resources is not just the limited tax incomes, the Provincial Councils do not use their maximum ability in tapping the financial resources within the given constitutional power. In addition, some administrative and legal procedures have also been hampering on this process. Meanwhile, there is an inadequacy between annual expenditures with delegated functions and revenue receipts of local governments in Japan, which has been a considerable issue on efficient service provision of local governments. As a result, Japanese local governments are largely dependent on short term revenue sources such as bonds issuance, treasury disbursements, special grants etc. If these considered all together, it is clear that there is an imperfection of current devolution packages in both countries, particularly in the fiscal/ financial devolution. Indeed, this is a usual characteristic that none of the countries, who have devolved their powers to sub national governments, have devolved power in hundred percent within their feasible and warranted level. Indeed, power decentralization cannot be completed within a short time by a one-off legislative act. Rather, the reform requires continuous attention looking at shortfalls and permanent fine-tuning, it must be implemented in several stages.

Table No 07: SWOT MATRIX ON FISCAL DEVOLUTION IN SRI LANKA AND JAPAN

Sri Lanka			
Strengths	**Weaknesses**	**Opportunities**	**Threats**
1. Political will of Central Govt. 2. Devolution of Financial statutory power 3. Establishment of Finance Commission 4. Financial support from Central Govt. 5. Ensure management of resources & skill transferred 6. Effective involvement of locally elected members 7. Strengthening the collaboration of decentralized institutions 8. Existence of local budgets/ development plans 9. Enhanced local partnership for financial resources mobilization	1. Weak financial Capacity of Centre 2. Weak implementation of decentralization laws and policies 3. Inconsistency in financial resources transfer 4. Resistance from central government 5. Limited financial resources to local governments 6. Weak coordination & communication between local governments 7. Weak coordination with central departments 8. Partiality in financial resources transfer by the central Govt. 9. High politicization of financial resource transfer process 10. Ad hoc limitation and measures on financial transfer	1. International/ Global trend 2. Existing legal provisions 3. Financial resources availability 4. Best practices of other countries 5. Availability of untap revenue sources 6. Collaboration with decentralized departments	1. Risk of politicization 2. Misuse of resources 3. Social and political crisis 4. Misuse of financial resources 5. Financial corruption 6. Lack of cooperation between some decentralized departments 7. Regional poverty 8. Loopholes of laxation laws
Japan			
Strengths	**Weaknesses**	**Opportunities**	**Threats**
1. Political will of Central Govt. 2. Financial autonomy with local governments 3. Broader local tax base 4. Gradual improvement of local governance 5. Local partnership for financial resources mobilization 6. Gradual strengthening of local governments' capacities 7. Financial supports from Central Govt. 8. Ensure financial resources transfer 9. Clear and consistent responsibilities of local governments 10. Effective involvement of local elected members 11. Strengthening the collaboration of decentralized institutions 12. Existing of local budgets/ development plans 13. Sound administration of local affairs	1. Limited financial resources allocated to local governments 2. Limited financial resources devolution 3. Limited financial resources allocation 4. Limitations and measures of financial mobilization 5. Partiality of resources and skill transfer by Central Govt. 6. Discrepancy between the territorial division of local governments 7. Inconsistency in financial resources transfer 8. Gaps of financial devolution 9. Financial procedures on financial transfers 10. Heavy duplication of roles and ambiguous fiscal responsibility of local governments 11. Overlapping of local government responsibilities 12. Duplication of tax bases between national tax and local tax	1. International/ Global trend 2. Autonomy in local resources mobilization 3. Country political stability 4. Enhanced partnership and decentralized cooperation 5. Country political stability 6. Resources availability 7. Best practices from other countries 8. Enhanced partnership and decentralized cooperation 9. Better functionality of decentralized department/services 10. More power and more freedom to act 11. Size of local government tasks 12. Agency Delegated Function System	1. Risk of politicization 2. Misuse of resources 3. Social and political crisis 4. Weak implementation of decentralized laws and policies 5. Misuse of financial resources 6. Lack of cooperation between decentralized departments 7. Weak capacities of some local governments 8. Rise in taxes and social insurance burdens 9. Fluctuations of economic growth effect 10. Complexity of tax system 11. Wasteful spending of national subsidies

Specially, looking at financial requirements which is the main hinderance in service delivering of local governments, necessary regulatory reforms should be done with effective enforcement of decentralization's laws and policies. Regarding this, it is generally assumed that inter-governmental transfers should be minimized and instead of that, strengthening, and broadening own financial bases it requires the creation of an adequate tax-base. With this, revenue base of local governments is become a long-term uninterrupted revenue base which certainly enables for an effective operation in service delivering. This SWOT analysis examines the existing avenues and stimulations for improvement of financial capacities of local government systems in Sri Lanka and Japan (Table No 07).

As stated in above Table No 07, there is a massive strength and an opportunity in improvement of local government capacity, especially financial capacity which is most cited strength. The political willingness is indeed available in both countries for this basically. Similarly, required legislative provisions have set up and improvement should be done where necessary, both countries have built the required legitimate foundation. The weaknesses imply that the areas should be concerned for reformation and the opportunities are endorsing their possibilities.

12. Conclusion

Power decentralization to sub national governments is a universal practice which brings government closer to citizens, creating conditions for the democratization of governance and for increasing its effectiveness. Political decentralization aims to give citizens or their elected representatives more power in public decision-making and balanced development in a country with shifting responsibilities and resources to subnational units of government. The power decentralization to regional and local entities is nearly similar in Sri Lanka and Japan that depicts a similarity of regional (provincial) governments in Sri Lanka with Prefecture governments in Japan and local governments in both countries. The structural framework of these governments is also nearly similar in general with some internal disparities, but the national government in Sri Lanka has two parts as Executive President and a Cabinet with a prime Minister. In Japan, there is not an Executive President, but there is a Prime Minister and Cabinet. Constitutionally Sri Lanka has given somewhat self-ruling rights to regional governments while local governments are operating under the both the Central Cabinet and the regional governments. Both Japanese Prefecture governments and local governments has also a comprehensive autonomy which is certified by the constitution in 1947 and further broadened it by successive reforms. However, the financial capacity of regional governments/ local governments is a vital weakness in both counties. None of the country has not devolved their full power on fiscal and financial management to regional and local governments and hence there is a significant controlling mechanism on revenue collection and expenditure with various regulations, limitations, and directions. Specially, a more strength of taxation power has been held by the Central Governments in both counties from the beginning. However, deficit gaps of revenues that need to finance annual expenditures of regional/ local governments are filled out by financial transfers of Central Government alternatively.

Under these fiscal and financial arrangements, the regional/ local governments of both countries are facing an unsatisfactory financial capacity in each year. Reason for such a situation in Sri Lanka is an inadequate power on revenue generation and the limit of tax earning sources. This is further weakened by non-implementation the existing tax power of regional governments. The existing power is utilized in two ways that on one side, the regional governments do not utilize their granted statutory power in detecting new tax sources and the other side, the devolved power to the regional governments has not been transferred fully by the Central Government in implementation of relevant legal procedures. Indeed, not implementing of given taxing power is a practical problem which leads to reduce the annual revenues of the regional government in Sri Lanka. Nonetheless, the Central government do not give the annual transfers in required level with existing limitations and shortage of funds. As a result, the annual revenues of both regional governments and local governments in Sri Lanka are never met the expenditure that they must do annually.

Relatively, the Central Government of Japan is also holding a more strength of taxation power as it collects a more tax revenue annually. Consequently, there is an undesirable mismatch of revenue receipts and expenditures of the Central Government and local governments in Japan. The dilemma of this mismatch is that the annual expenditures of local governments exceed the annual revenue receipts though they need a more income to finance annual operations. In fact, the local governments are required a more income to finance annual operations, but collection of revenues is often inadequate. The reason behind is that the revenue sources enumerated to the local governments are relatively limited, many productive revenue sources are on the hand of the Central Government. This deficit of local governments of Japan is financed by the Central Government through its transfers which come as allocation taxes, transfer taxes, specific grants etc. to the local governments. On the contrary, the annual collection of revenues of the Central Government often exceeds the annual expenditures though there is no need an extra income to finance annual expenditures. Indeed, the Central Government has a limited role to finance annually compared to the local governments.

Furthermore, according to these devolved fiscal and Financial Power to regional/ local governments in both countries, it seems that there is limited power for borrowing from outside sources and to get direct grants from foreign sources. Specially, borrowing authority in Sri Lanka has remained centralized and the Provincial Councils are allowed to raise loans, which somewhat offset limits on revenue generation via taxation. As well as, external resources are always channeled through central institutions, and a limited form of intergovernmental relations. Regarding local governments, there is a highly controlled & reliant power that the local governments can take funds from external sources such as private sector partnerships, local loan development fund from banks etc. for short term financing. Likewise, the local governments in Japan have an exclusive power to raise funds issuing local bonds to cover their annual expenditures. However, the law allows to issue local bonds to cover expenses of publicly owned corporations, disbursements, loans, refinancing of local bonds, disaster emergency projects etc. Furthermore, local governments may take out low interest long-term loans from financial institutions after receiving the approval of the Ministry of Internal Affairs and Communications.

The regional/ local governments in Sri Lanka and Japan have been operating for last many decades under the above mentioned fiscal and financial power with some required reforms & modifications time to time considering adverse consequences and demands of local authorities. However, as usual in power decentralization processes in the World, Sri Lanka and Japan has also not devolved a complete financial authority to the local governments as devolved the functional responsibilities. As a result, and in order to significant financial paucity of local governments, there is a huge demand for a more financial power in both countries. Specially, this situation is highlighting in Sri Lanka compared to Japan. Nonetheless, both countries are reflecting a significant avenue for further reformations of existing legitimate framework and demanding an extra power in potential boundaries of power decentralization.

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