

Performance Auditing from the Viewpoints of Equity

Shinji YAMASHIGE *

(Associate Professor, Graduate School of Economics, Hitotsubashi University)

1. Introduction

Recently, people have recognized importance of, and have attempted various approaches to, performance auditing for government activities. For private companies, business investment outcome will be reflected in profits. In the case of governments, however, the accounting book will not reflect government activity outcome. Thus, unless government activities are evaluated, we will not be able to say that they are audited properly. This is one reason why performance auditing is important. As with private companies' accountability to shareholders, desirably, the government should prepare its activity reports for citizens as shareholders, and these reports should be examined by an audit organization independent from the government. In other words, unless the government audit organization examines whether or not value for money has been realized, as well as the final accounts correctness as the revenue and expenditure record, the government audit organization will not meet taxpayers' expectations.

The Board of Audit, Japan, which audits government activities, clearly recognizes its role as described above. To institutionalize the role, the revised 1997 Board of Audit Law added the following stipulation as paragraph 3 to Article 20: "The Board of Audit shall conduct its audit for accuracy, regularity, economy, efficiency, and effectiveness, and from viewpoints it deems necessary for its audit". According to Miyakawa (2000) who examined future prospects for the current audit report trend, equity is considered one of the other "viewpoints it deems necessary for its audit".

Different people define equity differently, making the performance auditing from the viewpoints of equity difficult. Nevertheless, this viewpoint is extremely important; and people have the right to know whether or not policies are implemented equitably. In this sense, it may be seen as a big problem that this viewpoint is not explicitly mentioned in the stipulation above. Considering that taxation, which supports government activities, is essentially "an infringement on property rights of the people", it seems clear that tax policies and all other tax-based policies should be equitable and that performance auditing should be also carried out from the viewpoints of equity.

This paper discusses theoretical issues concerning the performance auditing from the viewpoints of equity. As pointed out by Miyakawa (2000), performance auditing from the viewpoints of equity concerns "whether or not costs and benefits of policies are equitably distributed to various societal groups". Therefore, this paper discusses two problems - "what distribution should be considered equitable?" and "which costs and benefits of

* Born in 1962. Received Ph.D. from Department of Economics, Johns Hopkins University. Served as assistant professor, Toronto University, from 1992 to 1996. Served as full-time lecturer, Department of Economics, Hitotsubashi University before taking up current position in 1998. Belongs to Japanese Public Finance Society and Japanese Economic Association. Main publications include: "Fairness in Markets and Government Policies: A weak Equity Criterion for Allocation Mechanisms," *Hitotsubashi Journal of Economics*, Vol. 38, 1997; "Kazoku Oyobi Chiiki Kyodotaino Kinoto Seifuno Yakuwari - Nihongata Fukushi Shakaino Keizaigakuteki Bunseki - (Functions of Families and Communities and the Roles of Governments - Economic Analysis of the Japanese Welfare Society -)," *Ikkyo Ronso*, Vol. 120, No.6, 1998.

which groups should be compared?”

In the following section, we first discuss “what distribution should be considered equitable”. This is a difficult task because it involves people’s sense of values, and this may be why performance auditing from the viewpoints of equity has been avoided. As mentioned earlier, however, we can not avoid it. In this paper, therefore, we start with the most basic concept of equity that will get a high degree of social consensus (horizontal equity in “opportunity equality”), and then discuss a more debatable concept of equity (vertical equity in “opportunity equality”). In the performance auditing from the viewpoints of equity, we first argue it is appropriate to urge improvement when the horizontal equity in “opportunity equality” is disturbed (such as inequality in income tax resulting from gaps in identification of income among different occupations); and then, we argue it is appropriate to urge the government to prepare and disclose data people can use to judge equity in policies (such as “generational accounting” to judge generational equity on net benefits from policies) and to examine accuracy of such data.

In Section 3, we discuss problems in auditing actual economic policies from the viewpoints of equity. In other words, we discuss “which costs and benefits of which groups should be compared”. Actual economic policies are broadly classified into four groups. For each such policy, we point out problems to be considered from the viewpoints of equity, and pick up some actual policies in which equity is likely to be disturbed. Section 4 summarizes the entire paper.

In this paper, I gave priority to summarizing theoretical issues involved in “performance auditing from the viewpoints of equity”, and I did not attempt any performance auditing of actual policies from the viewpoints of equity, which remains as a future task. Having examined theoretical issues concerning Japanese government economic policies, I have an impression that the Japanese government policies have many inequitable elements, and that such structural inequality may have created people’s distrust of policies, which may be a reason why some important policies have not been accepted by the people and the Japanese economy may have hit a snag. Therefore, I feel that “performance auditing from the viewpoints of equity” is urgently required, and that one of the important roles of the government audit organization is to identify any structural inequality in current policies and to recommend institutional reforms and law revisions to remove such inequality¹⁾.

2. Theories on equity

As indicated by the word, equity basically means “no disparities exist among members of society (i.e. members are treated equally)”. The question is in “what” no disparities should exist. Some people believe equity means no disparities in economic “outcome” such as income (“outcome equality”). In this paper, however, I basically take the position that equity means that there should be no disparities in economic “opportunities” (“opportunity equality”).

Many economists seem to share a view that markets, in general, cannot achieve a desirable resource allocation from the viewpoints of equity and that “opportunity equality” is a desirable notion of equity²⁾. In our economy, however, we will not be able to reach consensus on guaranteeing the “opportunity equality”, since we know it will also entail inefficiency. For example, equalization of economic opportunity requires assets inherited from a person’s parents and native abilities should be equalized. We will probably not reach social consen-

1) According to Miyakawa (2000) the relationship between the Board of Audit and the Diet is expected to be closer than before because of the recent revision in the Board of Audit Law. It is in this respect I claim that an important role of the government audit organization is to propose and recommend institutional reforms and law revisions from the viewpoints of equity.

2) Various principles of equity including “opportunity equality” are well-summarized by Ishikawa (1991, Chapter 2).

sus on such a policy³⁾.

Introducing two concepts, horizontal equity and vertical equity, is useful in examining this kind of problem. Horizontal equity for “opportunity equality” means a principle that policies should be taken so that individuals faced with the same opportunities in their initial states should have the same opportunities under the policies⁴⁾. On the other hand, vertical equity means a principle that policies should be taken so that individuals faced with different opportunities in their initial states should have the same opportunities as far as possible.

I have already mentioned that we would probably not reach social consensus on vertical equity, the stronger notion of equity. Conversely, the concept of horizontal equity will be widely accepted, because it does not, in general, contradict efficiency. Many actual policies, however, don’t necessarily guarantee this basic principle of equity, the horizontal equity. Therefore, when a public organization conducts performance auditing from the viewpoints of equity, it seems appropriate for the organization to strictly criticize policies which violate the horizontal equity. If opportunity inequality seems to exist from the viewpoints of vertical equity, it would be appropriate for the organization to submit data to the general public so they can decide whether the policies are equitable.

We can formulate a concept of “equal economic opportunity” and derive some policy implications; but, such a model and analysis will be very complicated⁵⁾. In this paper, therefore, I introduce a simplified judgment standard, although this involves some ambiguities⁶⁾. The standard is based on a fact that when “opportunity equality” is not guaranteed, we experience a “just envy”. Person A experiencing a “just envy” on person B means that person A feels that he/she is “unlucky” because he/she cannot get the same result person B has gotten, even if person A has made the same effort as person B. In other words, people will feel “just envy” on others when opportunity equality is not guaranteed. (Envy generated by causes other than the one above is called “unjust envy”.)

Therefore, in examining equity of policies from the viewpoints of “opportunity equality”, it is enough to examine whether or not some individual is feeling “just envy” under the policy. Concerning horizontal equity, we have only to examine whether policies are not generating “just envy” among individuals with the same opportunities in initial states, while concerning the vertical equity, we have to examine whether policies are not generating “just envy” among all individuals.

For example, consider equity in income tax policy. If two individuals with the same income paid different amounts of income tax, the person who paid higher tax will feel “just envy” against the person who paid lower tax. Here, the tax system clearly disturbed the horizontal equity. If two persons had the same native ability, and one person inherited a 100 million yen from his/her parents and the other person did not get any inheritance from his/her parents and paid the same amount of tax, the second person will feel “just envy” against the first. Here, the tax system disturbed the vertical equity, because there was an inequality in economic opportunity.

It is sometimes difficult to determine whether envy is just or not, especially in considering vertical equity. In general, however, it is relatively easy to examine whether or not envy is generated under certain policies. In this sense, our judgement standard above seems useful in examining equity of policies. In the following section, we examine equity of actual policies from such a point of view.

3) In reality, since we cannot equalize native abilities, we cannot, in general, achieve perfect equality in economic opportunities. Therefore, in such a circumstance, we may justify some degree of equalization in outcomes. It seems useful, however, to have a view that what has to be pursued first is the equality in economic opportunities and some degree of equalization of outcomes will be justified only if we cannot guarantee it.

4) Yamashige (1997) discusses that the horizontal equity in “opportunity equality” is guaranteed even in markets; and thus, it may be considered the most basic concept of equity.

5) Refer to, for example, Roemer (1996) who discusses some recent theoretical studies on opportunity equality.

6) Discussions on “envy” and “economic opportunity” here are the ones developed by Yamashige (1996) based on the ideas of de la Mora (1987). Foley (1967) and others advocated a theory that envy-free allocation should be considered equitable; and many studies have been done from this point of view. Refer to, for example, Varian (1974).

3. Actual policies and issues of equity

In modern society, the government implements various policies to overcome “market failures”. In this paper we classify policies into four groups: (1) provision of public goods and services; (2) tax/subsidy policies; (3) asset management policies, such as issuing bonds; and (4) regulatory policies. We examine possibilities of inequality in each type of policy.

3.1 Equity in provision of public goods and services

The government supplies various goods and services (hereinafter referred to as “public goods”). Certain public goods are supplied free (such as national defense, police activities, and roads), while other public goods are supplied for fees, depending on use (such as medical care, public facilities, and expressways). One basic theory of public economics says that if cost of collecting fees is zero, it is desirable to charge fees depending on use⁷⁾ from the viewpoints of efficiency and equity. The reason is as follows: if no charge is imposed, resources will be wastefully used (inefficiency) and persons who are able to use more public goods will benefit more than others (inequality). The cost of collecting fees, however, is not zero, in general, which justifies the free provision of public goods on the ground of efficiency and equity as long as their benefits are extended to all the people.

When evaluating policies concerning provision of public goods from the viewpoints of equity, we should practically examine the following problems:

- (A1) Don't we have inequality in benefits from free public goods (uneven distribution of policy benefits)?
 - (A2) Don't we have inequality in benefits from non-free public goods (uneven distribution of policy benefits)?
- Are charges (user fees) set equitably?

As specific examples, we can list up the following policy problems:

- (B1) Don't we have regional inequality in the central government's provision of public goods (problems of “regional equity”)?
- (B2) Are local governments' decisions on permissions for authorized nurseries and special nursing homes for the aged (i.e., selection of the people who benefit from public goods) equitable? Is information disclosed to citizens so they can determine whether or not selection rules are equitable⁸⁾? Are user fees imposed equitably?
- (B3) Don't we have cases in which rights to use public goods, such as telecommunications satellites or frequency bands, are given to certain companies free or for extremely low charges so that they gain significant benefits and make big profits which should have been attributed to all the people⁹⁾?

Concerning “regional equity,” it seems useful to discuss the problem in relation to the recently debated “public investment to rural areas.” The question is: if two people with the same ability-to-pay tax live in different regions and pay the same amount of national tax, but benefit differently in amounts of public goods provided by the national government, can this be justified from the viewpoints of equity?

From the viewpoints of efficiency, improving infrastructure such as roads in densely populated areas will be more desirable than doing so in under-populated areas. However, if, as a result, under-populated area inhabit-

7) “Pure public goods” (such as national defense), which are equally consumed by all the people without generating congestion, should be supplied free.

8) For problems on nursing for the aged and providing nursery services, refer to, for example, Yashiro (2000).

9) For cases of the United States and some other countries, where rights to use telecommunications satellites and/or frequency bands are sold by auctions among private enterprises to generate revenues of several trillions yen for the government, refer to, for example, McMillan (1994), and Kawamata and Baba (1997).

ants receive less public goods than those in densely-populated areas, the horizontal equity (most basic concept of equity) will be disturbed because these inhabitants will have different economic opportunities, although they pay the same amount of national tax.

Therefore, from the viewpoints of equity, it is important to examine whether benefits from public goods are evenly distributed to different areas, and whether they are properly provided in under-populated areas. This does not mean the central government should supply the same amount of public goods to all regions. The horizontal equity will be maintained if overall public goods benefits are essentially the same across all regions. Of course, verifying this will not be easy. It seems important, however, to keep this sense of regional equity in mind when many people advocate the efficiency-conscious policies (which are in no doubt important).

In postwar Japan, public investment initially concentrated in designated areas, such as urban areas, to promote economic development. Consequently, these areas were developed and had abundant economic opportunities. It is true that urban areas did not necessarily gain only benefits because problems such as pollution centered in urban areas. However, the fact that many people moved from rural to urban areas clearly indicates that the national policies to invest in designated areas created abundant economic opportunities in the areas.

In other words, the horizontal inequality in those days created the mobility of the people. The targeted investment may not necessarily be considered a bad practice from the viewpoints of efficiency to achieve economic development by fully utilizing the invested capital. People who remained in undeveloped areas, however, must have had an increased sense of inequality that the national policies are giving them much smaller economic opportunities compared with those of urban people who pay the same national tax¹⁰⁾.

From the 1970s to today, the central government seems to have tried to mitigate this sense of inequality by heavily allocating transfers and by significantly increasing public investment to rural areas. From the viewpoints of equity, we can understand why the central government did so. I believe, however, that many such policies were only stopgap policies to mitigate the sense of inequality, impairing local autonomy and efficiency of public investments.

Concerning the provision of public goods and services, it will be increasingly important to provide them efficiently while ensuring equity. Many institutional reforms such as raising beneficiaries' contributions, promoting decentralization, and reviewing financial relations between central and local governments, need to be carried out. To boldly promote these reforms, undertaking performance auditing from the viewpoints of equity (without adhering to superficial equity)¹¹⁾ will be important.

3.2 Equity in tax/subsidy policies

We have many kinds of taxes and subsidies. (Since subsidies can be considered negative taxes, taxes and subsidies are both hereinafter referred to as "taxes".) We can classify these taxes into three types: (1) those imposed depending on the person's economic power (taxes based on the ability-to-pay principle, such as income tax, consumption tax and public assistance); (2) those imposed depending on benefits (taxes based on the benefit principle, such as real estate tax and gasoline tax); and (3) those imposed to provide incentives for efficiency improvements (taxes based on the incentive principle, such as investment and education subsidies and liquor taxes).

Why do we have taxes with such different purposes? In a "welfare state", taxes have a basic role of procuring resources to supply public goods and redistribute income. In this sense, tax policies mentioned in item (1) above may be considered basic tax policies. Tax policies mentioned in item (2) may be considered attempts to resolve the problem mentioned in (A1) of the preceding section via the benefit principle. For public goods

10) One may argue that such a sense of inequality is an unjust envy because people have freedom to move. I do not think that it is an appropriate argument. The argument is like saying that a policy to discriminate in favor of rich people is not inequitable because any person can become a high-income earner if he/she tries. We cannot accept these arguments, because they disregard economic differences among people existent in the initial states.

11) Concerning regional inequality, we may be able to assess such inequality by preparing data on regional allocations of public goods, by questionnaire surveys, or by making a factor analysis on interregional mobility of the people caused by differences in the benefits of public goods.

supplied free due to the difficulties in collecting fees, their benefits need not be evenly distributed to all the people. In such a case, one possible measure to improve efficiency and equity is to impose taxes on people benefiting from such public goods. For example, imposing gasoline tax may be justified to finance road construction, since drivers are the main beneficiaries. For local public goods, imposing real estate tax may be justified, since benefits of these public goods must be reflected in land prices. Policies mentioned in item (3) above, known as Pigouvian tax policies, try to resolve “externalities,” one of the “market failure” problems, by imposing taxes on the people so they can properly understand social costs and benefits of their economic activities.

If taxes are classified as mentioned above, we must consider the following problems on tax policies from the viewpoints of equity.

- (A1) Are ability-to-pay taxes appropriately imposed to achieve both horizontal and vertical equity?
- (A2) Are benefit taxes appropriately imposed on those which reflect benefits of policies?
- (A3) Are incentive taxes really contributing to improving equity and efficiency? (Aren't they introduced to protect certain groups' interest?)

We must specifically consider such policy problems as:

- (B1) How serious are problems of the false tax returns, disrupting the horizontal equity in the income tax and the consumption tax? What changes in laws and systems are required to solve this problem?
- (B2) Is adequate tax (development value transfer tax) imposed on people who benefit from public facilities, etc.? Don't we have situations where adequate tax is not imposed on capital gains from rising land prices due to public policies, which not only benefits certain economic agents but also make it difficult for the government to acquire land from those people who expect such capital gains ¹²⁾?
- (B3) Are grounds for special tax measures and various kinds of subsidies rational and equitable? Is information disclosed so the people can understand the rationality of taxes and subsidies?
- (B4) Don't we have situations where taxes (or regulations) to restrain external diseconomies, such as pollution, are under-imposed to protect certain enterprises or industries, thereby threatening health and safety of the people?
- (B5) Aren't the current tax and social security systems generating inequality of economic opportunities between sexes ¹³⁾?
- (B6) Are changes in the tax and social security system desirable from the viewpoints of vertical equity? Are data showing their effects on asset/income distribution prepared and disclosed?

The biggest problem in the equity of tax policies is the horizontal inequality resulting from low identification rates of income other than those taxed at source. Economists have long studied the tax gap problem (refer to, for example, Kaizuka (1973), Ishi (1981), and Hayashi (1995)). Hayashi (1995) pointed out that the rate is moderately increasing; but, the rates for business income and agricultural income are still about 60 % and about 20 %, respectively. I cannot understand why ensuring horizontal equity, which seems to be the basis of the tax system, has not been achieved. If horizontal inequality is left unresolved, people will not respect the tax system.

12) The Basic Land Law, enacted in 1989, stipulates that development value should be transferred. However, since accurate estimation of the development values is really difficult, it seems this development value is not strictly transferred. Although accurate estimation may be difficult, we can do it to some extent. To maintain equality and avoid situations where unreasonably big amounts of tax revenues are spent to acquire certain land, we should recommend development value really be transferred. Refer to, for example, Okuno and Kuroda (1996) on this problem.

13) Refer to, for example, Ota (1994) and Kamiya (1997) on possibilities that tax and social security systems are restraining economic opportunities of women under current social norms, and countermeasures against the problem.

To mitigate salaried workers' sense of inequality from the low identification rates of income other than earned income, a policy has been applied of permitting a considerable portion of earned income to be exempt from tax. Although such a stopgap policy may have alleviated the sense of inequality, it did not provide a true solution and created new problems. For example, in order to alleviate self-employed workers' sense of inequality, after the introduction of privileges for salaried workers, similar privileges were introduced for self-employed workers. This may be a root cause of current fiscal problems¹⁴.

People's strong distrust of the tax system seems to result from the problems above. To resolve these problems fundamentally, we must introduce a system to ensure that income is, as far as possible, fully captured. For example, introducing taxpayer identification numbers may not necessarily guarantee perfect income assessment, but the system should improve the current tax system. As long as we have income tax, the taxpayer identification numbers seem to be necessary. To contribute to uncovering tax evasion, it may be helpful to introduce a system similar to the U.S. system in which taxpayers also have some obligations to prove correctness of their tax returns if they are suspected of having made false income tax returns. Or, we may have to strengthen punitive measures for false income tax returns¹⁵.

People seem to strongly distrust many subsidy policies. Although some subsidies and special tax measures for certain industries are justified from the viewpoints of efficiency and equity, unsubsidized industries generally tend to have a sense of inequality. To mitigate this sense of inequality, the number of industries receiving subsidies may increase, and the amount of subsidies and tax expenditures may continue to expand. It seems that we are also observing a negative effect that meaningful subsidies and special tax measures have been restrained for fear of the above problems¹⁶.

As suggested above, stopgap policies seem to have weakened Japanese international competitiveness and generated structural fiscal problems. In order to remove people's distrust of subsidy policies and to get their consensus for really needed policies, it would be necessary to require the government prepare explanatory notes which justify current and new policies from the viewpoints of efficiency and equity, and to examine these documents in detail.

As discussed in Section 2, concerning the vertical equity in tax policies, it would be appropriate to require the government prepare data showing effects of current policies and new policies on vertical equity, since different people have different sense of equity. For example, when we change gift and inheritance tax system, or income and consumption tax system, we should obligate the government to estimate their effects on asset/income distribution and explain how such changes are justified from the viewpoints of equity. Although scholars have attempted such estimates¹⁷, data obtained have been limited. Therefore, the government with the advantage of collecting data must carry out estimations by themselves and disclose results to the people who have the right to know not only policies but also policy outcomes and effects.

3.3 Equity in asset management policies, such as issuing bonds

Government deficits and government debts are tools to shift taxes and burdens to future generations. If the tools are properly used, we can achieve efficiency and equity simultaneously. On the other hand, it can also unreasonably infringe property rights of the future generations. Thus, it is a dangerous double-edged sword which can cut both ways¹⁸.

From the viewpoints of equity and efficiency, issuing public debts can be justified in the following two

14) I referred to Sato and Miyajima (1990) on these points.

15) A study by Sato (1992) on this problem is very interesting.

16) Refer to, for example, Wada (1992) and Yamauchi (1999) for histories and problems of special tax measures.

17) Refer to, for example, Honma (1991).

18) Various discussions have shown possibilities that issuing public bonds will not cause burdens on future generations. We cannot deny such possibilities. If public bonds, however, continue to increase over a long time in open economies, the arguments do not hold and burdens must be carried over to the future generations.

objectives:

(1) To share costs of public goods with long-lasting benefits (e.g., public investment) among people at different times.

(2) To equalize revenues, which may fluctuate due to economic cycles (or natural disasters).

Item (1), above, is the basis for justifying the construction bonds for public capitals. Item (2), above, is the basis for justifying the deficit-financing bonds. Whether or not actual public bonds issues and debt accumulation can be justified from the viewpoints above, however, should be always carefully examined.

Note that whether debt burdens are carried over to future generations should be judged by the change in the government's net assets, not by the change in the outstanding debts. For example, if revenue from sales of national property is all used for current consumption, then benefits, which should also apply to future generations, will apply only to the current generation. This will lead to unjust infringement of future generations' property rights. A fundamental rule for the "intertemporal equity" can be stated as follows: if net assets are maintained at a certain level over time, equity can be maintained. This is because net assets are maintained at a certain level if public bonds are issued to accumulate public capital and taxes are paid by each generation depending on their benefits. Considering the objective in item (2) above, we can also say that equity in policies will be maintained, as long as the net assets are changed only by economic cycles (or natural disasters) and maintained at a certain level in the long-run.

Considering "intertemporal equity" in the social security system, we can point out that we should calculate the net assets based on accrual accounting. Namely, it is important to record future social security benefits, guaranteed in the current social security system, as debts. For example, if the amount of social security benefits is increased without raising the amount of contributions, burdens will be shifted to the future generations. Such a change in policy will be correctly recorded as a policy to decrease the net assets, only if we adopt the accrual accounting.

Therefore, preparing balance sheets (based on the accrual accounting), as currently attempted by the central and some local governments, is extremely important not only because it allows us to know the level of net public assets each year, but also because it allows us to assess intertemporal equity of policies by monitoring its changes over time¹⁹.

Note, however, that we cannot judge "generational equity" by only monitoring changes in the public debts (or net assets, in general)²⁰. To analyze the "generational equity", we have to calculate net benefits each generation receives from the public sector and prepare the "generational accounting"²¹.

We have to keep it in mind, however, that having gaps in net benefits among generations does not necessarily mean "generational inequality." This is because the income transfer from younger to older generations can be justified from the viewpoints of vertical equity just as some gaps in the net benefits from the public sector between upper- and lower-income groups can be justified from the viewpoints of vertical equity. In any case, in the performance auditing from the viewpoints of equity, it would be useful to require the government prepare and disclose the generational accounting, the data which allows us to judge the "generational equity".

Needless to say, since the level of net assets in each fiscal year is also important data to find out the intertemporal distributions of benefits and contributions in assessing the "generational equity", in order to assess whether asset management policies are equitable, we must consider the following problems:

(A1) Whether or not a change in net assets from issuing public bonds or selling public property can be justified

19) Washimi, Akai and Tanaka (1999), for example, have constructed an interesting balance sheet of the Japanese general government based on accrual accounting.

20) Refer to Kotlikoff (1993). Note that in the "intertemporal equity" people at different times are compared, while in the "generational equity," people in different generations are compared. Refer to Yamashige (1998) for differences between these two concepts.

21) Reportedly, generational accountings were presented in the President's Budget Message for FYs 1993 and 1995. In Japan, a similar attempt was made in the Economic Survey of Japan for FY 1995.

from the viewpoints of intertemporal equity.

(A2) Whether or not a change in net assets from issuing public bonds or selling public property can be justified from the viewpoints of generational equity.

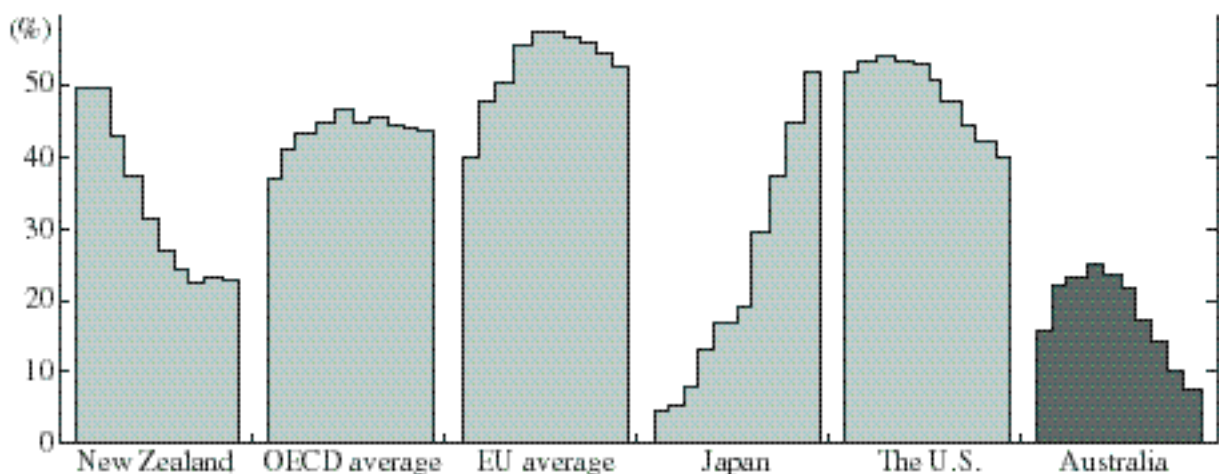
Specifically, the following policy problems would be useful to consider:

(B1) Are net assets calculated (based on accrual accounting)? Can changes in the net assets due to changes in policies be justified from the viewpoints of intertemporal equity?

(B2) Are net benefits calculated for each generation (is the generational accounting produced), based on accrual accounting? Can changes in the generational accounting due to changes in policies be justified from the viewpoints of generational equity?

As indicated earlier, “issuing construction bonds” and “issuing deficit-financing bonds during economic recession” can be justified from the viewpoints of equity. An institutional problem for issuing public bonds in Japan is that no rule governs issuing deficit-financing public bonds and it continues to get special treatment. In other words, Article 4 of the Public Finance Law was watered down. This is clearly reflected in a fact that the deficit-financing public bonds were not issued in only four FYs from 1990 to 1993 out of twenty-five years in and after FY1975.

Figure 1 shows trends of the general government sector’s net debts in selected countries mentioned in the Australian government Budget Message. Net debts are defined based only on financial assets for international comparison, and are not necessarily a satisfactory index. The analysis, however, is extremely interesting because it indicates Japan’s latest trends of the net assets²². (Note that in New Zealand and Australia, where performance auditing has been improved, net debts continued to decrease.) Just as in the discussion of the “(vertical) generational equity” above, if current generations reduce the net assets and receive income transfers from rich future generations in a period of high economic growth, such a reduction can be justified from the viewpoints of vertical equity. In the present Japan, however, in a period of low economic growth, the long-run decline in the net assets will not be justified.



(Source) Commonwealth of Australia, Budget Overview 2000-2001 (<http://www.pmc.go.au/budget>)

Figure 1 Trend in General Government Sector Net Debt as a Percentage of GDP (1992-2001)

22) Theoretically, Washimi, Akai and Tanaka (1999) offer a more satisfactory index for the Japanese government’s net assets in or before 1995.

Japan has responded to the structural fiscal problem, which generated the “intertemporal inequality”, by enacting the shortsighted “Fiscal Structure Reform Law”. As we all know, this law was also watered down. This structural problem will not be fundamentally resolved without structural reforms. Specifically, we must establish a rule for issuing deficit-financing public bonds by reviewing the Public Finance Law, and disapprove “special treatment²³⁾”.

3.4 Equity in regulatory policies

In modern society, various regulatory policies are implemented to help resolve the “market failure” problem. These policies include environmental regulations to help resolve externalities, such as environmental problems, regulations for medical or financial institutions to help resolve the problems of incomplete information, and entry restrictions to help resolve the problems of economies of scale. Although regulatory policies are implemented for various purposes, only the following question should be asked from the viewpoints of equity:

(A1) Can various regulatory policies be justified from the viewpoints of equity and efficiency? (Aren't they implemented just to protect certain groups?)

There are so many studies on appropriateness of various regulatory policies from the viewpoints of equity and efficiency; thus, we do not take up specific problems here²⁴⁾. As pointed out in the discussion of incentive taxes, I just want to emphasize that we should ask the government to produce an explanatory note for each regulatory policy to “prove” that maintaining existing regulations or introducing new regulations can be justified from the viewpoints of equity and efficiency.

4. Concluding remarks

In this paper, we have discussed theoretical issues concerning “performance auditing from the viewpoints of equity” in relation to the Japanese economic policies. I strongly believe Japanese economic policies have significant structural inequality.

In some countries where economic confusion has resulted from lax fiscal discipline and increased fiscal deficits (such as New Zealand and Australia²⁵⁾), systems have been established to oblige the government to explain to the general public appropriateness of its policy before and after implementing the policy. Introducing such a system seems to be based on a perception that the government need to mitigate people's distrust of current policies and persuade them to accept new policies, which require some burdens of the people but are necessary for achieving long-standing development, by providing them as much information as possible.

In Japan, which also faces various structural problems, I believe it is really important to explain to the general public, as shareholders, appropriateness of policies before and after implementing the policy (just as the managers of private companies explain to the shareholders) and to establish a system in which an audit organization

23) This also applies to local public finance with accumulated debts to finance revenue shortfalls. Local governments have an excellent “Adjusting Funds for Financing” system in which tax revenues changing from economic cycles are equalized. We must, however, examine whether this system really functions well. Local governments' bonds and borrowings from the Special Account for Allotting Local Allocation Tax, said to be about 18 trillion yen, were also provided to finance revenue shortfalls. Therefore, there exist structural problems of the “intertemporal equity” in local public finance. To resolve these problems, we also have to design some institutional rules.

24) Refer to, for example, Hatta and Yashiro (1995) and Yashiro (2000).

25) Refer to an interesting study by Davidson (1999) which explains the latest Australian performance auditing and evaluates the Japanese policy-making system in comparison with that of Australia.

independent from the government will audit such policies²⁶).

From the viewpoints of equity, we have to establish laws obligating the government: to prepare data showing current conditions on regional, intertemporal, and generational inequality in public goods benefits and tax burdens; to estimate effects of tax and welfare system reforms on asset/income distribution (or asset/income inequality); and to prepare “explanatory notes” providing that each special tax measure, subsidy, or regulation does not protect certain groups’ interests and can be justified from the viewpoints of efficiency and equity. We also should recommend to the government that some institutions and laws be revised to redress inequitable policies in welfare system, tax system, cost sharing, and land policies. I expect that Japanese policies would become more equitable by performance auditing from the viewpoints of equity in which inequitable policies will be strictly checked, structural inequality in current policies will be clarified, and structural reforms will be recommended to resolve such problems.

I believe that Japan is facing a situation where it cannot be permitted to continue stopgap policies that aim only at diverting general public dissatisfaction without trying to clarify and resolve the structural inequality. The Japanese government should be blamed for its irresponsible policy management. At the end of the 20th century, we must be aware of our responsibility for passing huge debts to younger generations who live in the 21st century. Unfortunately, it will take a long time to repay such debts. What we can do now is to establish a new system preventing such debts from increasing further and repay debts as much as possible while we are still alive. Using many people’s wisdom, we should start such a work now.

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26) Some people argue that the government need not make ex-ante and ex-post policy evaluations and that scholars, research institutions, etc. should do such evaluations. I do not agree with them. Although these external evaluations are important to supplement those made by the government itself, external parties also have institutional problems in terms of accessibility to government information; therefore, they cannot fully evaluate policies. Hence, we must establish a system under which the government prepares reports and an audit organization with access to all government information audits such reports. Incidentally, I want to point out that access to various statistical data collected by the government is limited in Japan, even if there is no problem of privacy. In many cases, access to these data is limited to scholars with some relationship with particular ministries or agencies. This limitation is a barrier to academic policy studies. Statistical data, which were collected by using taxes from the people, should be processed so they do not create problems of privacy and should be disclosed in the most useful forms. If statistical data are available for only a small number of privileged scholars, other scholars cannot re-examine reliability of such data and studies. This could harm scientific policy studies and further increase people’s distrust of government policies. I strongly hope this practice will be eliminated.

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