

Competition for private capital and central grants: The case of Japanese industrial estates

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Abstract

We investigate the determinants of the scale of the public investment in industrial estates in Japan, considering explicitly the fiscal competition among local governments. First, we construct a simple model in which each local government's public expenditure is used on public input to enhance the production of a private good. Our model captures two salient features of Japanese local public finance system: the first is that the differences of Japanese local tax rates are small since the allowable range of local tax rates is set by national law, and the second is that frequent personnel exchange between the central and local governments is observed. We could interpret the personnel exchange as a rent-seeking behavior of local governments by which each of them can appeal its want of fiscal aid from the central government. Second, we estimate policy reaction function of Japanese prefectures using the industrial estates data as well as the data of personnel exchange. We believe that the public input or infrastructure directly matters, rather than local government expenditures, to attract private capitals. Our estimate results suggest that the Japanese local governments do not respond directly to neighbors, while the number of prefectural government employees working in the central ministries has positive effects on the size of industrial estates. Thus, interregional competition for seeking central aid is more evident than that for inviting private capital in Japan. Personnel exchange can be taken as an effective way of information transmission if central government has incomplete information on local state. To determine which competition generates greater inefficiency is beyond the scope of our analysis, but the evidence we found suggests that vertical interdependence in the hierarchical fiscal system affects the way of interregional competition.

Key words: policy competition, business area development, spatial model

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