IMF tells Japanese government to raise consumption tax despite election defeat

John Chan
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The International Monetary Fund (IMF) this week told the Japanese government to push ahead with increasing the rate of the consumption tax, despite the ruling Democratic Party of Japan (DPJ) losing its majority in the upper house of the Diet in last Sunday's elections.

The defeat for the DPJ government headed by new Prime Minister Naoto Kan was a direct result of mounting public opposition to his proposed doubling of the 5 percent tax, and other austerity measures, in order to avoid a Greece-style debt crisis.

Nevertheless, the IMF pushed for an even greater increase in the tax, to 15 percent, starting in 2011. It insisted that "early and credible" measures were essential to tackle the nation's huge public debt, which is nearing 200 percent of gross domestic product, the world's highest debt to GDP ratio.

Kan stated at a press conference on Monday that the tax rise was the main factor behind the electoral loss, saying he did not "sufficiently explain the matter beforehand". However, he made it clear that the government would proceed, via a "more cautious and serious discussion of the matter".

Finance Minister Yoshihiko Noda said on Tuesday that the sales tax hike was inevitable in order to slash debt, even though he respected the election verdict. He declared that the government would "start by calling for cooperation from other parties on drastic tax reform, including the consumption tax".

Just a month after coming to office when former Prime Minister Yukio Hatoyama resigned in early June, the opinion poll approval ratings of Kan's cabinet have declined from 60-70 percent to below 40 percent. As soon as he took office, Kan unveiled an austerity program, combined with a plan to cut the corporate tax cut from 40 percent to 25 percent.

Sunday's election outcome is a sign that Japan's parliamentary system is increasingly unable to mediate irreconcilable social tensions. While the government retains control of the lower house, it faces a gridlock in the upper house. In the election for half the upper house, the DPJ secured only 44 seats out of the 121 contested. Its coalition partner, the Peoples New Party (PNP), and DPJ-backed independents won no seats. The DPJ now holds only 106 seats in the 242-seat upper house, while the PNP has 4.

The main opposition Liberal Democratic Party (LDP), whose public support rating had been consistently below the DPJ, unexpectedly won 51 seats, due mainly to popular hostility to the government. A new free-market Your Party, formed by former LDP figures, won 10 seats. Two reformist parties—the Communist Party of Japan and the Social Democratic Party—lost ground, winning just 3 and 2 seats respectively.

The voting pattern reveals deep discontent with the entire political establishment. While the LDP won more seats than the DPJ, the outcome was not a revival of the LDP, which previously held power, almost uninterrupted, for five decades. For the 48 seats allocated in proportional representation nationally, the DPJ won 31.6 percent of votes, compared to just 24.1 percent for the LDP. Of the 73 seats allocated to 47 prefectures, the DPJ won more votes (22.8 million) than the LDP (19.5 million).

However, the DPJ lost severely in more sparsely populated regional prefectures, the LDP's traditional base. Of the 29 single-seat prefectures that are generally regarded as rural, the LDP won 21. That was a drastic reversal from the 2007 upper house elections, when the DPJ and its allies took 23, and the LDP just 6. The swing indicated widespread disillusionment after the DPJ government planned to cut promised spending for economically depressed regional areas.

With the upper house able to block legislation, the parliament faces an impasse worse than in 2007, when the then LDP government lost its upper house majority. That debacle led to the resignation of Prime Minister Shinzo Abe, followed by a series of short and unstable governments that ultimately ended the LDP's long rule last year. In 2007, the LDP, with its coalition partner the New Komito party, still controlled a two-thirds majority of the more powerful lower house, giving it the power to push through legislation by overriding the upper house. The current DPJ government, however, lacks a two-thirds majority.

It will be difficult for the DPJ to find a coalition partner to form a majority in the upper house. In May, the Social Democratic Party quit the government after Hatoyama reversed last year's election promise to shut down the US Marine air base in Okinawa. Another major factor behind last Sunday's defeat was Kan's plan to retain Hatoyama's base agreement with the US. The DPJ is so unpopular in Okinawa that the party did not run a candidate in that prefecture.

Japan's parliamentary instability is rooted in the deepening tensions between the corporate elite and the working class, aggravated by the worst global economic crisis since the 1930s.

Last August, the DPJ led by Hatoyama came to power in the lower house elections under the slogan of "change" and with promises of increased public spending, including for childcare allowances and subsidies to farmers. That "historic victory" lasted barely nine months.

Hatoyama's June 2 resignation was immediately related to his broken electoral promise to move the US base out of Okinawa. But it also followed a global shift inaugurated at the G20 finance ministers' meeting—from the stimulus packages implemented during the 2008-09 financial crisis to austerity measures.

Hatoyama's successor, Kan, immediately came up with the policy of doubling the consumption tax, in order to pay off the huge public debts resulting from stimulus packages during the economic stagnation in the 1990s and the current crisis. He warned parliament last month that, as in Greece and across Europe, "our finances could collapse if trust in national bonds is lost and growing national debt is left alone".

The finance ministry estimates that Japan's public debts will reach 862 trillion yen (US$9.72 trillion) by March 2011, or 181 percent of GDP. However, the IMF warned in May that the debt would reach 227 percent of GDP this year, far worse than Greece's debt-to-GDP ratio of 130 percent.

This week, in a report issued after its annual consultation with the Japanese government, the IMF said reduction of Japan's public debt "will require a large and protracted adjustment that will be made more credible by an early increase in the consumption tax." It also spoke of the need for limits on spending, including "entitlement reforms".

The international rating agencies are also exerting pressure on Tokyo. On Monday, Standard & Poor's declared it may lower Japan's sovereign rating if "a hung parliament" slows the government's measures to improve its fiscal position. On Tuesday, Fitch Rating's Japan sovereign analyst, Andrew Colquhoun, declared: "If we don't see a credible plan come through by the end of this year, it will send a negative signal for its rating, adding pressure to credit rating."

The *Nikkei* business daily reported on Wednesday that Kan's government will cap annual government spending (excluding debt serving costs) at 71 trillion yen for the next three years. The *Nikkei* noted that the government would have to cut 10 percent from social services and local government funding, starting from the next fiscal year in April 2011. The only exception would be social security spending associated with retirees.

As in Greece and other European countries struggling with debt crises, cuts on this scale will deepen the gap between rich and poor, and provoke immense social and class conflict.