Japan’s lower house doubles consumption tax

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A political storm is looming within the ruling Democratic Party of Japan (DPJ) after the lower house of the Diet, or parliament, passed a bill last Tuesday to double the country’s deeply unpopular consumption tax to 10 percent by 2015.

In what was a first for a major piece of legislation, a substantial number of DPJ lawmakers—57, led by party powerbroker Ichiro Ozawa—voted against the bill. It was only approved because Prime Minister Yoshihiko Noda had secured the support of the opposition Liberal Democratic Party (LDP) and the LDP-allied New Komeito Party.

LDP support virtually guarantees that the tax hike will be approved in the upper house, which is controlled by the opposition parties. However, Ozawa has threatened to leave the DPJ and form a new party—a move that could potentially bring down the government. The defection of 54 lawmakers in the lower house would end the DPJ’s majority.

Several Japanese newspapers had reported that the formation of a new party would be announced this week. But Ozawa told reporters after the tax vote that he would engage in “final efforts” to persuade the DPJ leadership to abandon the tax increases.

Ozawa has criticised Noda’s tax hike as a breach of a key DPJ election promise in 2009 not to increase consumption tax. The DPJ ousted the LDP in those elections, ending half a century of virtually unbroken LDP rule. During the election campaign that Ozawa organised, the DPJ made a number of promises to increase social spending, most of which have since been broken.

The DPJ’s election platform was issued at the same time governments around the world initiated stimulus spending measures in response to the initial stages of the global financial crisis. Since then, however, the sovereign debt crisis emerged in Europe and austerity spending cuts are being imposed internationally.

Japan is vulnerable to a possible debt shock. Japan’s public debt level is more than 200 percent of gross domestic product (GDP), far higher than many European countries, including Greece and Spain. The replacement of Yukio Hatoyama as prime minister by Noda’s predecessor, Nanto Kan, in 2010 was driven in part by corporate demands for austerity. Kan initiated the debate on a higher consumption tax rate even though this cost the DPJ heavily, including its losing control of the upper house in the 2010 election.

Ozawa’s supporters are concerned that the sales tax increase will undermine the party’s already low public support. An opinion poll published by *Asahi* newspaper on June 6 found that 56 percent of respondents opposed the tax hike, up from 51 percent in May. Opposition to Noda’s government had only increased after he ordered to restart of two nuclear power plants in mid-June, ignoring widespread public fears following the Fukushima nuclear disaster in March 2011.

The consumption tax increase reflects the financial markets’ insistence that the burden of the debt crisis must be placed onto the working class. Noda told reporters after last Tuesday’s vote: “It is painful to have to ask the people to share the burden. ... I wish I could avoid this measure. But somebody has to support the social security system, which benefits everyone.” The burden is not falling on big business, however. Noda has cut the corporate tax rate from 40 percent to 38 percent.

The consumption tax increase is just one aspect of the "integrated tax and social security reform" negotiated by Noda with the conservative LDP. A key item of this agenda is to ditch another DPJ election promise—a guaranteed monthly pension for elders. The lower house has also passed legislation to integrate childcare with kindergartens in order to cut spending.

The government estimates that by increasing the consumption tax to 8 percent in 2014, and to 10 percent in 2015, it will generate an extra $170 billion in annual revenue by 2015. The measure will only partially shore up government finances. Currently there is a deficit of over $530 billion, for an annual budget of about $1 trillion, which is covered by issuing bonds.

The International Monetary Fund (IMF) stated recently that the tax increases were "crucial to demonstrate a commitment to fiscal reform and sustain investor confidence." But that was not enough. The IMF "recommended" that Tokyo lift the retirement age, reduce social security spending and increase the sales tax further to 15 percent.

Fitch Ratings downgraded Japan's sovereign credit rating in May to A+. After the lower house vote, the agency issued a statement declaring that no change would be made to Japan's rating, because the downgrade had already "factored" in the doubling of the sales tax. "As the only substantial measure planned to improve Japan's weak public finances, failure to pass the relevant legislation would have been negative for the sovereign," it warned.

Sharp divisions emerged within the DPJ even prior to the vote. In order to consolidate his premiership, Noda carried out a cabinet reshuffle earlier in June, removing five mainly pro-Ozawa key ministers. This was the price demanded by the LDP to support the government's tax legislation. The previous cabinet was largely a compromise that attempted to patch up a deeply divided party after Noda won the party leadership last year, defeating pro-Ozawa rivals.

The turmoil within the DPJ government is driven by sharpening class tensions in Japan. Three years ago, the Democrats won the election by calling for "change", to put an end to the discredited LDP's protracted rule. Popular illusions in the DPJ have largely disappeared. The government has proven to be just as ruthless in implementing the demands of big business as its conservative predecessors. Now, Ozawa's threat to split the DPJ and potentially bring down the government is threatening an even sharper political crisis.