

Divisions in Japanese government over consumption tax hikes

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Divisions have emerged in the Japanese government over whether to proceed with the scheduled doubling of the consumption tax over the next two years. All the establishment political parties are firmly united in demanding that the working class pay for the huge government debt, but sections of the ruling elite fear the tax hike's negative impact on consumer spending, economic growth and ultimately government revenue.

The previous Democratic Party of Japan (DPJ)-led government—supported by the now ruling bloc of Liberal Democratic Party (LDP) and New Komeito—passed legislation in 2012 to raise the consumption tax from 5 to 8 percent in April 2014, and 10 percent in October 2015.

Prime Minister Shinzo Abe has so far maintained that he will make the final decision on the issue in mid-September or later, ostensibly once various statistics become available and the autumn session of the Diet (parliament) begins.

Under conditions of stagnating real wages and rising cost of living, such as food and utilities, the doubling of the deeply unpopular consumption tax will dramatically lower working class living standards, and could become a focal point for mass social protests.

Abe's two economic advisors have voiced concerns. One, University of Shizuoka professor Etsuro Honda, recently called for a 1 percentage point a year rise in the tax, taking it to 10 percent over five years. He warned: "The economic structure is not as strong as it seems" and the hike "will have a great impact on consumption."

The other, Koichi Hamada, professor emeritus of economics at Yale University, also supports a 1 percent a year incremental tax raise. He told Reuters that Japan should only "raise the sales tax as planned ... if there are prospects that Japan's annualised GDP [gross

domestic product] growth will likely continue to stay around 4 percent in the next two quarters."

Although the Japanese economy expanded 2.6 percent on an annualised basis in the April-June quarter—down from 3.5 percent in the first quarter—this was below expectations and nowhere near 4 percent.

The opposition to the sales tax rise reveals deep fears among sections of the ruling class of a Greece-style debt crisis, where austerity measures slow growth, leading to decreased government revenue and further cuts. This will be exacerbated by falling investor confidence and higher interest rates, creating a downward cycle and triggering social unrest.

A *Yomuri Shimbun* editorial on August 13 warned that a tax rate increase of 3 percentage points would raise consumer prices by about 2 percent. "If prices rise but household income does not, consumption will suffer a blow." It recalled the experience of 1997, when the sales tax was increased from 3 percent to 5 percent. "Households suffered additional burdens ... This was accompanied by the Asian monetary crisis and serious financial uncertainties, thereby causing the national economy to slow down sharply. It must be remembered that these developments led to long years of deflation."

There is strong pressure on Abe not to delay the tax hike. The International Monetary Fund (IMF) said last month the measure was "an essential first step" in fixing Japan's fiscal problems. It has long called for the consumption tax to be raised to at least 15 percent. Many leading Japanese companies are pressing for the April tax hikes, with one Kyodo survey finding almost 70 percent of major firms backing it.

The prevalent view in the global financial markets was exemplified by Japanese economist Long Hanhua Wang at the Royal Bank of Scotland. Speaking to the CNBC, he insisted that the tax hikes are necessary,

even if, as a result, Japanese growth slows to 0.3 percent in 2013-14 fiscal year—far below the government forecast of 2.8 percent. In what amounted to an ultimatum, he said: “This is the last chance for Japan to do the tax hike. If Japan loses the trust of the international society there will be possible damage to the JGB (Japanese government bond) market in the mid to long term.”

On September 3, the Bloomberg financial web site also warned, after interviewing 32 economists, that the market sentiment was that “Japanese shares could plunge 10 percent or more” if Abe failed to carry out the planned tax increases.

While most Japanese government bonds are still financed domestically, the proportion is dropping, making Japan more vulnerable to the demands of the international financial markets. Knowing this sentiment, Deputy prime minister and finance minister Taro Aso has described the planned tax hikes as an “international contractual obligation.”

Japan’s government debt continues to grow, hitting 1 quadrillion yen recently. Although official propaganda blames rising social security costs for the national debt of over 200 percent of the GDP, much of it was incurred to bail out the Japanese banks and major firms when the real estate bubble burst in the early 1990s. On the revenue side, tax income dropped 25 percent from 58 trillion yen in 1990 to 43 trillion in fiscal 2013, mainly because of business tax cuts and exemptions.

Abe’s government leaked to the media last month that it was considering lowering the 38 percent corporate tax, the second highest in the world. However, government officials rapidly denied any formal request from Abe, due to fears that it would exacerbate the political difficulties in lifting the consumption tax. The IMF has long argued that Japan should cut the corporate tax rate to between 25 and 30 percent.

The government’s divisions over tax hikes underscore the fragility of “Abenomics.” Abe’s policy has involved substantial fiscal stimulus and massive monetary expansion—Japan’s version of the US Federal Reserve’s “quantitative easing” or electronically injecting money into the banks.

These measures are supposedly to be offset by “the third arrow” of structural reforms: that is, austerity measures and social spending cuts. Apart from the sales

tax hike, these so far include: the largest-ever welfare benefits cut, implemented on August 1, which will reduce payments by 6.5 percent over three years; moves to double out-of-pocket medical payments by patients aged 70 to 74; and proposals for a rise in the pensionable age.

“Abenomics” is not only driving the working class into a confrontation with the government, but also causing international trade tensions. Japan’s “quantitative easing” has led to the devaluation of the yen, undercutting other Asian export economies such as South Korea. The resulting trade tensions have been further exacerbated by Abe’s moves to revive Japanese militarism, which include increased military spending and calls to acquire pre-emptive strike capabilities.



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