

CAN THE DEMOCRATIC PARTY FINALLY RAISE JAPAN'S CONSUMPTION TAX?

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1. ARGUMENT AND ANALYTICAL FRAMEWORK

(1) Argument:

- The Ministry of Finance (MOF) has nurtured politicians in both ruling and opposition parties who can develop a policy of fiscal reconstruction and realise tax increases



- It is highly possible that an increase in consumption tax will be finally realised

(2) Analytical Framework:

- Institutional Changes
 - 1) During the 1955 regime (before the "political reform" in 1993)
 - a. Political corruption and pork-barrel politics
 - b. Policy-making process



- ① Strong Policy Research Council (PRC) and weak Cabinet
- ② Political bargaining behind the scenes
- ③ Factionalism
- ④ Seniority system and hereditary politics

2) Political Reform (1993):

- Electoral reform: Introduction of the single-seat constituency system
 - 1) Merger of small political parties
From multi-party system to two party system
 - 2) Strengthening of Prime Minister and party executives
 - a. Power to shuffle personnel
 - b. Power to dissolve the lower house
 - c. Power of resource distribution




3) Change of policy-making process


- a. Weakening of factions and PRC
→ Strengthening of Cabinet Office
 - b. Pork-barrel politics
→ Policy-oriented politics
 - c. Collapse of seniority system
→ New policy experts emerged
- (3) Policy-making process of tax system reform:
- LDP Research Commission on the Tax System (RCTS)
→ Ministry of Finance (MOF) and policy experts

(4) Actors concerned in tax system reform:
 Emerged in Ministry of Finance reform in 1990s

1) "Fiscal Hawks": Kaoru Yosano, Hakuo Yanagisawa, Sadakazu Tanigaki, Yasuo Fukuda
 Promoting "Fiscal Structural" → Resisting "MOF reform"



2) LDP's "new breed policy maker":
 Yasuhisa Shiozaki, Yoshimi Watanabe, Nobuteru Ishihara
 → Pursuing administrative reform



Show reluctance to raise tax which MOF promoted

3) New Party Sakigake and Japan New Party "New Breed Policy Maker":

① Naoto Kan, Yoshito Sengoku, Fumihiko Igarashi, Seiji Maehara, Yukio Edano, Yoshihiko Noda



② Pursue dismantling of MOF
 → DPJ change to cooperate with MOF

4) Ozawa group:
 Ichiro Ozawa, Yukio Hatoyama, Banri Kaieda, and "Ozawa Children"
 → Ultimately, pursue dismantling of MOF




5) Former-LDP veterans and Former-Socialist Party group:
 Have unexpectedly strong relationship with MOF
 e.g. Hirohisa Fujii, Naoki Minezaki




2. POLICY-MAKING PROCESS OF TAX SYSTEM REFORM (DURING THE 1955 REGIME)

(1) Policy-making process in LDP Research Commission on the Tax System (RCTS)

- Judging "Petition for Tax Reform" which collects industry demands (so-called "*denwa-cho*" or phone book)
 → Coordinate conflicting interests between industries
- Small number of tax experts (so-called "inner") substantively make decisions
 - 1) Pride themselves on taxation expertise
 - 2) Exclude amateurs from policy-making
 - "Boss of RCTS" Sadanori Yamanaka
 "Government Tax Research Commission is not downgraded, but ignored"




- Tax reform as hodgepodge of industry demands
 (Even Koizumi government could not realise drastic reform of tax system)
- 1990 process of introduction of Consumption Tax
 - 1) Conventionally MOF seemed to lead the reform
 - 2) In reality PM Takeshita exerted high coordination ability
 → Overcome industry opposition
 - a. Takeshita contacted 300 industries on RCTS to hear their demands
 - b. Problems: e.g. "Simple Taxation System"
 Give special consideration to supporters such as farmers and self-employed workers
 → Increased public distrust of consumption tax



3. FROM "POLITICAL REFORM" TO "KOIZUMI STRUCTURAL REFORM" (1990S ~2005)

(1) Why did politicians force through "Political Reform"?

- Reformist politicians recognised the limits of *zoku-giin* politics (politics of political tribe)
- Increase policy issues in which it is necessary to coordinate between ministries and agencies
 - e.g. US-Japan trade friction
 Japan's negotiator: Ichiro Ozawa (Vice-Chief Cabinet Secretary)
 → Significant for "Political Reform"
 - 1. Made strong connections between bureaucracy and industry
 - 2. Keenly realised limits of *zoku-giin* politics




(2) Realisation of "Political Reform":
Introduction of combination of single-seat constituencies and proportional representation (1993)

(3) "MOF organisational reform" was the main subject of administrative reform in the 1990s


- New Party Sakigake (predecessor of DPJ) advocated "MOF should be divided into four agencies"

1. Separation of financial section (Financial Services Agency)
2. Merger of National Tax Agency and Social Insurance Agency (Revenue Agency)
3. Separation of Budget Bureau (Budget Agency)
4. National property management




(4) MOF organisational reform in Hashimoto government:

- Financial Big Bang, Separation of Financial Bureaus



New breed policy makers versus pro-MOF politicians

- Fiscal Structural Reform



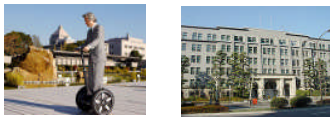
Pro-MOF politicians and Budget Bureau in MOF

→ In 1998 reform failed because LDP suffered a humiliating election setback

(5) Koizumi Structural Reform:

- Koizumi government created a close relationship with MOF in order to promote structural reform
- Koizumi stated "Consumption tax rate would not be increased during my terms of office"


→ Tax system was not reformed



4. LDP'S TAX SYSTEM REFORM (2006~2009)

(1) Prime Minister Koizumi lifted a ban on discussing increases in consumption tax


- In 2006 Yosano became minister in charge of economic and fiscal policy
- Yosano and Yanagisawa, chairman of RCTS in the LDP, proposed tax system reform through "the reform of both expenditure and revenue"



Hidenao Nakagawa, chairman of PRC in the LDP, planned for massive spending cuts


Cuts in spending by 2.2~5.1 trillion yen (1~2% increase in tax is necessary)

- "Yanagisawa's Paper"




Rise in consumption tax to be used for social security costs such as pensions, medical services and nursing care

"Tax for social security" was first advocated in a formal government document




→ Yanagisawa persuaded MOF to accept Yanagisawa's idea.

(2) Fukuda government:



- Consumption tax rate would be raised to 10% in the mid-2010s
- The government calculated that a tax increase to 10% would meet expansion of social security costs

(3) Aso government:



- The concept of "medium-size welfare, medium-size national burden" was advocated

(4) Change of RCTS in LDP

From initiative of *zoku-giin* (taxation experts) to initiative of MOF and new policy experts

5. DPJ'S TAX SYSTEM REFORM (2009~)

- (1) Restructuring Government Research Commission on Tax System (RCTS):
- Excluding RCTS in LDP from policy-making process
 - Membership:
 - 1) Chairman: Finance Minister
 - 2) Vice Chairman: Vice Minister of Finance, Vice Minister of Internal Affairs
 - 3) Committee members: other Vice Ministers
- ⇔ In LDP regime: advisory council of academics, industry representatives

- "Committee of Eleven Tax Experts" is established
 - 1) Provide expert advice to RCTS
 - 2) Four experts are former members of government RCTS during LDP regime
 - Securing continuity of tax system reform between LDP and DPJ regimes
- (2) Abolition of RCTS in DPJ
 - Blocking DPJ *zoku-giin* tax experts who represent interests of a particular industry

- (3) Relationship between MOF and DPJ regime:
- Finance Minister Fujii, Vice Finance Minister Minezaki
 - 1) Close relationship with MOF before regime change
 - 2) Argue necessity of consumption tax increase for social security
 - Similar to Yosano and Yanagisawa in LDP
 - MOF and DPJ shared views on direction of tax system reform when Hatoyama government was formed in September 2009



- (3) Integrated reform of social security and tax:
- Objective:
 - 1) Japan enters "aging society with a falling birthrate"
 - 2) Control rise in social security costs
 - 3) Secure revenue sources
 - Necessity to implement both tax and social security system reform is widely recognised

- Tax System Reform:
 - 1) Increase consumption tax from 5% to 10% by 2015
 - 2) Consumption tax revenues will only be used for social security costs
- Incremental reform of social security system
 - This reform plan is very similar to LDP's (2009 DPJ election manifesto contained a much more radical social security reform plan but this idea was dropped)

- Cabinet reshuffle in 2011: Prime Minister Naoto Kan appointed Yosano as Minister in charge of economic and fiscal policy

→ DPJ's reform plan became similar to the plan in LDP



- After Great East Japan Earthquake a few politicians tried to intervene in reform policy-making process

6. CAN THE DPJ FINALLY RAISE JAPAN'S CONSUMPTION TAX?

(1) Prime Minister Yoshihiko Noda faces difficulties:

- Opposition within DPJ- Ozawa Group (100 members)
- Noda tries to maintain party harmony

- 1) Higashi Koshiisi is appointed as Secretary General
- 2) Vice Ministers and Parliamentary Secretary:
Young members of Ozawa group are appointed
→ These moves are not successful



• Revival of RCTS in DPJ:

- 1) Former Finance Minister Fujii becomes Chairman
- 2) Make opposition within DPJ participate in discussion on consumption tax increase
→ Try to achieve consensus within the party

• Reversal to pork-barrel politics as in LDP regime:

- 1) Trade unions and industries lobby for RCTS
→ Claiming opposition to tax increase
- 2) Fujii retired as Finance Minister because of poor health and is also relatively old

(2) Prime Minister Noda encounters difficulties in managing Diet affairs:

- PM Noda requires LDP and Komeito opposition parties to participate in tax system reform discussions
→ Opposition rejects this
- Opposition strongly demands withdrawal of "DPJ's 2009 election manifesto"

1) Reduction in number of Diet members:

→ Difficult for DPJ and opposition to agree

- a. DPJ wants to reduce 80 PR seats
- b. Komeito and other small parties are strongly opposed.



2) Radical pension system reform:

- a. Three different pension systems for self-employed workers, corporate workers and civil servants
→ Create unified pension system geared to each individual's income + guaranteed minimum of ¥70,000 per month
- b. Additional consumption tax increase from 10% to 12.3-17.1% is necessary
- c. Included in DPJ 2009 election manifesto
⇔ LDP and Komeito strongly demand it is retracted

3) "Bill to issue deficit-covering bonds":

a. Fiscal 2012 budget:

- ① 40% of general account expenditure is covered by deficit-covering bonds
- ② Budget of 38.3 trillion yen will not be implemented if the bill is not passed through the Diet
⇔ LDP and Komeito criticise major policies in DPJ 2009 election manifesto:
 - child allowance
 - tuition-free public high schools
 - farmers income support allowance
 → Strongly demand their abolition

(3) Japan's consumption tax can be raised:

- Noda government will submit bills related to consumption tax hike to Diet in March

⇔ LDP and Komeito put pressure on PM Noda to dissolve the House of Representatives by the end of March or June

• Increase in consumption tax will be realised

- 1) DPJ and opposition parties strongly argue about the main policies in DPJ 2009 manifesto
- 2) They do not dispute increase in consumption tax itself


- Opposition parties:
 - a. LDP:
 - ① LDP's original reform plans for tax and social security systems are very similar to DPJ's
 - ② LDP pledged increase to 10% consumption tax in 2010 House of Councillors election. LDP will promise to raise consumption tax rate to 10% in their manifesto for next general election
 - b. Komeito declares tax reform is not a point of issue



(4) Uncertainties of realising consumption tax raise:


- Ozawa group and "Ishin no Kai" (Meeting of the Restoration) led by Osaka Mayor Toru Hashimoto
- a. Majority of members in Ozawa group are young
 - They are not electorally strong so it is difficult for them to separate from the main party
 - They are not a threat to the Noda government
- b. If "Ishin no Kai" is ready for next general election
 - ① *Ishin*, Ozawa, and other small parties will be able to form a united front against the main parties such as DPJ, LDP, and Komeito, which want an increase in consumption tax
 - ② This may trigger a "political realignment"

→ However, this is not realistic



(5) Ministry of Finance (MOF):

- a. Before the 2009 regime change MOF had discussed tax system reform with the DPJ
- b. Regime change is again a possibility
 - It is natural for MOF to start discussions with the LDP and Komeito. LDP executives such as Sadakazu Tanigaki, Nobutaka Machimura, and Bunmei Ibuki have a long-standing close relationship with MOF
- c. MOF has advanced discussion with DPJ, LDP, and Komeito.
 - Three parties' policy directions become similar



- d. It does not matter to MOF which party realises a consumption tax increase
- e. If DPJ loses power, LDP and Komeito will implement a tax rise with the abolition of the main policies in the DPJ manifesto

Thanks for your attention