



JAPAN: TAX MATTERS

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On Monday September 10 the leader of the party likely to win Japan's next general election, LDP's Sadakazu Tanigaki, threw in the towel in a surprise move. He had repeatedly expressed his intention to run in the election for party president and had a fair chance to be re-elected. He was also likely to secure a victory for his party in the upcoming election, and become prime minister. Tanigaki's resignation makes others see the writing on the wall, not least Prime Minister Yoshihiko Noda. And the root cause of his fall was Noda's decision to raise taxes.

A rule of thumb in Japanese politics is that a prime minister who proposes a tax increase will not be long-lived. In fresh memory are prime ministers who came up with just such an idea and fairly soon had to look for another job. In Japan, the only tax increase that seem to be generally accepted is that on spirits or tobacco, as in most Western countries. Thus, a golden rule for a Japanese prime minister who harbors the idea to propose a tax increase is to tread cautiously.

Against such a background, Prime Minister Yoshihiko Noda must be said to have been acting boldly. Soon after he assumed his office on September 2 last year he declared that he intended to double the sales tax to 10 percent. Despite steadfast resistance from large parts of his own party, the DPJ, other parties, and the general public, he did not waver. And he reached his goal. On June 26 the tax increase legislation passed the Lower House and on August 10 the Upper House took a similar decision, deciding that the 5 percent sales tax will be increased to 8 percent in 2014 and 10 percent in 2015.

Dramatic Consequences

The consequences for Noda himself, his party and his government are likely to be dramatic. Some of them have already materialized. The powerful Ichiro Ozawa, former chairman of the DPJ and still the kingpin, left the party on July 3 together with 49 other MPs and launched a new party. He accused Noda of having deceived the Japanese people by not acting in accordance with the DPJ's 2009

election manifesto. Ozawa was the strategist behind the DPJ's landslide victory, and wanted the party to keep its promise not to raise taxes.

Ozawa's move was a blow to the power position in the Japanese parliament of not only Noda but also the DPJ and the coalition government. In order to make it possible for the parliament to take a decision when a large section of his own party revolted, Noda joined forces with two opposition parties, the LDP and the Komeito. But in order to make them vote for the tax rise, Noda had to promise to call for new elections. He promised to do so "soon." A debate is raging now on what exactly this "soon" means.

Polls in recent months have shown that the popularity of Noda and the parties in the government is at a nadir. Thus, it is a fairly reasonable prediction that Noda and his party will have to hand over power to an opposition, led by the LDP, following the upcoming election. All polls indicate that the election will be close to catastrophic for Noda's party. It seems Noda will repeat the feat of Tomichi Murayama, a social democrat who led that government in the mid-1990s in such a way that his party went from having been the second largest party in the parliament for decades, to being close to annihilated; it was halved in the 1993 elections (from 142 to 70 seats) and won only 15 seats in the 1996 election.

A Question in Need of an Answer

Why has Noda been acting in a way that will ruin not only his own position as prime minister but will most likely re-



sult in a horrendous election defeat for his party?

It might be the case that Noda is only too aware of how precarious Japan's economic situation is. In September the government announced plans to cover about 38 trillion yen of the general account budget worth some 90 trillion yen by issuing deficit-covering bonds (*The Japan Times*), that is, a whopping 42 percent. Heavy borrowing has made Japan's outstanding debt equal to 214 percent of GDP – the largest by far of Western countries.

Floating bonds to cover up to 50 percent of governmental expenditures, as has been done in Japan in recent years, is not healthy for any country. That it is possible to do so year after year in the case of Japan is only because the Japanese people are rich and domestic savings are sizeable. But finance ministry bureaucrats realize that there's a limit to borrowing, and that this limit creeps closer with every year that passes with nothing being done about the heavy borrowing of the Japanese government. It is well-known that the top officials of the ministry are convinced that it is absolutely necessary for Japan to increase taxes.

Like his predecessor Naoto Kan, Noda came from the post of finance minister. Maybe the ministry's top bureaucrats scared Noda as they had done with Kan, to come up with a proposal of a tax increase. Maybe Noda is resolved to succeed where Kan failed.

It might also be that Noda intends to act in a way similar to one of his predecessors, Jun'ichiro Koizumi (2001–06). After having met decisive resistance to his key policies both in the parliament and in his own party, Koizumi played the strong hand that a prime minister has – the power to dissolve the Lower House and call for general elections. Acting decisively, Koizumi threw out his opponents from his party and had it put up candidates that supported the prime minister against his foes within the party. The result is well-known. The 2005 election became a landslide win, not for

the ruling LDP, but for Koizumi, who emerged from the election with a solid majority and an annihilated opposition.

The problem for Noda is that he is no Koizumi. While Koizumi was a master of taming both media and voters, Noda is a fairly dull politician. With the image of a bureaucrat, he lacks Koizumi's charisma. Noda knows this.

It's the Results that Count

Thus, most likely it seems to me, is that Noda has made a calculation and will act as the skilled bureaucrat he is seen as. Of course he knows how utterly unpopular a tax increase is and is painfully aware of the dismal fate of his predecessors who spoke up for tax increases and soon found themselves no longer premier. But there is potential for a significant pay-off. With the financial resources that will come with such a tax increase, Noda and his government could break the long row of lackluster governments, loosen the purse-strings and start to deliver on their promises. Presenting voters with tangible achievements and results is likely to be seen by him to be the key to secure prolonged trust from the electorate.

Of course Noda knows that he will have to go, but he knows that his successor can reap the benefits. More importantly, he knows that he will secure for himself something dear to any politician in Japan, earning a place in the annals of Japan's history as a rare creature among Japanese prime ministers, a doer.

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