

THE CURSE OF GENERAL INDIRECT TAXES IN JAPAN

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Executive Summary

1. Rising fiscal deficits have been a constant headache for successful Japanese governments since the late 1970s. While many prime ministers had placed it high on their agenda to increase tax revenues, few had succeeded.
2. The basic structure of Japan's postwar tax system was established in 1950. At that time, Japan had no general indirect tax; rather, a major portion of tax revenues came from regressive income taxes.
3. When economic growth decelerated in the late 1970s, the Japanese government started to face growing financial difficulties. To increase tax revenues, Prime Ministers Masayoshi Ohira and Yasuhiro Nakasone attempted to introduce a general indirect tax, in 1979 and 1986, respectively. Both attempts failed in the face of strong taxpayer opposition.
4. In 1987, Noboru Takeshita who took over from Nakasone had a strong political base in the Diet. Takeshita proposed a bill to introduce a general indirect tax, called the Consumption Tax (CT). The CT was enacted in April 1989, but its extreme unpopularity among the general public led to Takeshita's resignation as prime minister in June 1989.
5. The CT rate in 1989 was three per cent, which could not strengthen the financial condition of the government. In 1997, Prime Minister Ryutaro Hashimoto raised the rate to five per cent. However, a huge economic depression occurred six months after the hike. Under severe criticism, Hashimoto resigned as prime minister.
6. Nonetheless, the five per cent CT rate was still too low to collect sufficient tax revenues. While successive prime ministers were aware of the need to increase the CT rate, none of them succeeded in doing so, until 2014.

7. Before 1990, a CT hike was considered a “jinx” as an increase often ended with the resignation of the prime minister or his demise within a year. This apparent “jinx” has been referred to as “the curse of general indirect taxes”.
8. Current Prime Minister Shinzo Abe is seen as making an attempt to remove this curse. He increased the CT rate (a general indirect tax) from five to seven per cent in April 2014 and planned a further increase in October 2015.
9. The success/failure of Abe’s attempt to remove this curse is too early to be determined. So far, the tax hike has not resulted in a slump in Abe’s approval ratings. This may be considered as a sign of changing political dynamics pertaining to tax collection in Japan. However, an unexpected weak economic performance has forced him to delay the second tax hike by 18 months and to call for an early election.