



Where have integrity and modesty gone in the policy decision-making process?

Residual Problems in Japan's Democratic Government Stemming from The Second Postponement of The Consumption Tax Hike

The grounds for the first postponement of the consumption tax hike in November 2014 and the latest postponement are complete, and each will have an entirely different impact in the future. Nobody welcomes the raising of consumption taxes. While it is true that postponing the hike ensures victory in elections, the loss caused by this action is far too great.

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The prime minister held a press conference on June 1, 2016 in which he announced the government's final decision to postpone the consumption tax hike for a second time. Regardless of whether they were in favor of the actual consumption tax hike, there must have been a number of people who were perplexed, wondering if this represented a policy decision that had finally crossed a line. I also believed that even the prime minister was bound by both the official and unofficial policy consensus that had been developed. However, with the announcement of this second postponement, I felt that I was shown how wide the prime minister's discretion really is.

Of course, I have no intention of claiming that this sort of discretionary decision is an outright violation of laws. However, regardless of the views the prime minister held about the political consensus that had been developed through continued efforts, I believe that first and foremost the prime minister is required to possess the integrity to respect this consensus. If he intends to change it, he would then need to exhibit a sense of modesty, showing his intentions by providing a thorough explanation. These are the thoughts in my mind as I write this article now.



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Did the 8% consumption tax hurt the Japanese economy?

The agreement on the latest consumption tax hike was based on the confirmation of the three main political parties of the integrated reform of the social security and tax systems at the meetings of the secretary-generals of the Democratic Party of Japan (DPJ), the Liberal Democratic Party of Japan (LDP), and the Komeito in June 2012. However, the Act on the Comprehensive Reform of the Tax System that was created based on this three-party agreement included an economic assessment clause. Under this clause, the introduction of the consumption tax hike could be suspended if it was deemed necessary to do so based on the state of the economy.

The consumption tax rates were raised from 5% to 8% in April 2014 as planned. However, in November 2014, Prime Minister Abe Shinzo invoked the economic assessment clause and announced the postponement of the tax hike from 8% to 10%, pushing it back one and half years from October 2015 to April 2017.

At this time, Abe expressed his resolve on the postponement with an assertive tone, claiming, “I will never postpone this tax. That is something I can promise you. I will definitely move forward with the consumption tax hike in April 2017, and will not add an economic assessment clause.” Indeed, the economic assessment clause was omitted from the Act on the Comprehensive Reform of the Tax System that was revised in fiscal 2015.

Taking all of this into account, now we must look at the basis for Abe’s decision to apply the economic assessment clause in November 2014. The gross national product (GDP) for the third quarter of 2014 was announced the day before the prime minister held the press conference. The annualized growth rate fell 1.6% on a quarter on quarter basis, posting negative growth for the second consecutive period.

The figure shows the trends in GDP and household consumption. When consumption taxes are raised, there is a spike in demand ahead of the introduction of the higher tax, so it was only natural that in reaction production and consumption fell in the second quarter of 2014, the quarter immediately after consumption taxes were raised. As a result, policymakers needed to be wary of the economy slowing down and falling below the level for the fourth quarter of 2012, the quarter before advance demand started to become apparent. Certainly, from the standpoint in November 2014, I agree that it was not possible to definitively downplay the possibility that future GDP and household consumption would fall below the levels for the fourth quarter of 2012 by a large margin.

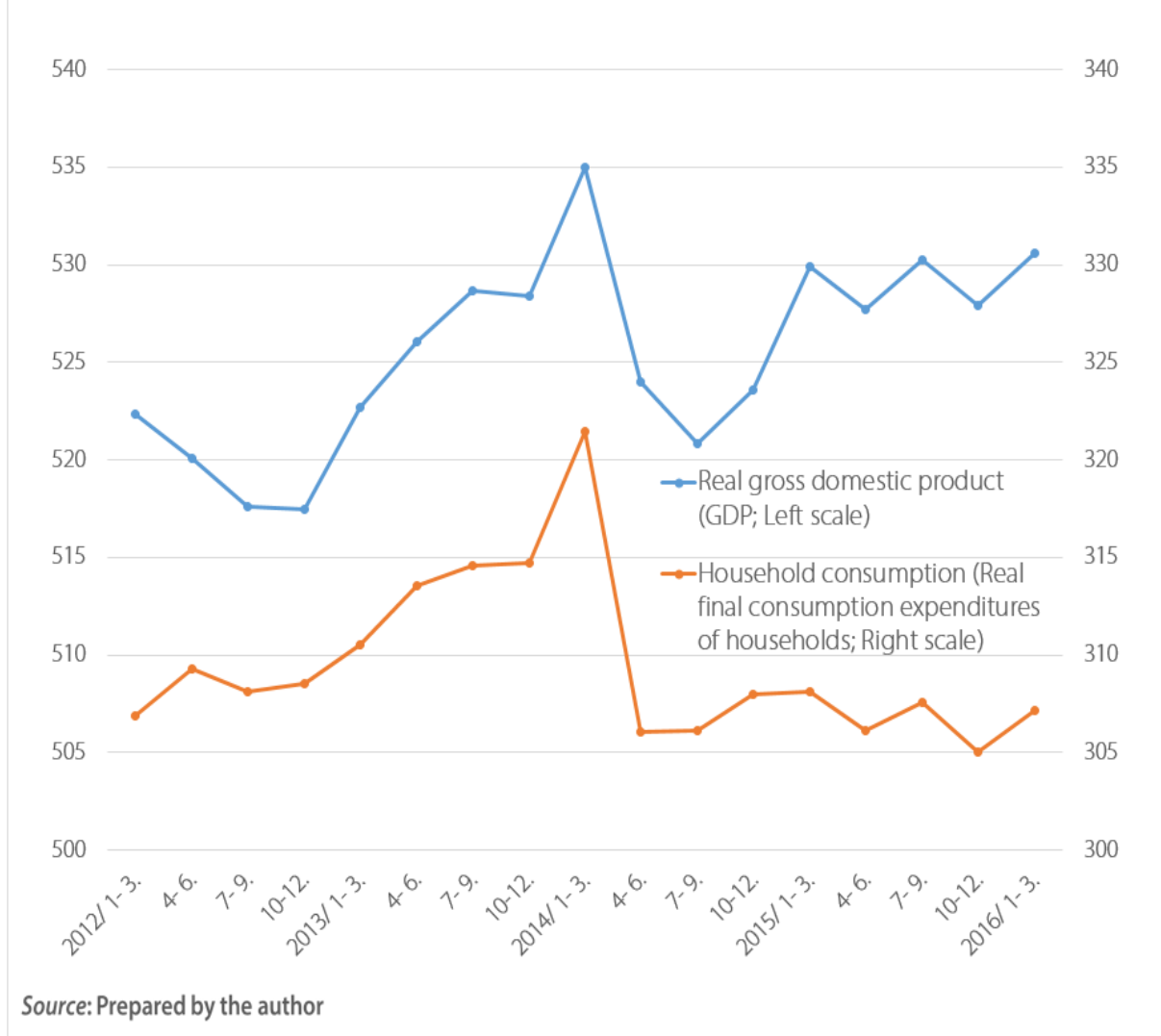
The thing that stood out most in Abe’s speech was his firm resolve about the suspension of the consumption tax hike based on the fact that the economic assessment clause was only applied once, and his complete confidence about the success of the economic policies pursued by his administration. This may sound overstated, but the prime minister’s resolve and confidence seemed to boost the hopes of many people. These high hopes were also reflected in the landslide victory of the ruling coalition in the general election that took place immediately after the prime minister’s announcement.

In fact, GDP and household consumption did not fall below the levels for the fourth quarter of 2012, but instead began to perform steadily in the second half of fiscal 2014. As the line graph on the left shows, GDP started to recover in the fourth quarter of 2014, and it remained at high levels from the first quarter of 2015. Looking at GDP trends, the negative impact of higher consumption taxes lasted for only the six months after the consumption taxes were raised.

By the first quarter of 2015, household consumption had recovered to the level for the fourth quarter of 2012. Since then it has remained slightly stagnant, but has never been in free fall. Sure enough, household consumption has not recovered as much as production in terms of GDP. However, instead of considering the gap between production and consumption to be directly caused by the effects of higher consumption taxes, it is more natural to view the gap as being largely caused by the state of real labor income that has remained sluggish since the start of the twenty-first century.

In spite of this, Abe must have been thinking that the Japanese economy would have been in a much better shape had it not been for the burden of the consumption tax hike in April 2014. I believe that the prime minister also wanted to do everything possible to avoid raising the consumption tax in April 2017, a hike which he felt might hinder the administration’s economic policies.

The Correct Understanding of The Impact of Higher Consumption Taxes: Production Recovers and Consumption Remains Stagnant (units: yen trillion)



It's perfectly natural for a politician to wish to successfully manage his own economic policies. Even so, the prime minister does not have free rein to throw out the existing consensus or ignore his own public commitments. He is required to carefully follow the policy decision making process, which is a requirement in any democracy.

As I stated earlier, the main political parties reached an agreement on the introduction of a higher consumption tax before the LDP returned to power, and the agreement was enacted into law. Nevertheless, the decision in November 2014 to postpone the introduction of higher consumption taxes was carried out legitimately based on the economic assessment clause. However, in doing so Abe publicly announced that it would not be postponed a second time in the future, so the clause was omitted from the act. In short, the prime minister restricted his own discretionary power with the

statements he made.

Common sense dictates that the administration should follow through on its commitment to make the consumption tax hike in April 2017. However, the administration is now coming up with a variety of excuses for postponing the tax hike a second time.

Foreign countries do not turn away from unpopular policies.

Despite the fact that the economic assessment clause had already been omitted, the argument that the higher consumption taxes would lead to stagnant household consumption began to reverberate like a constant figured base as an excuse for the second postponement during policy discussions over the consumption tax hike.

Abe started alluding to the possibility of considering postponing the consumption tax hike a second time if there was an economic crisis on the scale of the Lehman Brothers collapse or natural disaster such as a large earthquake. These were factors that had not been considered at all when the three parties reached an agreement or when initially deciding to postpone the hike.

There were those who called for classifying the Kumamoto Earthquakes that struck on April 14 and 16, 2016 as a great earthquake. These earthquakes were by no means small earthquakes. However, in terms of the damage they caused, the scale did not readily compare to that of the Great East Japan Earthquake and the Great Hanshin-Awaji Earthquake.

In regards to the occurrence of a serious economic crisis, which was considered to be one of the requirements for the second postponement, people also began to call for it to be rephrased as the risk of an economic crisis taking place.

The risks of economic crisis were proposed as an agenda item at the Analysis Meeting on International Finance and Economy, in which discussions with international economists were held, and at the G7 summit meeting. In fact, at the press conference in which the second postponement was announced, Abe justified the decision by stating that it was now necessary to correctly understand risks and avoid falling into the trap they pose.

I think that the previously described decision-making process contains a number of worrying issues that could potentially cause problems in the future.

First of all, the government, ruling parties, and the Diet all failed to hold extensive and adequate discussions assessing the circumstances for postponing the consumption tax hike a second time. I do not mean to sound emotional, but it pains me to think of the politicians and bureaucrats who were ardent supporters of the administration and the disappointment that must have fallen over them when they learned they were excluded from discussions about a critical policy matter like this.

Second, I begin to wonder whether Abe has forgotten that maintaining fiscal order is the most important precondition for large-scale monetary easing and fiscal actions. Since the establishment of the current administration, the Bank of Japan has been engaging in extraordinary monetary easing, while the Ministry of Finance took bold fiscal actions by developing a 15-month budget that combined the expansion of the reconstruction budget and the large-scale supplementary budget. I am sure that they took these actions based on a strong commitment to developing an environment suitable for raising the consumption tax and using it as a permanent fiscal resource.

At the end of May 2016, Governor of the Bank of Japan Kuroda Haruhiko referred to the joint announcement the Japanese government and the Bank of Japan made in January 2013 in which they

made a public commitment to promoting fiscal reconstruction. Kuroda went so far to mention that the joint announcement was made by former Governor Shirakawa Masaaki. While people often talk about the difference between the present and former bank governors, Kuroda's statement shows that both he and Shirakawa fully agreed that fiscal reconstruction is a critical precondition for unorthodox monetary easing

Third, I think many people are starting to doubt the approach taken by Abe, and wonder whether his desire to avoid painful conflicts is making him unwilling to take measures to reform the economic and financial structure. G7 leaders may also be starting to suspect the same thing.

It is impossible to avoid severe conflicts when structural reform that touches upon the core parts of the structure of interests is carried out. In France, the president and labor unions are in the midst of a fierce standoff over the easing of the dismissal of employees. In the United Kingdom, the former prime minister tried to persuade the populace to remain in the EU. In the United States, to normalize interest rates, the chair of the Board of Governors of the Federal Reserve System has continued to patiently hold dialogues with the financial market.

Nobody ever welcomes a consumption tax hike, and it is impossible to gain the trust of the public through a tax increase. That is why consensus was carefully forged through the political approach of the three-party agreement. To realize this agreement, it is essential for the government to have the integrity to respect processes that have been taken to date, and the modesty to hold comprehensive discussions. When the politicians lose their integrity and modesty, the heart of people who do not publicly express their views will likely lose faith in the government, or rather quietly but steadily lose faith in the political system.

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