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Keidanren, Consumption Tax, and the Lost Decade of the 1990s in Japan [1]

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Abstract

This study examines the dynamics of the "lost decade" of the 1990s in Japan by analyzing the major role of Keidanren (Japan Business Federation) in advocating the raise in the consumption tax rate from 3% to 5% in 1997. Some observers blame this action for halting an incipient recovery from an extended period of economic stagnation since 1990, throwing Japan into another recession, and hence contributing to the nation's deflationary doldrums that continue today. This paper traces the changing attitudes of Keidanren toward the consumption tax, from opposing proposals for it in the late 1970s to zealously advocating it in the mid-1980s, accepting its passage in 1988 at the rate of 3%, and supporting an increase to 5% in the middle of a severe economic downturn. The main motivation was to achieve long term goals of balancing the national government's budget and funding increased services for a rapidly aging population at the risk of hampering the shorter-term goal of economic recovery.

Keywords: Consumption tax, Keidanren, Economic stagnation

JEL classification: N15

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This analysis aims to elucidate some of the causes of the extended period of economic stagnation in Japan during the “lost decade” of the 1990s. Amid the many commentaries on this topic, this project hopes to make a distinctive contribution to the discussion through a specific case study that will analyze the role and motivations of the Japanese business community, especially Keidanren (The Federation of Economic Organizations), in promoting the decision to increase the national consumption tax (*shōhizei*) in 1997. Observers have often cited Keidanren, as the representative of large corporations, as the most prominent and powerful business group in Japan.

The dynamics of the “lost decade” and the raising of the consumption tax merit attention for several reasons. As the melodramatic term “lost decade” suggests, the sudden collapse of Japan’s economic growth in the early 1990s shocked observers. In a figurative instant the Japanese economy fell from the status of being an international superstar to that of a failure. Studies switched from analyzing the reasons for Japan’s economy being “Number 1” to wondering what had gone wrong. In this context, observers have blamed the raising of the consumption tax from three percent to five percent in 1997 for stalling an incipient recovery of the economy that began in 1996 and throwing the economy back into recession. Takahashi Fumitoshi, a specialist on comparative economic policy, asserts that in Japan “the peak of economic recovery following the collapse of the bubble [in the early 1990s] was in March 1997; relapses in the economic indicators began in April following the consumption tax increase.” More succinctly, historian Jeff Kingston calls the raising of the consumption tax the “height of folly" that "stifled a fragile recovery."[1] Probing the reasons for this tax hike when the economy was still so vulnerable is important.

In recent years, views of the "lost decade" have mellowed. Because economic growth has remained low with the exception of just a few years in the early 2000s, one could glumly argue that the "lost decade" has entered its third decade. Japan, though, has avoided high levels of unemployment and remains one of the most affluent nations in the world. Moreover, much of the rest of the developed world, especially since the Great Recession of 2008, has suffered from sagging economic growth. As one foreign journalist opined recently, "Japan had a genuinely lousy 1990s. But it turns out that, relative to other rich countries, the last decade has not been quite so bad."[2] In retrospect, it seems that Japan had the honor of first confronting the type of prolonged economic slump that would later confront the United States and members of the European Union. Japan's inability to recover effectively has been comparable to the record of other developed nations. This perspective makes the Japanese case less sensational but more relevant to them. The business community deserves attention, because it has played a crucial role in the formation of national economic policy, including the enactment of the tax raise in 1997. Keidanren's pursuit of this goal resulted from its adherence to achieving several different and contradictory aims without clearly prioritizing which was most important.

<u>The Origins of the Campaign for a Consumption Tax, 1977-1979</u>

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[1] Takahashi Fumitoshi, "Manipulations behind the Consumption Tax Increase, The Ministry of Finance Prolongs Japan's Recession," *Journal of Japanese Studies*, p. 92; and Jeff Kingston, *Contemporary Japan: History, Politics, and Social Change since the 1980s* (Chichester, West Sussex, and Malden, MA: Wiley-Blackwell, 2013), p. 26. See also, W.R. Garside, *Japan's Great Stagnation: Forging Ahead, Falling Behind* (Cheltenham, UK: Edward Elgar, 2012), pp. 116-119. Morinobu Shigeki spreads blame in arguing that several developments, including the raise in the consumption tax, caused the recession in 1997. See Morinobu Shigeki, *Nihon no shōhizei dōnyū kaisei no kei'i to jūyō shiryō* (Nōzei Kyōkai Rengōkai, 2000), pp. 93-94.

[2] David Pilling, *Bending Adversity: Japan and the Art of Survival* (New York: The Penguin Press, 2014), p. 120.

In order to fully appreciate the role of Keidanren and the Japanese business community in raising the consumption tax in the 1990s, one has to comprehend the way in which the issue of enacting the consumption tax arose in the late 1970s and developed during the 1980s. It was a major issue of national economic policy that became politically contentious. After two failed campaigns for the new tax, the Diet finally enacted it in 1989.

In the late 1970s pressure for a new source of revenue, such as a consumption tax, stemmed from shocks to the Japanese economy early in that decade.[3] Prior to that point, Japan had experienced almost two decades of double-digit economic growth spurred by the circumstances of an undervalued yen, a stable exchange rate, and low prices for raw materials. This situation, as is well known, began to change when President Richard M. Nixon of the United States in 1971 ended the postwar "Bretton Woods" system of fixed exchange rates for currencies by decoupling the value of the dollar from gold. One motive was to promote American exports and trim burgeoning trade deficits with nations, such as Japan. As expected, the dollar immediately began to lose value against the yen. By 1973 the yen had strengthened from 360 to the dollar to 265. In that year, this "Nixon Shock" was followed by the first "oil shock" when members of the Organization of Petroleum Exporting Countries (OPEC) began to reduce the overall production of crude oil and embargo the export of oil to certain nations. OPEC's aim was to pressure other nations, especially the United States, to moderate their policies of support for the state of Israel during the October War of that year. The price of oil jumped from $2.65 per barrel in January, 1973, to $11.65 twelve months later. Concerned about a possible downturn in the economy, the government abandoned the balanced budget policy that it had followed since the early 1950s in order to use deficit bonds to increase spending.

[3] Much of the analysis below is based on Takeda, Haruhito, *Nihon Keizai no jikenbō: kaikoku kara baburu hōkai made* (Tokyo: Nihon Keizai Hyōronsha, 2009), Chapter 14.

Consumer prices rose quickly, reaching an inflation rate of 10 percent per year in 1972 and 20 percent in 1974. The national government's total debt ballooned from 2.9 trillion yen in 1970 to 70 trillion yen in 1980. That burden loomed as a major problem for Japanese officials in the Ministry of Finance (MOF).

Ōkura Masataka, the head of the Tax Bureau at the ministry, kicked off the campaign for a consumption tax in early 1977 by arguing to a committee in the Upper House of the Diet that rebuilding public finance would require both a boost in the corporate tax and enactment of a consumption tax. This was the first attempt at substantial tax reform in Japan since the Allied occupation that ended in 1952. Frequent references by proponents to the use of the Value Added Tax in Western Europe suggested that its adoption by members of the European Community (now, the European Union) served as a model and inspiration. The ministry aimed, Okura explained, at achieving "'zero'" issuance of national deficit bonds by 1980. Tax revenue would therefore have to increase by almost 14 percent each year. Increasing the personal income tax, which provided 38 percent of all revenue, was "'politically and socially impossible'" because it already imposed a heavy burden on the people.[4] Next, the Government's Tax System Research Council (Seifu no Zeisei Chōsakai/Zeichō), a consultative group to the prime minister, took up the issue. By the late summer its subcommittees reported that a rise in taxes was feasible: "'For the income tax and the corporate tax the level of the [tax] burden is fairly low in international comparison; there is room to raise taxes….'" In regard to a consumption tax, the problems of placing a heavy burden on low income people and of sparking inflation "'[were] not decisive difficulties.'" Moreover, a general consumption tax could immediately produce "many trillions

[4] " Zōzei, hashira wa ippan shōhizei, fuka kachi zei fukume," *Yomiuri shinbun*, March 23, 1977. All references to articles in the *Yomiuri shinbun* (Yomiuri newspaper) are from the Yomidasu Rekishikan database available at Duke University in Durham, NC. Unless otherwise indicated, the citations are to the Tokyo morning edition.

of yen."[5] A few weeks later, the entire Zeichō affirmed that the government could consider raising the income tax and the corporate tax as well as creating a consumption tax. The Committee recognized that the new tax would generate controversy because of determined opposition from one sector (*ichibu*) since "the burden for the low income stratum (*teishotokusha sō*) would increase."[6]

Meanwhile, the Ministry of Finance continued to lobby for the new tax. Noting that deficit spending now provided 29.9 percent of the national budget, one vice minister exclaimed that the government must not break the "'30 percent wall.'" Soon, he claimed, the government would have to issue bonds to redeem previous ones that were coming due.[7] Leaders of the ministry announced that they intended to implement a consumption tax the next year, in 1978, even while details of the proposal—such as the tax rate, exemptions, and procedures for applying the tax at different stages of distribution—remained to be worked out.[8] A delay would only worsen the crisis in public finance.

Opposition to the new tax soon emerged. As expected, political parties opposing the governing Liberal Democratic Party (LDP) objected to the consumption tax as a "mass levy" that would hurt low income earners.[9] Within the business community nine groups representing wholesalers and retailers complained that a general consumption tax would dampen consumption by raising the prices of goods.[10] A report by the Tax System Committee of Keidanren emphasized that the government needed to focus on economic recovery by restoring the rate of utilization of manufacturing capacity from 76 percent to 90 percent. This task would take two or

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[5] "Shōhizei dōnyū nanten nai, Zeichō bukai hōkoku," *Yomiuri shinbun*, August 31, 1977.
[6] "Shotoku, hōjin zōzei no yochi, Fukōhei zesei ga fukaketsu," *Yomiuri shinbun*, September 14, 1977.
[7] *Ibid*.
[8] "Ippan Shōhizei, rainendo jisshi no ikō, Ōkurashō shunō hajimete jiki shimesu," *Yomiuri shinbun*, September 22, 1977
[9] *Ibid*.
[10] "Ippan shōhizei ni ryūtsū gyōkai mōhanpatsu," *Yomiuri shinbun*, September 23, 1977.

three years, and until then "planning the recovery of the economy [had to] be the most important current policy topic." "Rebuilding public finance [was] possible" only when the economy was "riding on the road of stable growth." Intriguingly, the Committee left open the possibility for considering a general consumption tax in the future because of the rapid aging of Japanese society.[11] Meanwhile, the powerful Ministry of International Trade and Industry (MITI) took a similar stance. It opposed a rapid adoption of the new tax by stating that "'it [was] necessary to investigate cautiously whether or not the introduction of a general consumption tax [was] desirable as a means'" of "'securing a source of revenue,'" because it would "'deepen the recession'"[12] This resistance helped ensure that a final proposal did not develop until the fall of 1978. Meanwhile, the MOF ended up having to yield on the budget. Facing strong pressure from "economic circles" for increased spending that would stimulate economic growth, the budget indeed broke the 30 percent barrier in 1978.[13]

This temporary defeat seemed to fortify proponents' resolve to enact a consumption tax in 1979. They now aimed to eliminate dependence on deficit bonds by the mid-1980s, a goal that would require increased revenue of ten trillion yen per year.[14] In September, the Government's Tax System Research Council issued its final draft. This proposal would levy a flat rate of five percent on sales of goods at different stages of processing to generate three trillion yen per year. In a concession to small enterprises, the proposal exempted firms whose annual sales fell below a certain limit from paying the tax.[15] Earlier in the year, members of the Council had broached the idea of designating the consumption tax to fund social welfare services in the hope of building

[11] Zeisei Iinkai, "Kongo no zaisei un'ei to zeisei no arikata ni kansuru kenkai," September 27, 1977, pp. 1-2. Available online at the Library of Keidanren in Tokyo, Japan.
[12] "Ippan shōhizei no sōki dōnyū, tsūsan wa kyōkō hantai," *Yomiuri shinbun*, October 7, 1977.
[13] "Ippan shōhizei 54 nendo ni dōnyū, Zeichō tōshin meiki e," *Yomiuri shinbun*, December 12, 1977.
[14] "Ippan shōhizei 5% uchi ni, Zeiritsu medo hajimete meigen," *Yomiuri shinbun*, July 19, 1978.
[15] "'Ippan shōhizei' de zeichō saishū an," *Yomiuri shinbun*, September 5, 1978.

more support for the measure. The MOF, however, had balked at creating "a source of funding with strings attached."[16] In September, the Zeichō explained that the consumption tax would be collected as a "general tax" but would "in reality have a hidden meaning as a tax for social welfare services and would be appropriated in a prioritized manner related to the expansion of the administration of social welfare services."[17] In the 1980s, proponents of the consumption tax would emphasize its potential contribution to social welfare services in a rapidly aging society.

At this point representatives of the most important business organizations came out against the consumption tax. As reported by the *Yomiuri shinbun*, a meeting of vice-chairmen of Keidanren produced expressions of concern about the adverse influence of the new tax on business conditions. These business leaders acknowledged the goal of balancing the national budget but believed that "when considering the order of priorities it is most essential at the present time to have Japan's national economy riding on a path of stable growth by achieving a growth rate of 7 percent….for the next year too it is necessary to continue an economy led by public finance." Makers of consumer goods such as Yoshiyama Hirokichi, the president of Hitachi, were especially opposed to levying a consumption tax. [18] Worries about a stalled economic recovery prompted three major business groups—Keidanren, the Japan Chamber of Commerce and Industry (JCCI), and the Japan Association of Corporate Executives (Keizai Dōyūkai)—to issue a formal joint protest against a rapid enactment of a general consumption tax even if deficit bonds would end up providing 37 percent of revenue in 1979.[19] Noting that the strategy of expanding the government's fiscal stimulus had yet to increase "private demand," the Tax System Committee at Keidanren called for greater efforts in that direction for at least one or

[16] "Ippan shōhizei wa 'fukushizei' ni," *Yomiuri shinbun*, May 25, 1978.
[17] "'Ippan shōhizei' de zeichō saishū an," Yomiuri *shinbun*, September 5, 1978.
[18] "Zaikai 'shōhizei' ni hantai," *Yomiuri Shinbun*, September 5, 1978.
[19] "Ippan shōhizei no sōki dōnyū, Zaikai 3 dantai ga hantai," *Yomiuri shinbun*, September 27, 1978.

two more years. Its report argued that "if [we] ignore the normalization of the economy as a whole and advance the restoration of public finance impatiently, the economy will stagnate and bring about results that contradict the restoration of public finance." As before, the Committee's report ended with a vague concession that if Japanese decided at some time in the future that they needed to raise taxes, a "cautious investigation of which taxable items to choose would be necessary,"[20] Comments from MITI officials affirmed the need, from its perspective, to maintain a strong economic growth rate, which they predicted might slip to a rate of four percent from the current level of five percent growth in 1978, far from the ministry's target of seven percent growth.[21] In response to this pressure, the MOF prepared for 1979 a "budget to stimulate business conditions" that would rise by 16.6 percent to [expenditures of] 40 trillion yen and require deficit spending to supply 40 percent of the budget."[22]

Late in 1978 Minister of Finance Murayama Tatsuo announced his intention to introduce legislation for a consumption tax in 1979 in order for it to start in January, 1980. He argued that if Japan continued to increase employment "'only through public finance'" it would collapse.[23] Shortly afterwards Prime Minister Ohira Masayoshi, who had forged a career in the MOF before entering politics, pledged to enact a consumption tax in 1980.[24] He consistently maintained that a general consumption tax was essential to rebuilding public finances, which he identified as the main task in managing the economy.[25]

Resistance to the consumption tax, however, ultimately forced the LDP to change its tune, especially as national elections for the Lower House approached in early October, 1979. As the

[20] Zeisei Iinkai, "Kongo no zeisei no arikata ni tsuite no kinhonteki na kangaekata," September 27, 1978, p. 1. This report is available online at the Library of Keidanren in Tokyo, Japan.
[21] "Seichō 4% dai ni," *Yomiuri shinbun*, November 21, 1978.
[22] "Ōkurashō ga kihon hōshin: kibō 40 chō en nose ka," *Yomiuri shinbun*, November 21, 1978.
[23] "Ōkurashō wa shōhizei dōnyū o uttae," *Yomiuri shinbun*, November 21, 1978.
[24] "Shushō 55 nen jisshi katameru, Tsūjō kokkai ni teishutsu mo," *Yomiuri shinbun*, December 19, 1978.
[25] "Shōhizei no rainendo dōnyū shushō futatabi kyōchō," *Yomiuri shinbun*, June 6, 1979.

Yomiuri newspaper noted in late September, the prime minister's comments on the consumption tax had "toned down." After boldly promising to implement the new levy, his rhetoric had become more cautious. He began talking about "'creating a forum to debate the general consumption tax'" and to investigate "'alternative plans.'"[26] Finally, he announced the end of efforts to implement the tax.[27] Even so, the LDP barely managed to maintain a majority of seats in the Lower House.

Holding only a slim majority of seats in the Lower House both before and after the election, the LDP did not feel confident about pushing through a consumption tax. Beyond the expected hurdle of the Japan Socialist Party and other opposition political parties, the two main economic ministries had split on the issue, as MITI rejected the MOF's initiative in order to encourage strong economic growth. Moreover, many members of the business community, from small businesses to large corporations, expressed doubts. Success would not occur until the government and the business community achieved a measure of unity in support of the measure.

<u>Keidanren: Developing a New Perspective on the Economy and Public Finance</u>

After its disappointing results in the election of 1979, the LDP understandably shied away from the issue of the consumption tax. In fact, the Lower House of the Diet passed a resolution specifically noting the failure of the proposal for a consumption tax and asserting that the "rebuilding of public finance should not depend on a general consumption tax." The cabinet of Prime Minister Suzuki Zenkō adopted a policy of "fiscal reconstruction without a tax increase."[28] This strategy sought to restore public finance by cutting expenses through downsizing the government, a process termed "administrative reform." Accordingly, Suzuki in

[26] "'Shōhizei' yureru Ōhira hatsugen," *Yomiuri shinbun*, September 26, 1979.
[27] "Yosan hensei, hageshiku minaoshi, hōjinzei 3% appu," *Yomiuri shinbun,* September 27, 1979.
[28] Takeshita, Noboru and Hirano, Sadao, *Shōhizei seido seiritsu no enkaku* (Tokyo: Gyōsei, 1993), pp. 41-42, and Harumi Hori, *The Changing Japanese Political System: The Liberal Democratic Party and the Ministry of Finance* (New York and London: Routledge, 2005), pp. 79-80.

early 1980 appointed Dokō Toshio, the retiring chairman of Keidanren, to chair the Second Temporary Council on Administrative Reform. When it submitted its final report in 1983, Prime Minister Nakasone Yasuhiro pledged to enact its proposals. The most extensive reforms centered on privatizing three large government corporations—Japan National Railways, Nippon Telephone and Telegraph (NTT), and the Tobacco Monopoly. The Diet passed legislation to accomplish this goal in 1985.[29]

In this context, Keidanren's strategy for restoring public finance and ultimately the group's attitude toward the consumption tax began to change. After 1978, Keidanren's Tax System Committee (Zeisei Iinkai) initially hardened its opposition to possible tax raises of any type. Dropping all mention of future consideration of new taxes, including a consumption tax, the Committee's reports concentrated on opposing increases in the corporate tax, a measure that the Ministry of Finance started to champion in the wake of the government's failure to create a consumption tax. That the government in 1980 raised the corporate tax rate by two percent and in 1984 by 1.3 percent along with boosts in the liquor tax and levies on other specific commodities alarmed Keidanren.[30] The Tax Committee countered by arguing that raising the corporate tax would only hinder the international competitiveness of Japanese firms while increasing the public deficit by dampening economic growth. The Committee pointed out that the administration of President Jimmy Carter in the United States and nations in Western Europe were, in fact, cutting corporate taxes. Far from raising the corporate tax, the Japanese government should be lowering the rate and follow the example of Western nations in creating a

[29] Takeda, *Nihon keizai*, pp. 300-314.
[30] *Ibid.*, pp. 303 and 311; Hori, *The Changing Japanese Political System*, p. 80; "Business to Foot Bill for FY '84 Income Tax Cut," *Keidanren Review on Japanese Economy*, No. 85, February, 1984, pp. 2-3; and Nihon Keizai Dantai Rengōkai, *Nihon Keizai Dantai Rengōkai gojū nen shi* (Tokyo: Nihon Keizai Dantai Rengōkai, 1999), pp. 309 and 318. This study discusses in some detail the struggle between Keidanren and the MOF during the early 1980s over the corporate tax rate (See pp. 307-325).

"policy tax system" that provided incentives to lighten their tax burden by expanding firms' investments in equipment and research.[31]

Meanwhile, within Keidanren a new concern arose. Members perceived that because the standard policy in an economic downturn of inducing economic growth through fiscal expansion was not working as well as expected, Japan was entering a period of low economic growth that would require novel remedies. A long report of the Economic Research Committee (Keizai Chōsa Iinkai) introduced this incipient shift in perspective in early 1979. The report expressed disappointment in the nation's economic performance since the "oil crisis" of 1973. The report referred to that period as a "long-term recession (chōki fukyō)" because annual economic growth had rebounded to five percent but had not broken that barrier. Japan was slipping from a period of "high growth (*kō seichō*)" to an era of middle growth (*chū seichō*)." This pattern prompted doubts as to whether the expansion of fiscal policy had reached its limits of effectiveness, as budget deficits had accumulated and decreasing profits for companies had slowed their investment in equipment and research. Future growth, therefore, had to depend not on public works or exports, as in the past, but on strengthening the private sector and expanding domestic private demand.[32] Members foresaw that in the near future deficit spending would have to continue, but in the longer term the nation had to "plan the thorough implementation (*tettei*) of cheap government." The report added a vague reference to the need for new revenue: "To restore public finance, the need for an increase in general tax income is recognized."[33]

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[31] For example, see Zeisei Iinkai, "Wagakuni keizai no tōmen suru kadai to zeisei kaisei ni kansuru iken," December 3, 1979, pp.1-2, and Zeisei Iinkai, "Kigyō katsuryoku no hakki to kongo no zeisei no arikata ni kansuru kenkai," October 28, 1980, pp. 1-2. These reports are available online at the Library of Keidanren in Tokyo, Japan.
[32] Keizai Chōsa Iinkai, "Nihon keizai no genjō to chūkiteki kadai," January 23, 1979, pp. 1-4. This report is available online at the Library of Keidanren in Tokyo, Japan.
[33] Ibid., p. 10.

A year and a half later, one vice-chairman of Keidanren, Hasegawa Kaneshige of Sumitomo Chemical Industries, elaborated on these ideas at a forum on fiscal policy and tax policy. Citing cuts in the corporate tax enacted by President Carter as well as tax reductions implemented by Prime Minister Margaret Thatcher in Britain, Hasegawa boldly proclaimed that in the United States and Europe "the type of thinking of [Sir John Maynard] Keynes was disappearing" as developed nations shifted away from Keynes's emphasis on using fiscal pump-priming to revive an economy in a recession and moved toward an "economy [based on] the new economists' stress on supply." Noting the 1979 report of the Economic Research Committee, Hasegawa argued that "prosperity centered on a free private economy had to plan for [a transition] from a type [of economic prosperity] led by public investment as in the past to economic prosperity centered on private investment." He specifically recommended emulating new policies in the United States and Western Europe, such as reducing the corporate tax rate and providing tax incentives for firms to invest more money in equipment and research. Again echoing the 1979 report, he also urged Japanese, "as the first step toward restoring public finance to realize cheap government, carry out administrative reform, reduce government expenditures, and implement rationalization." As a subsequent step, he called for raising "indirect taxes" as they would be borne widely by the people and were, he claimed, most neutral toward economic activity. He predicted that in the future the introduction of a general consumption tax was inevitable.[34]

In early 1983 a lengthy report from the Economic Research Committee placed its previous insights about the advent of a new economic era into a broader historical context. Committee members explained that Japan was no longer dealing with just cyclical recessions but

[34] Dainanakai Keidanren fuoramu, Zeisei no arikata o kangaeru (September 25, 1980) (Keidanren: Keizai Kōhō Sentā, 1980), pp. 6, 8-10, 12, and 19.

with a basic shift in the global economy. Economic growth in all developed nations had slowed from five percent per year in the 1960s to no more than a one percent annual rate during the past three years. Meanwhile, in many nations unemployment rates and inflation rates had increased.[35] The roots of inflation and hence economic stagnation, according to the report, lay in the 1960s, when social welfare services, government administration, and the tax burden expanded while wages rose with escalating prices for goods. The resulting suppression of companies' profits dampened firms' desire to invest in equipment and "seized the dynamism of the private sector" as "raising productivity became difficult." The slowdown in economic growth caused a crisis in public finance because of the fall in tax revenue.[36] In sum, the authors argued that "[b]ecause the various systems [in place] since the period of high growth have been left in place despite changes in the [economic] situation, the economic stagnation of developed nations has come from very deep problems that have arrived at an impossible stage." The report noted that some nations, "beginning with America and Britain," were "starting to grope toward implementing basic policies to break [this] deadlock…through severing the vicious cycle of the rise of wages and prices, reducing public expenses by reconsidering social welfare services, and by abolishing and moderating the government's regulations to realize a small government."[37]

In the eyes of the Economic Research Committee Japan shared the same woes as other developed nations. Even though the nation's recent economic performance surpassed that of the United States and Western European nations, Japan's economic growth had fallen from an

[35] Keidanren, "1980 nendai o tōzuru Nihon keizai no kadai—Antei keizai to kigyō katsuryoku no hakki o motomete." (1983), p. 2. The copy of the report that I read in the Library of the Faculty of Economics at Tokyo University does not indicate the date of publication, but an authoritative source explains that the Economic Research Committee of Keidanren compiled the report and issued it on February 22, 1983 (See Keizai Dantai Rengōkai, *Keizai Dantai Rengōkai gojū nen shi*, p. 275.) The copy of the report in the Library of the Faculty of Economics at Tokyo University was donated on August 15, 1984.
[36] *Ibid*., p. 3.
[37] *Ibid*., p. 4.

annual rate of 10 percent in the 1960s to only 3 percent in the early 1980s. Moreover, the Japanese faced mounting trade friction over increasing surpluses in foreign trade, especially with the United States, and a dramatic worsening of public finance where "the dependence of the national budget on bonds continue[d] at a high level of 30 percent not seen in [other] developing nations." Hence, the authors feared that "strong inflationary pressure [was] lurking." [38]

To adjust to these challenges, the Committee urged that Japan soothe trade friction by liberalizing imports and prevent the pernicious effects of inflation by reforming public finance. In this regard, cutting expenses still took priority over raising taxes. In particular, the report stressed that the corporate tax, which the government had managed to raise twice in recent years, "had reached the highest level from an international perspective." The authors worried that if Japan did not re-energize its private sector, it might fall behind: "Japan's enterprises are now highly regarded for their flexibility and international competitive power. However, if, as mentioned before, policies in America of prioritizing the dynamism of enterprises and their efforts are realized by the end of the 1980s, the reversal of competitive power between us and them could even occur."[39] The omission of any reference, no matter how vague, to creating or raising any "indirect" taxes fit the stance of the Tax System Committee in opposing any increase in taxes.

During the early 1980s reports of the Tax System Committee maintained its strategy of "rebuilding public finance without raising taxes." Believing that Japan had entered a protracted era of lower economic growth, members proposed that "the driving force for overcoming this [problem] is to utilize (*hakki suru*) private energy," primarily through tax cuts. In order to decrease taxes, the government had to reduce expenses. As political pressure mounted in the

[38] *Ibid*., pp. 5-6.
[39] *Ibid.,* pp. 9-14.

mid-1980s for the government to slash the individual income tax, the Tax Committee resolutely opposed compensatory raises in other taxes, such as the corporate tax and sales taxes on selected products.[40] The reports did not even mention the possibility of instituting a general consumption tax.

In early 1986, however, the public strategy of Keidanren changed abruptly to support the creation of a general consumption tax. A long report issued in the name of the entire Federation explained several reasons for this shift in attitude. One reason was that although five years of preparing budgets under the policy of "restoring public finance with no tax raises" had some success in privatizing government corporations and "freezing general expenditures," "the expansion of national bonds and the crisis of public finance had deepened still more." The national debt had growth from 56 trillion yen in 1979 to 143 trillion yen in 1986. Interest payments equaled 20 percent of expenses.[41] Moreover, with the rapid aging of the society, the demand for public funding of services was bound to expand.[42] In addition, many individual taxpayers felt that the burden of the income tax was too heavy because of its severely progressive character, with rates rising in fifteen brackets from 10.5 percent to 70 percent despite a comparatively equal distribution of income in the society. Large portions of the report examined complaints about the operation of the income tax and ways to reform it.[43] In addition, businesses felt aggrieved at recent boosts in the corporate tax of 2 percent in 1981 and 1.3 percent in 1984.

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[40] See Zeisei Iinkai, "Gyōzaisei kaikaku to kongo no zeisei no arikata ni kansuru iken," November 24, 1981, pp. 1-2; Zeisei Iinkai, "Tōmen no zeisei mondai ni kansuru kinhonteki kangaekata,' December 7, 1982, pp. 1-2; Zeisei Iinkai, "Zeisei o meguru tōmen no sho mondai to kongo no hōkō," October 12, 1983, pp. 1-2; and Keidanren, "Genkō zeisei no sho mondai to kongo no hōkō, September 25, 1984, pp. 1-4. All of these reports are available online at the Library of Keidanren in Tokyo, Japan.

[41] Keidanren, "Gyōzaisei kaikaku to zeisei no konpon kaikaku ni tsuite—chūkan hōkoku to teigen," March 26, 1986, pp. 2-3. This report is available online at the Library of Keidanren in Tokyo, Japan. For a chart showing the growth of the Japanese government's debt from 1965 to 1999 see Zeisei 5, Kōsai zankō ruizō, Morinobu, Shigeki, *Nihon no shōhizei: Dōnyū, kaisei no kei'I to jūyō shiryō* (Nōzei Kyōkai Rengōkai, 2000), p. 554.

[42] Ibid., p. 2.

[43] Ibid, pp. 2, 4, and 7-8.

Keidanren argued for a repeal of these measures as a step toward restoring Japanese firms to an "equal footing" with overseas competitors, many of whom were lowering corporate taxes.[44] The refrain became that Japan needed a reformed "tax system in which the people widely and thinly bore the burden."[45] Simply put: if the strategy of reducing public expenses had reached its limit, Japanese had to focus on enhancing revenue.[46]

The leaders of Keidanren decided that the main solution to the nation's fiscal problems would be a general consumption tax, because it would produce a lot of revenue and help distribute the burden of taxes more fairly. "If the unfairness and irrationality of the current tax system are to be reformed and the Japanese people demand a large-scale expansion of demand for public finance such as an expansion of benefits, which would involve expenditures of public finance, and a large reduction of the income tax, a re-examination of the tax system including revision of the ratio between direct and indirect taxes will be inevitable." Furthermore, "if [we] correct the unfairness and irrationality inherent in the current income tax, corporate tax, and indirect taxes, as a result in many cases fairness and justice will be guaranteed in regard to the people bearing the [tax] burden widely and thinly." The report concluded with an exhortation for the Japanese to investigate carefully the advantages and disadvantages of introducing a new indirect tax.[47]

Although the public announcement of Keidanren's shift in direction in regard to the consumption tax seemed abrupt, this change had been building for some time. As discussed above, reports of the Tax System Committee in 1977 and 1978 mentioned the possibility that in

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[44] Ibid., pp. 2-3, 7, and 10-12. During the early 1980s Keidanren and the Ministry of Finance engaged in a lengthy and heated dispute about the international ranking of corporate taxes in Japan. MOF argued that Japan's corporate tax rate was relatively low, but Keidanren claimed that if one included local taxes Japan's corporate rate was the highest in the world.
[45] Ibid., pp. 2 and 5-8.
[46] Ibid., p. 6.
[47] Ibid., 16-17.

the future Japanese might have to consider new taxes to pay for increased services to a rapidly aging society. The Economic Research Committee took a similar stance in early 1979. In 1980 Vice-Chairman Hasegawa Kaneshige viewed the introduction of a consumption tax as inevitable. Meanwhile, economic developments also closed off other options for restoring public finance. In the late 1970s the failure of fiscal expansion to jumpstart high economic growth above five percent per year and boost tax revenue led to the strategy of balancing the budget through slashing expenditures without saddling the private economy with tax hikes. By 1986 the leaders of Keidanren viewed that approach as a failure, because the government's debt continued to rise. In addition, they could perceive that aside from the long-term obligation to fund more services for the elderly in the future an urgent strain on the budget was arising from political pressure exerted by opposition parties in the Diet for cuts in the individual income tax.[48] In fact, the boost in the corporate tax rate in 1984 resulted from the government's decision to produce more revenue to fund a cut in the income tax. Realizing that the corporate tax was vulnerable to further pressure to produce more revenue, leaders of the Federation wanted to provide a substitute source of new funding. They argued as well that the new tax would be fairer by spreading the burden of paying taxes more widely. In brief, by 1986 the leaders of Keidanren observed that neither the old Keynesian solution of fiscal pump-priming nor the new supply-side approach of trying to slash public expenditures had been able to restore a balanced budget for the national government. Only a new stream of revenue would enable it to reform perceived deficiencies in the tax system and meet to provide essential services.

The Second Try

The second attempt to institute a consumption tax in the mid-1980s again sparked a major political struggle. Proponents dubbed the proposed levy a "sales tax" (*uriagezei)*, perhaps to

[48] Takeshita Noboru and Hirano Sadao, *Shōhizei seido seiritsu no enkaku* (Gyōsei, 1993), pp. 50-54 and 68-70.

distance it from the failed push for a consumption tax in the late 1970s. This time, Keidanren helped initiate the campaign, when in late September, 1986, Suzuki Eiji, the chairman of the Federation's Tax System Committee, hand delivered to Prime Minister Nakasone Yasujirō a report supporting a "Japan style of VAT" shortly after its approval by the Board of Directors.[49] Affirming the main conclusions of its interim report in March, Keidanren declared the need for a cut in both the personal income tax and the corporate tax and the introduction of an indirect tax, such as a consumption tax. Such measures would bring needed relief to the main body of individual taxpayers and to companies. The new levy, essential to funding tax cuts, would help to reduce the national deficit and spread the burden of paying for government services. The measure could usher in a new economic era: "What is demanded by basic reform of the tax system is that [we] reconsider the strains and distortions of the tax system that have accumulated over thirty years since the recommendations of [Carl S.] Shoup [during the Allied occupation of Japan] from the viewpoint of fairness, impartiality, simplicity, and [economic] vitality as well as an international [perspective] and expect new developments of economic society."[50]As opposition mounted, the Federation remained steadfast in its backing. In February, 1987, Vice-Chairman Hiraiwa Gaishi emphasized the general goal of adjusting the ratio of direct and indirect taxes: "'If [we] think of the future, [we] must implement the sales tax.'"[51]

If Keidanren, as the representative of large corporations in Japan, now believed in the economic need for a sales/consumption tax, small and medium enterprises wailed from the start. Gotō Noboru, chairman of the Japan Chamber of Commerce and Industry (JCCI), explained to the LDP his determined opposition to a sales tax. He worried that it would become, in effect, an

[49] "Nihonkei fuka kachi zei no dōnyū," *Yomiuri shinbun*, September 25, 1986.
[50] Keidanren, "Zeisei konpon kaikaku to 62 nendo zeisei kaisei ni kansuru iken," September 24, 1986, p. 1. This report is available online at the Library of Keidanren in Tokyo, Japan. See also, Keizai Dantai Rengōkai, *Keizai Dantai Rengōkai gojū nen shi* (Tokyo: Keizai Dantai Rengōkai, 1999), p. 623.
[51] "'Shōrai kangaete ima uriagezei no jisshi o'/Hiraiwa Keidanren fukukaichō," *Yomiuri shinbun*, February 26, 1987.

"'enterprise tax'" because "'excessive competition'" among small firms would prevent price changes to accommodate the tax. Moreover, he cynically predicted that the government could easily raise the tax after its introduction and "'checks on the swelling of public finance will vanish.'"[52]

Undoubtedly aware of opposition to a new tax and mindful of the failure of the proposal seven years beforehand, the Government Tax System Research Council tread lightly in its report of October, 1986. It endorsed a "Japan style value added tax" in principle but did not set forth any details. The Council concluded only that "'it is not possible to plan a solution to [Japan's fiscal] problems with an expansion of the current form of individual consumption taxes'" in which the sale of some goods, such as *sake*, were each taxed at different rates and others were not taxed at all. The report also stressed the need for reform of the income tax to help the typical white collar worker (*sarariman*). For example, the government could reduce the highest personal tax rate from 70 percent to 50 percent and the number of tax brackets from 15 to six.[53]

When the LDP proposed an Outline for Reform of the Tax System in December that included a sales/consumption tax along with cuts in the income tax and the corporate tax, Gotō of the JCCI affirmed his opposition to the consumption tax as a leader of an organization representing small and medium enterprises: "'I have a feeling that [the tax reform] is opening the window for a raise in taxes.'" He noted, as well, a lack of a "'sufficient consensus'" to support the measure in "'distribution circles'" and "'manufacturing circles.'"[54] A few months later dislike of the proposal induced a rare instance of collaboration between two groups usually at

[52] "Shinkei kansetsuzei de seifu zeichō no 4 an ni Nisshō ga zenmen hantai Jimin ni ikensho," *Yomiuri shinbun*, September 18, 1986.
[53] "Shinkei kansetsuzei wa 'Nihonkei' ga nozomashii, Ittaika wa dekizu/Seifu zeichō saishū tōshin katamaru," *Yomiuri shinbun*, October 21, 1986.
[54] "Zaikai, Shinzeisei ni fukuzatsu na han'ō, Hōjin genzei hyōka, Uriagezei wa hihan," *Yomiuri shinbun*, December 24, 1986.The proposed rate was five percent. "Zeisei kaikaku san hōan (Shotokuzeihō, uriagezeihō, sozei tokubetsu sochihō) no yōshi," *Yomiuri shinbun*, January 30, 1987.

opposite ends of the political spectrum, when leaders of the National Federation of Textile Industry Workers' Unions (Zensen Dōmei) and the Japan Chain Store Association (JCSA) met to discuss cooperation to "'advance a movement to smash the sales tax from the standpoint of each [organization] as a common problem of labor and management.'"[55] The Japan Department Store Association (JDSA) announced its strategy of freezing its monetary contributions to the LDP and of lobbying individual members to switch sides unless the party agreed to drop the sales tax.[56] Two days later, the "Grand Meeting of a Consumers' and Citizens' Rally convened to protest the sales tax." As the *Yomiuri Newspaper* reported, "at this first national meeting of consumer groups" in the Hibiya Concert Hall in Tokyo approximately 10,000 people from 302 organizations participated. They included the well-known Housewives Association (Shufuren) and the Japan Consumers Cooperative Federation (Nihon Seikyōren).[57] Just a few days later at Meiji Park in Sendagaya more than 70,000 citizens joined the March 1st Meeting to Smash the Sales Tax and the Bad Changes to the Tax System (*zeisei kaiaku*). The participants represented over 100 groups of artists, housewives, workers, and small businesses. Speakers emphasized the regressive nature of the so-called tax reforms, because people with low incomes would not benefit much from tax cuts but they would pay more taxes through the sales tax.[58]

Still, Prime Minister Nakasone vowed to push through the tax reform. Conceding that proposing a raise in taxes shortly before nation-wide local elections posed a challenge, Nakasone asserted that tax reform was essential to "open up the future of Japan's economy." The LDP could not just consider its own interests, he explained, but the party had to carry out its "destiny."

[55] "Uriagezei no funsai de gōi/Zensen Dōmei to Chēnsutoa Kyōkai," *Yomiuri shinbun*, February 19, 1987.
[56] "Jimin e no konkin 3000 man'en o tōketsu, Uriagezei dōnyū de, Hyakkaten kyōkai," *Yomiuri shinbun*, February 25, 1987.
[57] "Uriagezei hantai ni ichi man nin sanka, Zenkoku Shōhisha Dantai Rengōkai no shimin kekki taishūkai," *Yomiuri shinbun*, Evening Edition, February 27, 1987.
[58] "Uriagezei hantai shūkai hiraku, Rōdō dantai yobikake, Meiji kōen ni nana man nin" *Yomiuri shinbun*, March 2, 1987.

In grandiose fashion he invoked the examples of previous Japanese leaders who had made unpopular decisions for sake of the long-term welfare of the nation. For example, he compared himself to Foreign Minister Komura Jutarō who in 1905 had provoked riots in Tokyo by accepting apparently lenient terms in a peace treaty in order to achieve a needed end to the Russo-Japanese War. Nakasone also cited the example of Prime Minister Kishi Nobusuke whose determination in 1960 to ram through the Diet a revised Mutual Security Treaty with the United States had triggered massive protests from opponents of any military cooperation between the two nations.[59]

In any event, Nakasone's political *bravado* did not work. The results of the local elections in the spring of 1987 for the LDP were weak enough to embolden the leaders of opponents, such as the Japan Chain Store Association and the Japan Department Store Association, to interpret the party's poor showing as expressing the "'will of the people'" on the topic of the proposed sales tax and to call for its withdrawal.[60] At a large rally in Hibiya Park organized by opposition parties Diet representatives wore headbands vowing to "'Smash the sales tax.'" Speakers demanded not only that Nakasone abandon the sales tax but also that he resign. At a subsequent rally for "the unheard voices of the salaryman" the prime minister emphasized the need for "'reform of the tax system for the 21st century.'"[61] As doubts about the sales tax spread within the LDP, however, Nakasone had to concede defeat.

The overall campaign for an overhaul of the tax system, however, would continue. As Suzuki Eiji, the chairman of the Tax System Committee of Keidanren, maintained, "'there [was]

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[59] "Uriagezei no jimin zenkoku kaigi, Nakasone shushō ga netsuben 'aete kachū no kuri o hirō,'" *Yomiuri shinbun*, February 11, 1987.

[60] "'Shikai' tōitsusen jimin haiboku keizaikai, Nao uriagezei ronsō Ōkurashō ni wa sekinin tsuikyū ron," *Yomiuri shinbun*, April 14, 1987. On the results of the local elections, see Takeshita and Hirano, *Shōhizei seido*, p. 116.

[61] "Uriagezei 'Hibiya no jin,' yatō ga hantai shūkai, Nakasone san suishin taikai de iyoku hyōmei, Tokyo tō" *Yomiuri shinbun*, April 18, 1987.

no change in the need for reforming the ratio between direct and indirect taxes and for a new indirect tax.'" Significantly, in early May the four major business groups, including the JCCI, agreed to "tackle together the creation of a plan for a new type of indirect tax."[62] JCCI chairman Gotō revealed that discussions had already begun. This development indicated that in the future the business community would take more of a common stand in support of the consumption tax. Not surprisingly, the next effort would succeed.

Success at Last: Passing the Consumption Tax in 1988

The third effort to pass a consumption tax began in the fall of 1987 with a proposal from the LDP's Tax System Research Council headed by Yamanaka Sadanori. Tying in with the perspective that Keidanren adopted in the early 1980s, this report accepted the notion of the development of a new economic era, namely the "future arrival of an aging society and the further internationalization of economic society," that mandated novel responses. In order to achieve a "'society of people's welfare and long life'" Japan had to "sweep away the feeling of unfairness regarding the people's taxes." The government had to spread the burden "widely and thinly" and "realize a tax system that can support society based on mutual cooperation between generations." In recalibrating the ratio between direct and indirect taxes the new system had to balance taxes on income, consumption, and financial assets. Cuts in the income tax should relieve the "heavy pressure regarding the taxes of the main body of taxpayers (chūken shotokusha sō)," while lowering the corporate tax would make Japanese firms more competitive in the international arena.[63] Two months later, Prime Minister Takeshita Noboru announced that he would aim to implement a consumption tax in the fall of 1988.

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[62] "'Chokkan zesei' wa hitsuyō/Uriagezei no 'haian' de zaikai han'ō," *Yomiuri shinbun*, April 24, 1987, and "Shinkei kansetsuzei no kōsō zukuri, Zaikai yon dantai ga kyōdō de, Nisshō mo ashinami," *Yomiuri shinbun*, May 8, 1987.
[63] "Jimintō no zeisei kaikaku hōshin=yōshi," *Yomiuri shinbun*, October 12, 1987.

If various business groups differed in the degree of enthusiasm they each displayed toward such a measure, they avoided the dramatic split evident during the spring of 1987. Saitō Eishirō, the chairman of Keidanren, announced to a special press conference that "voices seeking an indirect tax to reform an unfair tax system [were] rising in economic circles."[64] Eager to consult widely on the matter, the LDP's Tax System Research Council scheduled eight days of hearings in early April with invitations sent to 330 groups. The first day was reserved for the four main economic organizations. Keidanren, the Japan Employers' Federation (Nikkeiren), and the Japan Association of Corporate Executives all supported some type of new indirect tax. For example, Hijikata Takeshi, the chairman of the Federation's Tax System Committee, argued for a VAT applied to all domestic transactions to fund reductions in income taxes and corporate taxes. Even the JCCI backed a new tax, albeit with three conditions. As Chairman Ishikawa Rokurō explained, the tax would have to be applied "widely, thinly, and without exception"; there would have to be a "strong check on future rate increases"; and price changes—necessary to pass on the impact of the tax to consumers—would have to be easy to implement.[65] To be sure, some grumbling continued. Takaoka Sueaki, chairman of the Japan Chain Store Association, wondered whether the consumption tax would have a "bad influence, such as cooling consumption."[66] According to the *Yomiuri* newspaper, at another set of hearings representatives of small and medium enterprises complained about the policy of "applying a funding source from a new tax in order to reduce taxes for large companies and high income earners."[67]

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[64] "Ippan shōhizei hitei no kokkai ketsugi ni kōsokuryoku was nai/Saitō Keidanren kaichō," *Yomiuri shinbun*, February 24, 1988.
[65] "Nisshō mo shinkei kansetsuzei mitomeru, Hikazei nashi o jōken ni jimin zeichō no iken chōshū de hyōmei," *Yomiuri shinbun*, Evening Edition, April 5, 1988.
[66] "Chēnstoa kyōkai, Shinkei kansetsuzei ni 'jōkentsuki sansei' e, Seifu jimin ni shtisumon o yōi," *Yomiuri shinbun*, May 28, 1988.
[67] "Jimin zeichō, Shinkei kansetsuzei de *shinbun*, Tokyo Evening Edition, May 31, 1988.

The government did try to accommodate at least some of the complaints of small enterprises. In this regard, the stance of MITI toward the consumption tax changed significantly. Whereas in the late 1970s MITI had joined Keidanren in staunchly opposing the tax, this time the cabinet asked the ministry, as an important agency of the government, to cultivate support for the new tax in various industries. Hence, even if MITI officials held little enthusiasm for the tax, their strategy shifted to attempting to blunt some of the potentially harmful effects of the tax rather than to resist it entirely. For example, MITI sought to assuage some concerns of small enterprises by successfully lobbying for a temporary exemption to the Anti-Monopoly Law to allow managers of small enterprises to meet to discuss together the implementation of price increases that the new levy would necessitate. The ministry also worked to prevent what it viewed as the excessive taxation of the petroleum industry.[68]

In June, Yamanaka outlined the LDP Council's official proposal. Prime Minister Takeshita pledged to "risk the fate of his political power on this issue." The government would enact, in effect, a value added tax of three percent along with a large tax cut exceeding 5 trillion yen by simplifying brackets for the income tax and lowering the corporate tax from 42 percent to 37.5 percent. Indeed, the tax reductions would exceed the gains from the consumption tax.[69] Despite continued criticism from opposition parties, the legislation with some changes passed in December, to the cheers of Keidanren. Chairman Saitō noted dryly that the tax had beōōen a "'pending proposal for many years for the people.'" Suzuki Eiji, now chairman of the Japan

[68] "Uriagezei de keiki dō naru,' *Yomiuri shinbun*, December 24, 1986; "'Shikai' uriagezei, Tsūsan no kunō fukashi, Honne shiritsutsu gyōkai settoku e," *Yomiuri shinbun*, February 5, 1987; "Uriagezei dōnyū e jimin, Tahōmen sakusen, PR hisshi no kōbō," *Yomiuri shinbun* , February 2, 1987; "Uriagezei dōnyū kakaku tenka, Dokkinhō de rūru tsukuri, Shitauke, chūshō no 'hogo' e," *Yomiuri shinbun*, February 6, 1987; "Shōhizei kakaku tenka no enkatsuka o jimin zeichō nado ni yōsei e/Tsūsanshō," *Yomiuri shinbun*, June 25, 1988; "Gen, jūyū kanzei no teppai yōkyū, Tsūsanshō ga Ōkurashō, Jimintō to chōsei e," *Yomiuri shinbun*, July 9, 1988; "Shōhizei tenka karuteru fusoku, Hō shikkō to dōji jisshi, Zei tekiyō ni wa yūyo kikan mo" *Yomiuri shinbun*, July 12, 1988.
[69] "Shōhizei 3%, Genzei 5 chō 6000 oku en, Jimin ga zeisei kaikaku taikō kettei, Ronsen rinji kokkai e," *Yomiuri shinbun*, June 15, 1988; and "3% shōhizei dōnyū wa kyūmu, Shinmei sasage **[check]** torikomu, Takashita shushō ga shogen hyōmei ensetsu," *Yomiuri shinbun*, Tokyo Evening Edition, July 29, 1988.

Employers Association, claimed that the changes were "'essential for [Japan's economic] soft landing in the twenty-first century.'" Ishihara Takashi, representing the Japan Association of Corporate Executives, called the reforms "'epochal in the history of the tax system.'"[70]

The Significance of Enacting the Consumption Tax

While previous accounts of the enactment of a consumption tax have emphasized the role of the MOF in promoting the measure, the Japanese business community, especially Keidanren, played a crucial role. By the mid-1980s the Federation had become an active proponent. Moreover, the consumption tax passed the Diet only after the *zaikai* united to at least some degree behind the new levy, as evident in the endorsement, with and without specific conditions, by the four most prominent business groups. The JCCI, which represented small businesses, showed the least enthusiasm,[71] but it succeeded in exacting substantial concessions in return for its grudging support. Hence, the proposed rate for the consumption tax fell from five percent to three percent and the exclusion of very few items from the levy simplified its administration. In addition, the measure exempted very small enterprises with sales of less than 30 million yen. Finally, that the LDP combined a substantial cut in the income tax with the consumption tax helped to counter arguments that it would dampen consumption.[72]

While citing foreign models in backing a "Japanese style of indirect tax," Keidanren developed a distinctive version of the doctrine of neoliberalism that was emerging in the United States and Britain. Just as the introduction of the consumption tax in Japan drew inspiration from

[70] "Shōhizei seiritsu, 'Kakiteki' to zaikai ga kangei," *Yomiuri shinbun*, December 25, 1988.

[71] Ironically, executives from large corporations often led the JCCI. For example, Gotō Noboru was the president of the Tōkyū Company, which operated a chain of major department stores. Ishikawa Rokurō served as president of the Kajima Company, a large construction firm. His father was the first president of Keidanren in 1948.

[72] "Shōhizei 3%, Genzei 5 chō 6000 oku en, Jimin ga zeisei kaikaku taikō kettei, Ronsen, Rinji kokkai e," *Yomiuri shinbun*, June 15, 1988. The Japan Socialist Party (JSP), however, calculated that the regressive character of the combined tax reforms increased as family income decreased, because families with a modest income would not benefit much from the planned cuts in the income tax but would have to pay the consumption tax on goods purchased. "Seifu no zeisei kaikaku an, Nenshū 856 man ika wa zōzei, Teishotokusō ni funtanzō/Shatō shikisan," *Yomiuri shinbun*, June 25, 1988.

the earlier enactment of a VAT by members of the European Community (later, the European Union), the policies and rhetoric of Presidents Jimmy Carter and Ronald Reagan in the United States and Prime Minister Margaret Thatcher in the United Kingdom influenced Japanese business leaders in terms of stressing the goal of re-invigorating the private sector by downsizing government. As mentioned above, reports produced by Keidanren and statements by individual leaders after 1979 referred to these economic policies. Accordingly, Chairman Inayama Yoshihiro explained that "an example is set for us to follow by British Prime Minister Margaret Thatcher who asks for sacrifice from the people and with a firm resolve pursues the goal of revitalizing the British economy."[73] While working toward "administrative reforms" that would shrink government, Keidanren, though, chose not to argue for a reduction in the overall tax burden. Instead, holding true to the goal of moving toward a balanced budget, the Federation advocated a regressive indirect tax in order to fund reforms that would moderate the progressive character of the income tax and take a modest step toward liberating the private sector from what it viewed as an unfairly high corporate tax.[74] Business leaders framed these measures in a historical context of responding to sweeping changes in the economy and society—in particular, the aging of Japanese society and the "internationalization" of the economy with the attendant intensification of international competition. This perspective would continue to shape Keidanren's views, even as it confronted a startling slump in economic growth in the 1990s.

<u>The Campaign for Raising the Consumption Tax in the First Lost Decade</u>

[73] "Priorities Defined for National Economy," *Keidanren Review of Japanese Economy*, #78, December, 1982, p. 2.

[74] Keidanren was not entirely consistent on the issue of "small government." In September, 1986, Saitō Eishirō, as president of the Federation, called for an increase in national construction bonds to stimulate "internal demand." See "Saitō Keidanren kaichō no kensetsu kokusai zōhatsu hitsuyō no kenkai shimesu," *Yomiuri shinbun*, September 12, 1986. Even if such demands became less frequent afterwards, Keidanren consistently advocated increased government spending for research and development to benefit companies.

As the leaders of small and medium enterprises feared, it did not take long for a campaign for raising the consumption tax to begin, even as the economy headed quickly toward a downturn. Such was the strength of Keidanren's new convictions and determination. As is well known, in 1989 the Bank of Japan started to increase its prime rate to rein in speculation in the stock market and the real estate market. After the prime rate had more than doubled by August, 1990, the stock market fell sharply and the real estate market started to decline. Overall economic growth slowed.[75] Although the government was successfully ending its dependence on national deficit bonds,[76] Keidanren once more raised the issue of the need to boost tax revenue and to lessen the burden of direct taxes as a vital economic concern.

To Keidanren the structure of taxes remained a crucial issue. While the Federation's major report on the tax system for 1992 offered a number of reforms, the centerpiece was clearly raising the consumption tax. According to the report, a major specter hanging over the nation was the rapid aging of society, which would reach its peak in 2020, when the "rate of burden for the people [would] reach 53.5 percent."[77] Companies and the bulk of employees were already laboring under tax rates that were comparatively high. As the aging of society increased citizens' demands for services, the government would have to find new sources of revenue while acting to energize the economy. The report noted that "[i]n the three years since the introduction of the consumption tax, it has become part of the people's life" and predicted that "[i]t is inevitable that [we] will make as our basic tax system a consumption tax through which the people will divide

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[75] Takeda, *Nihon keizai*, p. 339; Yves Tiberghien, "Thirty Years of Neo-liberal Reforms in Japan," in *Sebastien Lechevalier, ed., The Great Transformation of Japanese Capitalism*, trans. By J.A.A. Stockwin (Abington and Oxon: Routledge, 2014), p. 39.
[76] "Zeishū fusoku, Akaji kokusai rongi ga fujō mo, 'Chokusetsuzei tayori' no yowami, Shotoku genzei no yukikata bimyō ni," *Yomiuri shinbun*, May 8, 1993.
[77] Keizai Dantai Rengōkai, "Heisei 5 nendo zeisei kaisei ni kansuru kenkai," September 22, 1992, p. 1. In other words, at that point, taxpayers, individuals and firms, would be paying over 50 percent of their income and/or profits to the government.

the burden widely and thinly." Raising the rate would require a "sufficient consensus of the people" and had to be combined with a "large reduction in the corporate tax and the income tax."[78]

In November, 1993**,** the Government Tax System Research Council, headed by Keio University Professor Katō Hiroshi, released a preliminary report calling for a reduction of five trillion yen in the income tax for the "'main body'" of taxpayers and a hike in the consumption tax to a range from five to seven percent. The goal would be to realize a "'fair and energized aging society'" in which "members of society would share the burden widely" to provide a "stable structure for tax revenue." Despite increasingly evident signs of economic weakness, the Council insisted on the principle of replacing revenue lost through tax cuts, which might stimulate the economy, with new funds from another source.[79] The report added a new wrinkle by including a local consumption tax of one percent whose revenue would go to local governments.

Responses somewhat reflected old battle lines. Hiraiwa Gaishi, as chairman of Keidanren, commented that he "'could understand'" the need to link a reduction in the income tax with a rise in the consumption tax. Inaba Kōsaku, chairman of the JCCI, agreed with the "'basic ideal'" of "evening out'" the tax burden between generations of an aging society but he did not think that the government should begin investigating the raising of the consumption tax until an economic recovery had started. Otherwise, as he commonsensically pointed out, the raised consumption tax would simply cancel out any expansion of consumer spending induced by the cut in the income tax. Sekimoto Tadahiro, president of the large electronics manufacturer NEC

[78] Keizai Dantai Rengōkai, "Heisei 5 nendo zeisei kaisei ni kansuru kenkai," p. 16.
[79] "Genzei, Shōhizei age ittai de, seifu zeichō 'kongo no zeisei' chūki tōshin, chūkensō no futan keigen," *Yomiuri shinbun*, November 20, 1993.

and president of the Japan Electrical Machine Industry Association, welcomed reductions in the income tax to aid recovery.[80]

Raising the consumption tax also assumed an international dimension, as the American government took an interest in the issue. After the government Council's interim report became public President William J. Clinton in November, 1993, sent a letter to Prime Minister Hosokawa Morihiro to advise that increasing the consumption tax should not negate the effects of the cut in income taxes. Painfully aware of the continuing large trade deficits that the United States continued to run in its trade with Japan, American officials were urging the Japanese government to stimulate economic growth in order to expand the market for American exports. Enacting a consumption tax would head in the opposite direction. In response, the prime minister avoided any specific commitments on the issue while pledging in general terms to concentrate on encouraging Japan's economic recovery.[81]

Early in 1994 a consensus regarding tax policy began to emerge within the business community and the Japanese government on implementing a hike in the consumption tax only after a cut in the income tax. At a press conference, leaders of the four main business groups agreed on the need for an early tax cut, although they split on the timing of the tax raise. Chairman Hiraiwa of Keidanren, and Chairman Hayami Masaru of the Japan Association of Corporate Executives advocated designating in relevant legislation a date for upping the consumption tax following the tax cut. Inaba from the JCCI and Nagano Takeshi, chairman of the Japan Employers Association, however, favored postponing even the discussion of a raise until the implementation of the tax cuts.[82] Sekimoto Tadahiro from NEC backed a "large cut in

[80] "Seifu zeichō chūki tōshin –zaikai, shōhizei age ni sanpi," *Yomiuri shinbun*, November 20, 1993.
[81] "APEC Hosokawa Kurinton kaidan, ken'an yamaseki, jitsumu tōgi e," *Yomiuri shinbun*, November 20, 1993
[82] "'Keiki kaifuku was jūgatsu irai'—genzei sōki jisshi motomeru, keizai yon dantai shunō ga kyōdō kaiken," *Yomiuri shinbun*, January 6, 1994.

the income tax" but cautioned that a rapid enactment of a higher consumption tax could exert a "'bad influence on the psychology of consumers and invite political confusion.'" He suggested that one should not "'think in a rigid way'" about the connection between the two taxes but one should view them as in a "'flexible relationship as if they are connected by a rubber cord." Fearing that the economy was reaching a point of crisis in which "'the bottom might drop out,'" Suematsu Ken'ichi of the Sakura Bank backed a delay in boosting the consumption tax because the government could use deficit bonds for revenue until the tax increase took effect. Yamashiro Yoshinari of NKK (Japan Iron and Steel) stated flatly that the "'only option was to enact an income tax cut first with deficit bonds as a funding source.'" He conceded that raising the consumption tax was important in the long term to revise the ratio between direct and indirect taxes but asserted that "'it is impossible to accomplish together [both] a tax cut as a policy for improving business conditions and tax reform aimed at [coping with] the arrival of an aging society.'" Kawakami Tetsurō, the president of the large Sumitomo Bank, opposed the tax cut, because "'the expectations for [expanding] consumption are small and [the cut] goes against [the goal of restoring] public finance to health.'" He insisted that if the government enacted the planned cut in the income tax, the consumption tax would have to rise to a rate of 7 percent within 15 months. Distrustful of the political process, he recommended that the law implementing a tax cut had to include the raise in the consumption tax in order to avoid such a commitment being "'made into wastepaper.'"[83]

Both Kawakami and Yamashiro raised important issues about the contradictions in the proposed strategy of pursuing the dual goals of stimulating the economy in the short term and effecting structural changes in tax policy in order to solve longer-term problems. At a basic level,

[83] "Fukyōka no konmei, Seiji wa ima nani o subeki ka, Keizeikai no ronkyaku 5 shi ni kiku," *Yomiuri shinbun*, January 23, 1994.

the strategy of reducing some taxes while raising others ran the risk of accomplishing neither the goal of stimulating the economy nor of increasing revenue to deal with anticipated expenses in the future. The main rationale for persisting in this strategy was the hope that increasing revenue from the consumption tax would at some point allow for a reduction in the corporate tax that would theoretically impart an extra boost to business activity and hence economic growth. In any event, the MOF clearly stated that it would resist efforts to implement an expansionary fiscal policy. Minister of Finance Fujii Hirohisa announced bluntly that he would "'absolutely not permit [the use of] incontinent (*tarenagashi*) deficit bonds. (Doing so) would leave [a legacy of] shame for future generations.'" Sharing Yamashiro's distrust of politics, other MOF officials emphasized that a measure to enact tax cuts first would have to "specify the period for raising the consumption tax."[84] MITI announced its full support for this stance by declaring jointly with MOF the need for a raise in the consumption tax only one year after cuts in the income tax because of the need to raise revenue to fund services for an "aging society."[85]

Gradually the major players regarding this issue inched toward agreement on a detailed proposal. In June the Government Tax System Research Council, headed by Katō, and the Ruling Parties Tax System Reform Council each issued reports that "recognized" the need for a "rise in the consumption tax above the decrease in the income tax" in order to support an aging society.[86] Although the report of the government's Council did not specify a rate, Katō explained members' general opinion that "it [was] necessary to raise the rate [of the consumption tax] to more than seven percent" in order to "'progress toward a net increase in taxes (in order to

[84] "Zaigen tanpo no nai genzei, Tsuyoku kensei/Fujii Ōkurashō," *Yomiuri shinbun*, February 2, 1994.
[85] "Zōgenzei ittai shōri, Ōkura to tsūsan ga 'kyōdō sensen,' Kōreika shakai e no kikkikan ga haikei ni," *Yomiuri shinbun*, January 14, 1994.
[86] "Shōhi zeiritsu wa seiji handan ni, Seifu zeichō ga tōshin, Yotō zeisei kaikaku kyō no hōkoku o teishutsu," *Yomiuri shinbun*, June 22, 1994.

create a source of funding for welfare programs).'"[87] In July, the ruling coalition formed a Governing Parties Tax Reform Project Team headed by Hino Ichirō of the Japan Socialist Party. The JSP, despite having been a bitter and once powerful rival of the LDP from 1955 through the 1980s, had joined a coalition with the LDP in 1993. The socialists had staunchly opposed the consumption tax since the 1970s but in their weakened state could now only hope to moderate the impact of the tax.[88] Meanwhile, a meeting of the LDP's Tax System Research Council reached several conclusions: "1) regarding the contentious issue of a raise in the consumption tax, to manage the increase and decrease in taxes together [in a way] that will specify at the same time a tax cut [as well as a tax increase] in a proposed law related to reform of the tax system, 2) to make the period of a hike in the consumption tax April, 1997, two years after [the tax cut], 3) [to make] the scale of the increase and of the decrease in taxes the same amount."[89] Shortly afterwards, the three ruling parties—the LDP, the JSP, and Sakigake—agreed to split the proposed income tax cut into two levels, a "permanent reduction (*kōkyū genzei*)" and an "annual fixed reduction (*tannendo no teiritsu genzei*)." The aim of this approach, which the JSP and Sakigake advanced, was to encourage the government in two years to keep only the "permanent" tax cut and to reduce the size of the corresponding raise in the consumption tax.[90]

Two weeks later the three governing parties agreed on a plan. In April, 1997, the consumption tax would rise from three percent to five percent, although the rate could be reconsidered six months beforehand. The cut in the income tax would take a "'two-level form'" in which 3.5 trillion yen would be "permanent" and two trillion would be "fixed" through 1996,

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[87] "Shōhizei wa '7% ijō ga taisei,' Katō kaichō ga kaiken de akasu," *Yomiuri shinbun*, June 22, 1994.
[88] "Zeisei kaikaku wa zōgenzei ittai de shingi, Yotō sho kaigō de kakunin," *Yomiuri shinbun*, July 20, 1994. The other member of the ruling coalition was the Sakigake political party.
[89] "Shōhizei hikiage wa 2 nen ato, Zōgenzei ittai shōri de Jimintō zeichō hōshin," *Yomiuri shinbun, Evening Edition*, September 2, 1994.
[90] "Shotoku genzei 'nikaitate' ni seido kaisei to tannendo kiteiritsu kumiawase, Yotō hōshin," *Yomiuri shinbun*, September 11, 1994.

at which point the "fixed" portion of the cut could end. To mitigate the impact of the consumption tax on more vulnerable members of society the government would make temporary payments to elderly recipients of pensions. In addition, the lowest bracket of the income tax with a 20 percent rate would expand from those earning a maximum annual income of six million yen to those earning up to nine million yen. The plan touted the goal of "'advancing three reforms together—[reform] of the tax system, administrative reform, and [reform] of [funding] welfare services.'" Accordingly, the proposed changes would re-adjust the ratio of direct and indirect taxes, promote decentralization by allotting one percent of the projected five percent rate to local governments, and provide funding to "'prepare for an aging society with few children.'" Because designating a portion of the new revenue to local governments proved popular with local chambers of commerce, this provision may have mitigated opposition to the consumption tax from the JCCI.[91] Minister of Finance Takemura Masayoshi hoped to raise the consumption tax in 1996 if business conditions permitted, but Minister of Foreign Affairs Kōno Yōhei advocated a delay in response to pressure from American officials on the Japanese government to stimulate the domestic economy to boost imports.[92] In November, 1994, the Diet passed the plan for raising the consumption tax and reducing the individual income tax.

The Federation continued to press for further reforms of the tax system, including measures specifically to aid large corporations. A proposal approved in October made clear that the "revision of the ratio of direct and indirect taxes ha[d] not occurred sufficiently" and set out a strategy of continuing to pursue a "reconsideration of the ratio of direct and indirect taxes as a

[91] "Shōhizei 97 nen 4 gatsu kara 5%, Seifu yotō, Zeisei kaikaku taikō o kettei," *Yomiuri shinbun*, September 23, 1994, and "Chihō shōhizei no dōnyū mondai, kakuchi shōkō kaigisho nado ga taido o nanka," *Yomiuri shinbun*, September 15, 1994

[92] "Chihō shōhizei sōsetsu e chōsei, Chōzei, kokuzeichō itaku de, Takemura Ōkurashō ga hyōmei," *Yomiuri shinbun*, September 18, 1994; and "Shōhizei age 97 nen 4 gatsu, Yotō 3 tōshu, Genzei 3 nen senkō de gōi, zeiritsu nado saikyōgi," *Yomiuri shinbun*, September 21, 1994.

central topic of drastic reform of the tax system" in order to "respond to an aging society and international harmonization [in economic matters]." Other issues meriting "reconsideration" included the rate of the consumption tax, fiscal reform, a "vision for welfare services," and reduction of the comparatively high corporate tax. The Federation also argued for a reduction of the land tax, which in a case of unfortunate timing the government had enacted in the early 1990s in order to cool off the speculative market in real estate that had emerged in the late 1980s. The tax now imposed a heavy burden on owners since land prices had deflated.[93] When Federation Chairman Toyoda Shōichirō met with Prime Minister Murayama Tomo'ichi nine months later in 1995 he lamented that "'our economy is in a severe situation in which a collapse of business conditions is feared.'" First on Toyoda's proposed list of reforms were tax measures—lowering the corporate tax and the income tax, and abolishing the land tax.[94]

Despite the new emphasis on deregulation and administrative reform aiming at a smaller government, the leaders of Keidanren recognized the benefits of some government aid. While they were urging the enhancement of "efforts of the people to help themselves and the dynamism of the private sector," leaders advocated expansion of a system of reserve funds for helping banks deal with bad loans.[95] While meeting with Prime Minister Murayama, Toyoda recommended increased public works and in regard to "'managing the problem of bad loans, setting drastic policies for a solution, including the introduction of public finance.'"[96]

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[93] "'Rainendo zei, zaisei un'ei ni kansuru kenkai' o kengi," *Keidanren shūhō*, No. 2236 (October 31, 1994), pp. 4-10. For further information regarding Keidanren views on the issue of the land tax, see Keizai Dantai Rengōkai, *Keizai Dantai Rengōkai gojū nen shi*, pp. 636-638.

[94] "Keizai katsuseika ni muke, jikkō aru daitan na kinkyū keizei taisaku no jisshi o motomeru," *Keidanren kurippu*, No. 13, July 13, 1995, p. 7.

[95] "'Rainendo zei, zaisei un'ei ni kansuru kenkai' o kengi," *Keidanren shūhō*, No. 2236 (October 31, 1994), pp. 4 and 7.

[96] "Keizai katsuseika ni muke," p. 7.

In the fall of 1995 Keidanren pressed its case. Reducing the corporate tax was an “urgent issue” for “restoring dynamism to the Japanese economy.”[97] While Japan needed to “raise the portion of taxes on consumption to correct the government’s excessive dependence on direct taxes, the real tax burden for enterprises should be on an internationally equal footing,” especially as enterprises were “in an era of mega-competition in which firms aggressively advance[d] abroad.” Japan’s high corporate tax rate could even cause domestic firms to move overseas. Insistence that the corporate tax had to fall at least to the level of the American rate of 40 percent became a constant refrain. According to the Federation, the land tax was at the very least too heavy for some industries in some regions.[98]

An internal discussion of issues produced even more strident comments. One executive observed that in 1995 central and local indirect taxes provided only 25 percent of revenue, whereas in Europe they provided 40 percent of revenue. He noted that the Japanese consumption tax would rise from three percent to just five percent, whereas European rates varied from 15 to 25 percent. As a result, Japanese firms paid 49 percent of their profits in taxes compared to a range from 33 to 34 percent in the United States. Moreover, in 1995 there were four workers in Japan to support each citizen over age 65, but in 2020 that ratio would be only two to one. Another executive proposed that the consumption tax should increase to 15 percent, while yet another suggested the radical goal of a 50/50 ratio of direct to indirect taxes.[99] The discussants noted as well that the high corporate tax rate might account in part for the low level of foreign investment in Japan.[100]

[97] “Kigyō no zei futan no keigen ni yoru keizai katsuseika ga fukaketsu,” *Keidanren kurippu*, No. 20, November 9, 1995, p. 1.
[98] Keidanren, “Zeisei kaisei ni kansuru teigen,” October 11, 1995, pp. 1-4.
[99] “Korekara no Nihon ni fusawashii zeisei o kōchiku suru,” *Gekkan Keidanren*, December, 1995, pp. 8-11.
[100] *Ibid.*, pp. 13-14.

Keidanren's response to what it now recognized as a dire economic crisis brought out more starkly the contradictions in its approach. While supporting increased government spending to rescue banks from their non-performing loans, the Federation advocated lowering the corporate tax and increasing the consumption tax. This strategy aimed to save Japan's financial system, but it would shift the tax burden from companies to ordinary citizens. Moreover, attempts to balance tax cuts and raises were unlikely to stimulate the economy. Recognition of the difficulties that these policies were likely to produce came in the outline of a ten-year plan to reform public finance that would gradually limit the rise of public expenditures, lower the ratio of public expenditures in regard to the gross domestic product, and reduce the use of long-term bonds. The plan proclaimed: "'to realize again a prosperous and dynamic economic society [we] must first accept suffering.'" Japanese society had to adopt a "spirit of 'first pain, then recovery.'"[101]

From the fall of 1994 to the fall of 1996, the government fended off a number of challenges to its pledge to increase the consumption tax. As the date for the change neared, worries surfaced about its impact on dampening consumption, especially because the government would also end the "fixed" cuts of two trillion yen in the income tax. Finance Ministry officials, however, pointed that not only was the consumption tax needed to fund at least some of the permanent cuts in the income tax that were already in effect but that the government needed to close the gap between its overall expenses and revenue. In June the Tax System Research Councils of both the government and the LDP each endorsed raising the

[101] Zaisei minshushugi no kakuritsu to nōzei ni ataisuru kokka o mokushi shite," *Keidanren kurippu*, No. 46, December 26, 1996, pp. 8-9.

consumption tax to five percent.[102] Looking further ahead, the LDP under Prime Minister Hashimoto Ryūtarō released a draft of "'The Hashimoto Vision.'" It advocated cuts in the corporate tax and the income tax and touched on the "possibility of raising the consumption tax" still further.[103] Still, statements by two opposition parties, the New Progressive Party (Shinshintō) and Kōmeitō, signaled a new movement in the Diet to freeze the consumption tax.[104]

Meanwhile, Keidanren's campaign for lowering the corporate tax encountered resistance. The Government Tax System Research Council decided to take up the issue. Its approach, however, of slashing the overall tax rate by eliminating firms' deductions for creating "reserve funds" for employees' bonuses and retirement packages drew strong opposition from the business community. In any event, the Government Zeichō decided to delay its report until the spring of 1997, well after national elections for the Lower House in October, 1996.[105] The increase in seats in the Lower House won by the LDP in that election helped ensure that the ruling coalition cabinet would stick to its commitment to raise the consumption tax. While beating back, a formal proposal from the New Progressive Party to keep the current rate in place for three years, Prime Minister Hashimoto invoked the power of historical inevitability: "'the consumption tax is a response of the tax system to the structural changes of the advance of an aging society. Following the law, [we] must implement (the raise from April of next year).'" He

[102] "Shōhi zeiritsu hikiage, Sangyōkai ga kōjin shōhi no hiekomi kennen," *Yomiuri shinbun*, June 21, 1996; "Shōhizei 5% kakutei, Zōshū nen 4 chō 4000 oku en, Fukureagaru kokusai, Akaji anaume ni tōku," *Yomiuri shinbun*, June 21, 1996; "21 hi kettei shita shōhi zeiritsu ni kansuru gōi bunsho no yōshi," *Yomiuri shinbun*, June 22, 1996.
[103] "Jimin Hashimoto bishion gen'an zenyō, Hōjinzei, Shotokuzei sage, Shōhizei hijū fuyasu," *Yomiuri shinbun*, Evening edition, July 02, 1996.
[104] "Rinji kokkai, Raigetsu kaikai no yōkyū e, 'Shōhizei' 'Okinawa' o shingi/Shinshintō," *Yomiuri shinbun*, August 20, 1996, and "Kōmei ga shōhizei appu no hantai ikenshoan o tōgikai ni teishutsu," *Yomiuri shinbun*, September 7, 1996.
[105] "Seifu zeichō kyō saikai, Hōjinzei sage ga shōten, Jitsugen semaru keizaikai, Shōhizei wa senkyō ni eikyō mo," *Yomiuri shinbun*, September 13, 1996, and "Seifu zeichō saikai, Shōhizei sueoki ron hihan, Chūki tōshin, toshiake irai," *Yomiuri shinbun*, September 14, 1996.

remained convinced that the negative effects of the tax boost would be relatively minor. "'Private demand,'" he predicted, "'will increase its firmness; as for the economy, the movement of recovery will continue. Raising the consumption tax will influence the economy but not the basis of the road to recovery of business conditions.'" He thus hoped that the effects of upping the consumption tax would in the short term not be too bad and would lay the foundation for further recovery. The LDP, though, ended up taking a cautious attitude toward reducing the corporate tax. Members of the LDP Tax System Research Council observed that "'while waiting for the raise in the consumption tax next spring it is best not to touch other matters that can cause problems.'" "'When increasing a mass tax such as the consumption tax, cutting taxes only for business makes no political sense.'"[106] The Council decided to postpone consideration of the corporate tax until 1998.[107]

Conclusion

Keidanren and the business community played a central role in the infamous hike in the consumption tax in 1997, just as they had done in the rejection of the consumption tax in 1979 and 1987 and in its enactment in 1989. The MOF had initiated the campaign for the consumption tax in 1977, but gaining approval from the business community turned out to be crucial. Opposition from both large and small enterprises had helped throttle the tax in the late 1970s, and a split in the business community between Keidanren and the JCCI had doomed the measure in 1987. By then Keidanren had decided to support the consumption tax, as other strategies—namely, fiscal expansion and fiscal retrenchment—failed to restore high economic growth and to

[106] "Shōhi zeiritsu sueoki hiketsu, 'raishun kara 5%,' kakutei e/Shūin tokubetsu i," *Yomiuri shinbun*, December 13, 1996; and "JImin zeichō, zeisei bappon kaisei sakiokuri e, Kentō no kikan mijikaku, Shōhizei ritsuage mo eikyō," *Yomiuri shinbun*, December 9, 1996.

[107] "Rainendo zeisei kaisei taikō kettei, Shōhizei 5%, Tokubetsu genzei uchikiri, Kokumin futanzō 7 oku en," *Yomiuri shinbun*, December 19, 1996. The government did lower the corporate tax rate in 1999 and 2000. See Keidanren, "Zeisei bappon kaikaku no arikata ni tsuite" (February 19, 2002), p. 7. (Accessed online at http://www.keidanren.or.jp/japanese/policy/2002/009/honbun.html, on June 5, 2012.)

balance the national budget. Moreover, the Federation perceived the need for a new stream of revenue to fund expanded social services for a rapidly aging population and to accommodate political pressure to slash individual income taxes. In addition, a new source of revenue would forestall attempts to increase the corporate tax rate and thus help keep Japanese firms competitive in an increasingly globalized market. Implementing the consumption tax required concessions to small and medium businesses, particularly in terms of keeping the rate for the consumption tax low compared to the rate in Western European nations.

As noted above, some business leaders pointed out in the mid-1990s that Keidanren was pursuing several different and contradictory goals. It was in the short term trying to stir the economy from its six years of lethargy through lowering the income tax rate for individuals and attempting to decrease the corporate tax rate. At the same time the Federation justified boosting the consumption tax by arguing that it would provide new revenue for pursuing longer term goals of restoring a balanced national budget, preparing for funding increased social services in a rapidly aging society, and shifting the nation's tax structure to enable Japanese firms to compete more effectively in a more globalized world. In addition, realizing by 1995 the precarious situation of many Japanese banks caused by a large number of non-performing loans, the leaders of Keidanren urged the use of government funds to aid the banks. These executives and government officials knew that raising the consumption tax would temporarily dampen economic growth but they thought that the longer-term gain would outweigh the short-term "pain."

The case of Keidanren and the consumption tax demonstrates that a preoccupation with long-term goals can create contradictions in national economic policy during an economic slump. In particular, the Federation's concern for the long-term goal of restoring public finances interfered with the short-term goal of effecting economic recovery. This result should not have been a surprise, because in the late 1970s Keidanren had opposed the introduction of a consumption tax by arguing that economic recovery had to precede a successful effort to balance the budget of the national government because premature efforts toward that end could worsen the fiscal crisis by lowering economic growth and thus the flow of revenue to the government. Raising the consumption tax in 1997 hampered economic growth and may even have helped undermine the achievement of the long-term goal of balancing the budget to the extent that contributing to the persistence of the nation's economic slump helped cause a decline in the government's revenue.[108] In other words, neither Keidanren nor the government developed a coherent strategy to achieve the short-term goal of economic recovery or the long-term goal of restoring public finances.

[108]Christian Broda and David E. Weinstein show that government revenue which had stabilized for three years did decrease for about three years after 1997, recovered, and then declined again. See Broda and Weinstein, "Happy news from the Dismal Science: Reassessing Japanese Fiscal Policy and Sustainability," in Takatoshi Ito, Hugh Patrick, and David E. Weinstein, ed., *Reviving Japan's Economy* (Cambridge, MA: The MIT Press, 2005), pp. 49-51, especially figure 2.1. See also, Maurice Wright, *Japan's Fiscal Crisis: The Ministry of Finance and the Politics of Public Spending, 1975-2000* (Oxford: Oxford University Press, 2002), p. 49, figure 3.2.