

The Economics of Tax and Social Security in Japan

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Preface

The Comprehensive Reform of Social Security and Tax: Japan (hereafter The Comprehensive Reform) was implemented with the aim of stabilizing social security, securing stable financial resources, and reconstructing finances. Social security accounts for a large proportion of the expenditure items in the finances of not only Japan but also other developed countries. Alongside a population aging remarkably fast, Japan's social security expenditure for the elderly, including pensions, medical care, and long-term care, have continued to increase and the country is now facing the problem of how to reduce this expenditure.

Among the developed countries, Japan has an economy that is in a serious condition and is impinging on the state's ability to support its social security system through insurance contributions and tax revenues. Therefore, to fulfill its fiduciary duty, the government is relying on government bonds. The question then arises of how to position the tax system to secure stably financial resources to overcome such structural weaknesses. There have long been arguments over determining the main basis for taxation: whether consumption and income are preferred or a combination of both is desirable. Most current arguments favor the selection of income tax and general consumption tax. However, the trust in income tax has eroded, while the comprehensiveness of the taxation base and an accurate supplementation rate are both difficult arguments to deal with. In addition, the effects of a progressive tax rate structure on economic activities are notable.

Therefore, in The Comprehensive Reform, importance is given to securing stable financial resources, and consumption tax is cited as the main financial resource. The idea of raising the consumption tax rate to secure the financial resources required for social security has been under consideration for quite some time. In the second half of the 1970s, it was foreseen that the increase in social security expenditure due to an aging population would pose a threat to finances in the future. In 1979, the Liberal Democratic Party's (LDP's) Ohira administration aimed to introduce a general consumption tax, and then in 1987, the Nakasone administration proposed the initiation of a broad-based indirect tax, a sales tax; eventually neither was introduced. In 1988, the Takeshita administration enacted the Consumption Tax Law and introduced a 3% consumption tax from April 1989. In February 1994, the

Hosokawa administration, which took over from the LDP administration, proposed raising the tax rate to 7%, changing the name to National Welfare Tax, as a financial resource for social security, but in the face of opposition, the proposal was withdrawn. After the creation of a coalition that included the LDP, in 1994 the Murayama administration decided to raise the tax rate to 5%, which came into effect in April 1997. The Asian currency crisis began in the same year (1997) and Japan slipped into an economic recession.

The facts that the cabinet collapsed on the introduction of the consumption tax and that the hike in the tax rate overlapped with the timing of the Asian currency crisis are reasons that the Japanese people have a negative view of the consumption tax, and it is Japan's political Achilles heel. In 2008, the Hatoyama government of the Democratic Party of Japan (DPJ) came to power and pledged it would not raise the consumption tax rate. However, it was unable to secure sufficient financial resources for social security, and the DPJ administration was forced to change its policy.

In 2012, the Noda Cabinet submitted a bill to raise the tax rate to 8% in 2014 and then to 10% in 2015, and the bills were passed. Subsequently, in December 2013, once again, the administration changed hands, and an LDP–Komeito coalition government came into power.

In April 2014, the Abe administration raised the consumption tax rate to 8%. However, in November of the same year, the government announced its decision to postpone the scheduled increase to 10% in 2015 by a year and a half.

Even during this period, social security expenses continued to increase. The system of long-term care insurance was introduced from fiscal 2000. With a rapidly aging population on the one hand, the need for social security services is rising; but on the other hand, the biggest challenge facing Japan is how to secure stable financial resources to pay for social security.

Several measures are currently being undertaken through The Comprehensive Reform to address this challenge. Certainly, the consumption tax is an important financial resource for social security, but at this time it is important to consider not only the consumption tax, but also individual indirect taxes. Having said that, the consumption tax is not the only financial resource for social security. If the consumption tax is considered to be the only financial resource in The Comprehensive Reform, then the outlook becomes extremely narrow.

Important financial resources for social security are insurance contributions and self-payments (primarily, the amount paid by individuals themselves). Income taxation also plays an important role as a financial resource and it must be considered widely in the framework of The Comprehensive Reform. In fact, income taxation largely supports Japan's finances, including social security finances, as a fundamental tax.

In this book, we consider the approach to be adopted for The Comprehensive Reform in order to analyze the methods for allocating the tax burden, which is a financial resource for social security, and the enormity of the burden social security will place on households, companies, and the government. The prologue explains the point of view taken in the book, the specific analyses in each chapter, and the

approach for The Comprehensive Reform in the final chapter. As the author, I will be extremely happy if this book contributes toward the progress of that reform.

*** **

In terms of the conclusions I reach in this book, I am grateful for the useful comments that I received from many people, even at different stages of publishing each chapter as research theses and presenting reports at conferences. While writing this book, I received several research grants that have supported me up to the present. The grants include those from: the Japan Society for the Promotion of Science KAKENHI Grant-in-Aid for Scientific Research, Fundamental Research (C) “Verification of policies to support women’s employment, childbirth, children, and childcare in a declining birth-rate society”; the Unicers Foundation Research Grant, “Study on households’ consumption and burden of medical care and long-term care services”; and Government Finances, Finance, and Financial Legislation Research Fund Research Grant, “Analysis of the financing of social security services in local governments”.

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