Tax Hike Initiative Launched to Remedy Debt-Ridden Finances

FOR years, Japan has tried to get out of deflation and a protracted economic slump by increasing public spending. It is now changing course and is about to launch a tax hike initiative to extricate itself from the doldrums of its debt-ridden finances. The government has decided to halve the 1999 fixed-rate income tax cuts in FY 2005. In addition, debate on whether to raise the consumption tax from the present 5% is expected to start in a few years.

Surprisingly, Japan has the worst fiscal situation among the G7 major economies. The balance of Japan's long-term debt at the national and local levels is projected to reach ¥774 trillion at the end of FY 2005, with the ratio of that balance to GDP standing at over 150%. This is in stark contrast to some 60% for the United States, which is now beleaguered with the twin budget and trade deficits. The ratio for Italy is about 120%, the second-worst among the G7 major economies. Japan's per-capita debt exceeds ¥6 trillion. Japan needs to continue paying ¥1 billion in government bond interest per hour despite extremely low domestic interest rates.

The government aims to have the primary balance – tax revenue minus outlays other than debt-servicing costs – show a surplus in the 2010s, with tax revenues exceeding government spending. The balance improved from a deficit of ¥19 trillion in FY 2004 to ¥16 trillion in FY 2005. But the fact that spending on the nation's social security programs has been swelling by more than ¥1 trillion a year makes it no easy task for the government to achieve its goal.

Japan's ratio of taxes and social-security costs to national income stands at around 35%, compared with more than 50% for Britain and other European nations. The Japanese ratio will inevitably rise sharply in the years ahead if the current social security system remains unchanged.

The government intends to secure financial resources for social security by raising taxes, including the consumption tax. But Japanese taxpayers will remain unconvinced unless public expenditures are slashed substantially in state budgets. Reforms of national finances are expected to focus on whether taxpayers should accept a heavier tax burden or lower social security benefits amid the rapid aging of society and the falling birthrate.