SECOND MEETING OF THE OECD GLOBAL FORUM ON VAT

The History and Development of the Consumption Tax policy in Japan

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Outline

- Fiscal situation and the role of the consumption tax in Japan
- History of the consumption tax policy
  - Introduction of the consumption tax (1989)
  - First consumption tax rate hike (1997)
  - Second consumption tax rate hike (2014)
- Future steps
- Questions
Trends in General Account Tax Revenues, Total Expenditures and Government Bond Issues

(in trillion yen)

(Total Expenditures)

(Tax revenues)

(Special Deficit-Financing Bond Issues)

(Construction Bond Issues)

(Note1) FY1975-2012: Settlement, FY2013: Including supplementary budget, FY2014: Budget
(Note2) Following various bonds are excluded: Ad-hoc Special Deficit-Financing bonds issued in FY1990 as a source of funds to support peace and reconstruction activities in the Persian Gulf Region, Tax reduction-related Special Deficit-Financing bonds issued in FY1994-1996 to make up for decline in tax revenues due to a series of income tax cuts preceding consumption tax hike from 3% to 5%, Reconstruction bonds issued in FY2011 as a source of funds to implement measures for the Reconstruction from the Great East Japan Earthquake, Pension-related Special Deficit-Financing bonds issued in FY2012,2013 as a source of funds to achieve the targeted national contribution to one-half of basic pension.
Government Financial Liabilities and Household Financial Assets

### Trends in General Government Financial Liabilities and Household Financial Assets

**General Government Gross Debt (International Comparison)**

- Japan: Growth trend from 1999 to 2013
- Italy: Stability from 1999 to 2013
- France: Growth trend from 1999 to 2013
- U.K.: Growth trend from 1999 to 2013
- U.S.: Growth trend from 1999 to 2013
- Canada: Growth trend from 1999 to 2013
- Germany: Growth trend from 1999 to 2013

**Household Gross Financial Assets**
- Japan: Growth trend from 1989 to 2011
- Italy: Growth trend from 1989 to 2011
- France: Growth trend from 1989 to 2011
- U.K.: Growth trend from 1989 to 2011
- U.S.: Growth trend from 1989 to 2011
- Canada: Growth trend from 1989 to 2011
- Germany: Growth trend from 1989 to 2011

**Household Net Financial Assets**: Some liabilities such as home mortgage are excluded from gross financial assets.

**General Government Gross Financial Liabilities**

**General Government Net Financial Liabilities**

**Notes**
- (Note1) The data are as of the end of FY.
- (Note2) Figures represent the general government-based data

(Source) OECD “Economic Outlook 94” (November, 2013)
### Aging Population

#### Ratio of People Older than 65 years to the Total Population

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>7.1</td>
<td>17.4</td>
<td>31.6</td>
<td>10.3</td>
<td>14.2</td>
</tr>
<tr>
<td>Germany</td>
<td>13.6</td>
<td>16.3</td>
<td>28.2</td>
<td>2.7</td>
<td>11.9</td>
</tr>
<tr>
<td>France</td>
<td>12.9</td>
<td>16.0</td>
<td>23.2</td>
<td>3.1</td>
<td>7.2</td>
</tr>
<tr>
<td>U.K.</td>
<td>13.0</td>
<td>15.8</td>
<td>21.1</td>
<td>2.8</td>
<td>5.9</td>
</tr>
<tr>
<td>U.S.</td>
<td>9.8</td>
<td>12.4</td>
<td>20.1</td>
<td>2.6</td>
<td>7.7</td>
</tr>
</tbody>
</table>

#### Japanese Life Expectancy

<table>
<thead>
<tr>
<th>Year</th>
<th>Male</th>
<th>Female</th>
</tr>
</thead>
<tbody>
<tr>
<td>1961</td>
<td>66.0</td>
<td>70.8</td>
</tr>
<tr>
<td>1973</td>
<td>70.7</td>
<td>76.0</td>
</tr>
<tr>
<td>2012</td>
<td>79.9</td>
<td>86.4</td>
</tr>
</tbody>
</table>

- **Life Expectancy at age 65**
  - Male: 11.9, 13.2, 18.7
  - Female: 14.1, 16.1, 23.8

- **Life Expectancy at age 75**
  - Male: 6.7, 7.4, 11.6
  - Female: 7.8, 9.1, 15.3

Balance between beneficiaries/contributors in social security system is getting vulnerable

(Source) “Population Estimates” and “National Census” (Ministry of Internal Affairs and Communications), ”Population Projection for Japan (middle fertility and mortality projection)” (National Institute of Population and Security Research)
Social Security Benefits

GDP 479.6 trillion yen (FY 2012)

109.5 trillion yen (22.8%)

Social Security-related Expenditures 36% up

148.9 trillion yen (24.4%)

Others: 9.0 trillion yen (1.5%)
Childcare: 5.6 trillion yen (0.9%)
Nursing Care: 19.8 trillion yen (3.2%)

Medical Care: 54.0 trillion yen (8.9%)

53.8 trillion yen (11.2%)

Pension: 53.8 trillion yen (11.2%)

Pension: 60.4 trillion yen (9.9%)

Medical Care: 35.1 trillion yen (7.3%)

Medical Care: 54% up

Pension: 12% up

GDP 27% up

GDP 610.6 trillion yen (FY 2025)

(Note) This reflects the impact on prioritization and efficiency of social security system based on “specific measures, process flow and cost projection of social security system reform.”
(Source) Ministry of Health, Labor and Welfare
The role of the consumption tax

Characteristics of consumption tax
- Stable revenue source
- Neutral for economic activities
- Large amount of revenue

Maintenance of the social security system and Fiscal consolidation; To achieve these two goals simultaneously, make use of the consumption tax as a main resource for tax revenues.

In fact, during the introduction and twice rate hikes of consumption tax, we had gone through difficult and winding paths.
Frequency of the consumption tax rate hikes - international comparison
Pre-history of the consumption tax

- From the accession to OECD to the present
  - In 1964  Accession to OECD
  - +25 years later  In 1989  Introduction of the consumption tax (3%)
  - +25 years later  In 2014  Second hike of the consumption tax rate (8%)

- History to Introduction
  - Comparison of tax revenues (in trillion yen)

<table>
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<tr>
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<th>Tax Revenue in General Account</th>
<th>Individual Income Tax</th>
<th>Corporate Income Tax</th>
<th>Commodity tax etc.</th>
</tr>
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<tr>
<td>FY 1975</td>
<td>13.7</td>
<td>5.5 (39.9%)</td>
<td>4.1 (30.0%)</td>
<td>0.8 (5.5%)</td>
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- Need to shift the balance from direct taxes to indirect taxes
- 1978  Consideration of General Consumption Tax by LDP
  - Election rout  recalled
- 1987  Submission of the bill of Sales Tax by LDP
  - Abolished
- Cause of the above failure: unpopularity among salaried employees and small/medium businesses
Introduction of the consumption tax

- Introduction of the consumption tax
  - 1988 Submission of the bill of the consumption tax act by LDP ⇒ Approved by the Congress
  - 1989 Introduction of the consumption tax

- Contents of the tax reform
  - Introduction of consumption tax: 3%
    - Simple requirement for keeping books and/or bills without introducing invoices
    - Special measures for SMEs: exemption threshold, simplified tax scheme
  - Individual income tax cut: decreasing tax rate, expanding deductions (ex. basic deduction)
  - Corporate income tax cut: staged decreases of tax rate (42% → 37.5%)

- Comparison of tax revenue (in trillion yen)

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<td>FY 1990</td>
<td>60.1</td>
<td>26.0 (43.2%)</td>
<td>18.4 (30.5%)</td>
<td>4.6 (7.7%)</td>
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<td>13.7</td>
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Note: Commodity tax was abolished when the consumption tax was introduced.
First consumption tax rate hike (1997) - 1

- Steps toward the consumption tax rate hike
  - 1994 Consideration of National Welfare Tax by SP coalition forces ⇒ Recalled
  - 1994 Submission of the bill of the consumption tax rate hike by LDP coalition forces ⇒ Approved by the Congress
  - 1997 Consumption tax rate hike

- Contents of the tax reform
  - Consumption tax rate hike (3%→5%)
    - Reduction of special measures for SMEs: lowering exemption threshold, narrowing simplified tax system
  - Individual income tax cut: introducing special tax reduction, reducing progressivity of the tax rate, expanding deductions (ex. basic deduction)

- Comparison of tax revenue (in trillion yen)

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<td>FY 1998</td>
<td>49.4</td>
<td>17.0 (34.4%)</td>
<td>11.4 (23.1%)</td>
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Trends in Real GDP and Private Consumption before and after the Increase of the Consumption Tax Rate in 1997

Real GDP growth (Change from the previous quarter, seasonally adjusted, %) (Right axis)
- Increase of the consumption tax rate (April 1997~)
  - Annual rate: +3.0% (Max: 3.5%)
  - Annual rate: +1.6%
- The Asian currency crisis (July 1997~)
- Bankruptcies of Sanyo Securities, Hokkaido Tokushoku Bank and Yamaichi Securities (November 1997)

Private consumption (Changes of the previous quarter, seasonally adjusted, %) (Right axis)
- (Annual rate: +3.0%)
- (Annual rate: ▲3.7%)

Private consumption (Left axis)
- (FY 1994)
  - Real GDP: 1.5%
  - Private Consumption: 2.1%
- (FY 1995)
  - Real GDP: 2.7%
  - Private Consumption: 2.3%
- (FY 1996)
  - Real GDP: 2.7%
  - Private Consumption: 2.4%
- (FY 1997)
  - Real GDP: 0.1%
  - Private Consumption: ▲1.0%
- (FY 1998)
  - Real GDP: 0.3%
  - Private Consumption: 0.5%

Real GDP (Left axis)
- (FY 1994)
  - April-Jun: 64
  - July-Sep: 111
  - Oct-Dec: 113
  - Jan-Mar: 112
- (FY 1995)
  - April-Jun: 66
  - July-Sep: 114
  - Oct-Dec: 115
  - Jan-Mar: 115
- (FY 1996)
  - April-Jun: 67
  - July-Sep: 117
  - Oct-Dec: 119
  - Jan-Mar: 119
- (FY 1997)
  - April-Jun: 67
  - July-Sep: 68
  - Oct-Dec: 69
  - Jan-Mar: 67
- (FY 1998)
  - April-Jun: 67
  - July-Sep: 68
  - Oct-Dec: 68
  - Jan-Mar: 68

Source: Cabinet Office "SNA (National Accounts for Japan)," real GDP, seasonally adjusted.
Note: Real GDP and private consumption are calculated by dividing the actual yearly amount by 4.
Second consumption tax rate hike (2014)

- Steps toward the second hike
  - 2009 Enactment of the Program Act (Aso cabinet) ⇒ Change of the government
  - 2012 Enactment of the Act on Comprehensive Reform of Tax System ⇒ Change of the government
    - 2014.4 5% → 8%, 2015.10 8% → 10%
  - 2014 Consumption tax rate hike 5% → 8%

- Contents of the tax reform
  - Using the consumption tax revenue as a main resource for the social security
  - Raising top rate of the individual income tax
  - Taking economic measures (about 5 trillion yen)
    - Measures for alleviating the consumption tax burden on the purchase of houses
    - Measures for activating of private investment (ex. R&D tax credit)
  - Measures for smooth pass-through of the increased consumption tax on sales price
    - Background: SMEs have shown concerns that they would suffer from being beat down of prices by large enterprisers or rise in prices of their commodities and services would not be accepted by consumers.

- Act for the measures to ensure the smooth and proper shifting of the tax increase to prices (ex. establishment of G-men for pass-through and over 150 thousands of investigations)
  - Measures for low-income households ⇒ This theme will be presented by Director Ito (Session 6).
International Comparison of VRR among OECD Countries

VRR (Vat Revenue Ratio) = \frac{\text{Vat Revenue}}{(\text{Consumption Expenditure} - \text{Vat Revenue}) \times \text{Standard}}

Future steps

- During the introduction and twice rate hikes of the consumption tax, we had gone through difficult and winding paths; however,
  - Single rate structure has been maintained.
  - Special measures for SMEs have been diminished.
  ⇒ The efficiency of Japanese consumption tax is fairly well.
  - However, rate is still low.

- Future
  - By the end of this year: final judgement of the consumption tax rate hike from 8% to 10% in October 2015.
  - By FY 2020: Accomplishment fiscal consolidation target(Achieving a primary surplus)

- Based on the experience about the introduction and hikes of the consumption tax,
  - the consumption tax policy is discussed discretely among politicians.
  - The People are sensitive to economic conditions and issues of price rise.

- However, considering the fiscal situation and the rapid aging of the population, raising the consumption tax rate is necessary.
Questions

- Have you ever gone through similar difficulty in raising the consumption tax?

- In a political context, are consumption tax rate hikes impressed favorably or unfavorably?

- In case oppositions exceed supports about raising the consumption tax rate, what sort of measures have you taken? Have the measures succeeded or failed?