

***Consumption Taxes and the Welfare State  
in Sweden and Japan***

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*“The art of taxation is one of plucking the goose so as to get the greatest amount of feathers with the least amount of hissing.” Jean Michael Colbert.*

As the modern state has grown, so has its need to raise revenue. In all democratic countries this means that governments must find ways to generate revenue without alienating voters. This is no easy task. Citizens like government spending but are deeply suspicious of government's attempts to raise the taxes needed to pay for it. There are, in short, no popular taxes.

The political challenges of taxation have been nowhere more apparent than in the recent attempts of many democracies to introduce or raise consumption taxes. Consumers tend to dislike most consumption taxes because they raise the price of what they want to buy; governments tend to like them because they are highly efficient sources of revenue which often can be less visible than direct income and capital taxation. In this chapter, we examine two advanced industrialized democracies that have met the challenges of consumption taxation in dramatically different ways: Sweden and Japan. In so doing, we highlight the significance of consumption tax politics for the political economy more generally. By emphasizing the particular political compromises that have encouraged or hindered consumption taxation in Sweden and Japan, moreover, we hope to explain the relationship among consumption, taxation

and the size and effectiveness of the welfare state.

## **Consumption Taxes and Consumption**

What are consumption taxes? This is not as simple a question as one might think. The Organization for Economic Cooperation and Development (OECD) has difficulty categorizing consumption taxes, because while many taxes directly affect consumption, only some of them are paid directly by the consumer.<sup>1</sup> It is easy to understand that a classical sales tax is a consumption tax. Other consumption taxes such as tariffs, however, are more difficult to place, even though they are ultimately shouldered by consumers. The OECD lists over 42 different categories of consumption tax in its inventory of taxes. These range from the general Value Added Tax (VAT), which can apply to all goods sold in a country, to specific taxes on things like salt, wigs, video cassettes, gasoline, advertising, gambling, fur coats and *sake*. Most countries have literally hundreds of different consumption taxes on specific goods and services. In fact, they are among the oldest and most relied upon taxes in history for the obvious reasons that they are relatively easy to collect and can generate enormous revenues. But consumption taxes have also been the source of intense political controversy. In the United States and India, to cite two extreme examples, opposition to consumption taxes on tea and salt, respectively, triggered major revolutions.

In recent years, taxes on general consumption have grown enormously while taxes on specific goods and services have declined across the advanced capitalist world. There appears to be a growing consensus among tax policy elites that the revenues generated by specific taxes do not justify their high administrative costs. At the same time, the liberal consensus that swept the

world in recent decades posits that governments should not be in the business of shaping individuals' consumption choices.<sup>2</sup> General consumption taxes (most importantly the VAT) are seen as less distortional because they generate huge revenues and are relatively easy to administer. Consumption taxes are now the single most important source of revenue in the OECD, accounting for an average of 29.9 percent of total government tax revenues in member nations.<sup>3</sup> Given the increasing difficulty of taxing income and profits in a globalizing world economy, most analysts agree that broad-based consumption taxes are likely to grow in importance as a major source of state financing.

**TABLE 1**  
**Sources of Tax Revenue, Percent GDP, 2001**

	<b>Consumption</b>	<b>Income and Profits</b>	<b>Social Security</b>	<b>Total taxes</b>
<b>OECD Avg.</b>	11.1	13.4	9.2	37.4
<b>Sweden</b>	12.6	19.3	14.5	54.2
<b>Japan</b>	4.6	8.9	9.9	27.1

Source: OECD Revenue Statistics 1965-2002 (2003), table 3.

As Table 1 illustrates, some countries tax their societies a lot more than other countries. Sweden takes in 54.2 percent of GDP and has the world's heaviest tax burden, while the Japanese tax burden of 27.1 percent of GDP is the lowest of any democracy in the world (as of 2001). But the biggest single difference between the tax structures of these countries is the amount of revenue each collects in consumption taxes. Japan is at the bottom of the OECD, collecting only 2.4 percent of GDP in general consumption taxes (VAT), while Sweden is near the top,

collecting 9.1 percent of GDP with its VAT (see Table 2).

**TABLE 2**  
**Consumption Taxes as a Percent of GDP, 1965 and 2001**

	Tax on General Consumption		Tax on Particular Goods and Services	
	1965	2001	1965	2001
<b>Sweden</b>	3.6	9.1	6.7	3.5
<b>Japan</b>	0	2.4	4.6	2.1
<b>OECD Avg.</b>	3.3	6.9	5.8	4.0

Source: OECD Revenue Statistics 1965-2002 (2003), tables 28, 30.

These data reveal only the most general differences in the ways countries have raised, lowered and used consumption taxes. In the following pages we explore the politics of consumption taxes in Sweden and Japan, the world's most dissimilar democratic welfare states. Despite their obvious differences, we believe that comparing these two countries makes good sense. First, each has achieved admirable levels of economic prosperity and wealth. Counted among the poorer countries of the world only a century ago, they are now two of the richest and most technically advanced countries. Second, both countries achieved this economic growth and prosperity while reducing economic inequality.. Third, both countries are noted for having strong states—governments that have actively directed their economies towards commonly agreed upon social and economic goals. That said, the ways in which Sweden and Japan have developed their political-economic systems have been remarkably different.

While Sweden has built the world's most generous (and expensive) welfare state, Japan's

welfare state is one of the least developed in the industrialized world. Sweden established a universal social insurance system that offers "cradle to grave" social insurance coverage to all citizens. Conversely, Japan has constructed a minimalist welfare state that relies heavily on the private sector (either family or company networks) to provide most social services. Sweden has financed its generous welfare state in large part by heavily taxing workers and consumers, while Japan has taxed its workers and consumers at low rates by international standards. We find this interesting—and worth explaining—because the Swedish government has been dominated for roughly six decades by a self-defined socialist party whose rhetoric is generally pro-worker, pro-consumer and anti-capitalist. The Japanese government, by contrast, has been controlled for most of the past half-century by the conservative Liberal Democratic Party (LDP), which has long emphasized economic growth objectives over the rights or interests of consumers and workers. We would expect, in other words, the Japanese government to tax consumers and workers at much higher rates than its Swedish counterpart. By exploring the politics of consumption taxes in these two countries, we hope to better understand these puzzling outcomes. As Garon and Maclachlan observe, our story highlights the fact that while rising consumption is considered an important objective in most countries, it may often play second fiddle to other social, political and economic issues that are important in specific national contexts.

We argue that these different tax systems are best understood through an institutionalist lens. Specifically, we show how political institutional structures contributed to fundamentally different consumption-tax policy choices in these two countries. Briefly stated, the structure of Swedish corporatist decision-making institutions (which are themselves the products of both the electoral system and the existence of powerful producer groups) encouraged political and economic elites to strike a distinctive political bargain. In this bargain, labor and consumers

were required to shoulder tax increases that would in turn allow the construction of a generous welfare state. This welfare state would support higher and more equitable standards of living—and thus higher levels of consumption for society's poorest individuals. In Japan, by contrast, the multi-member electoral system (in existence from 1948 to 1994) has prevented elites from imposing short-term costs (taxes) on citizens, thereby hindering the expansion of social programs that would benefit these same citizens. Although there have been many attempts over the years to increase consumption taxes for social welfare purposes, most have been undermined by politicians who face short-term electoral incentives. In short, what Garon and Mochizuki call the "social contract" is different in Japan and Sweden.<sup>4</sup> Our study hopes to explore why this is so and what the consequences are in terms of funding these two social welfare states.

### **Taxing Consumption in Sweden**

We begin this section with the curious fact that Sweden, which has been dominated by a (self-proclaimed) “socialist” party for most of the past six decades, imposes some of the heaviest and most regressive consumption taxes of any country in the world. There is a simple explanation for this: the Social Democrats believe that taxing general consumption is necessary to finance the expansionist welfare state. We have found no evidence to suggest that the Swedish government uses general consumption taxes to reduce consumption levels and promote savings; instead, the Social Democrats use these taxes, along with other forms of taxation, to *redistribute* consumption. By taxing all citizens heavily and then redistributing that income, the government is effectively "churning" income within society. The result is that even the poorest

have relatively high levels of real and disposable income, good housing, and the ability to take periodic vacations. At the same time, however, the Swedes have taxed "sins" very heavily in the hopes of reducing certain kinds of consumer behavior. But this type of tax appears to be an exception to the general tax rule in this country.

Despite the nominally socialist label held by the Swedish Social Democrats, tax policy in Sweden is about generating revenues to build a redistributive and just social welfare state *without interfering in the capitalist economy any more than necessary*.<sup>5</sup> To be sure, taxes on income and profits are used to encourage general investment in Sweden, but tax policy is not manipulated to encourage or discourage particular patterns of consumption in favor of Swedish manufacturers or industries.

The key to understanding these curious policies lies in the particular character of Swedish corporatist decision-making institutions. In this highly centralized system, business, labor and political elites meet in (literally) closed-door sessions to coordinate annual wage demands, tax policy and social-welfare spending policy. Like politicians everywhere, Social Democratic elites are continually faced with pressures to increase public spending. In Swedish corporatism, the government is able to go to the very agents of these demands (the unions) and offer them a deal: increased spending on health care or public housing in return for increased taxes. The employers' federation (SAF), which is also sitting at the table, will oppose increases in profits taxes because they reduce investment levels and thereby jobs. Another option is to increase income taxes on workers by lowering tax thresholds and increasing rates at lower income levels. But since labor union officials do not want to be held responsible for the direct taxation of their own workers, the government generally finds it preferable and less politically painful to increase general consumption taxes.

### *Electoral rules, Corporatism and Tax Policy*

When the Social Democratic Party (SAP) attained power in 1932, it promised its supporters (particularly labor unions) that it would create a more equitable tax system. But the mid-1930s were difficult economic times, of course, so tax increases had to wait until circumstances would allow them. Time, it so happened, was what the Social Democrats had plenty of. They would remain in office from 1932 to 1976.

What accounts for the enormous stability of the Swedish government? Up until 1974 Sweden had a bicameral legislature in which Lower House seats were filled every three years in a proportional representation (PR) electoral system, while Upper House representatives were selected on a regional basis (also PR system), but with only 1/8th of the members up for election each term. Thus, once a party controlled both houses of parliament, as the Social Democrats did by the 1940s, it could be quite confident that it would *continue* to dominate the government—even if it lost seats in the next election. This institutional fact is the cornerstone for understanding the development of tax policy in 20th century Sweden.

Precisely because of its enormous electoral stability, the Social Democrats (SAP) were able to engage in long-term tax planning. Equally important, stability allowed them to make deals with interest groups and other political parties in ways quite unimaginable in countries with more fluid or uncertain electoral outcomes. Put bluntly, the Minister of Finance could (and did) force both labor unions and companies to the negotiating table and promise them that deals struck in this corporatist setting would be enforced for many years to come. At the same time, however, Sweden's PR system made it unlikely that the Social Democrats would control the parliament as an absolute majority.<sup>6</sup> This effectively constrained the SAP. Even if the Social

Democrats wished to impose radical redistributive policies, they would probably not be able to push those policies through parliament unless they happened to be in alliance with another smaller party. In short, Sweden's particular electoral institutions had a profoundly stabilizing and regularizing effect on the government's political choices because they dramatically shaped the strategic context of all the major political actors involved.

One should note that in 1974, under significant pressure to "democratize" the political system, the Social Democrats agreed to a major constitutional revision. The key feature of this revision was elimination of the Upper Chamber. Significantly, in the next (1976) election the Social Democrats were removed from government for the first time in 44 years. Though most of the basic systems and structures underlying the Swedish tax and social welfare system were well in place by then, there can be no doubt that politics became more "politicized" over the next several years. But one should not overemphasize the effects of this change. Sweden's system of proportional representation continues to this day and still provides enormous political stability—especially when compared to single member district systems like those found in the United States and Britain.<sup>7</sup>

The most dramatic and obvious consequence of these institutional incentives on Swedish tax policy was apparent by the late 1930s. In 1938-39 the SAP decided to bring the unions and employers to the negotiating table. Up to that point, Sweden had the highest strike rate of any country in Europe and strikes and lock-outs were severely damaging the country's economic performance. The SAP offered both the unions and employers incentives to bargain together more peacefully. After a series of negotiations that are far too complex to reiterate here, the unions received a set of recruiting tools, including the power to distribute unemployment insurance. Large corporations, meanwhile, obtained generous tax breaks that virtually

eliminated their tax burdens for as long as they reinvested their profits in Sweden. This was the beginning of Sweden's famous "Historic Compromise" or "corporatist" system—a system in which tax policy always played an important part.

In Sweden, as in most countries, World War II resulted in large tax increases and an expanding public debt. A temporary sales tax was introduced at this time, as were increases in a variety of excise taxes (taxes on particular items). Probably the most important innovation was the introduction of the mass-based income tax. Income taxes had been a fixture in Sweden since early in the century but had been levied mostly on the wealthy. During the war, finance officials realized that as average wages increased, they could tax these incomes and generate huge revenues. Conveniently, these taxes could be collected through the "Pay as You Go" (PAYG) system in which employers deducted taxes from their employees' paychecks. This system proved to be an enormously efficient and effective means for raising revenue. To balance the new working class taxes, the government also increased inheritance taxes, wealth taxes, special wartime "excess profits" taxes and income tax rates on high-income earners. The rates and levels of each of these taxes were negotiated annually in the corporatist setting discussed above. And since it was wartime, the government had few problems convincing the participants that everyone had to sacrifice to keep Sweden strong and neutral.<sup>8</sup>

To the surprise and disappointment of many, taxes were not dramatically scaled back at the end of World War II. Although the temporary sales tax was abolished, there was a widespread understanding that for as long as the government shouldered its enormous war debts, taxes must remain high. The Swedish economy was also rapidly modernizing, which meant that the need for government spending would grow. At the same time, Swedish workers had begun to demand benefits like higher pensions and public health care. Against this backdrop, cutting

back taxes was simply not an option. But the Social Democrats also understood that taxing Swedish firms too heavily would kill the goose that laid the national income egg.<sup>9</sup> Fortunately, the new mass-based income tax generated enormous revenue growth. Effectively, then, the politics of taxation in Sweden (as elsewhere in the 1950s) became the politics of tax cuts. And as annual negotiations among labor, business and the state were institutionalized, potentially explosive tax, wage and public spending policies grew remarkably depoliticized.<sup>10</sup>

### *Consumption Taxes and the Welfare State*

The major exception to the depoliticization of fiscal policy occurred vis-à-vis consumption taxes. As the Swedish economy developed, the Social Democratic elite reasoned that they would not be able to depend forever on the "automatic" revenue growth generated by bracket creep and inflation because of the political backlash that would inevitably arise. At the same time, they fully believed that social justice required the construction of more comprehensive and better financed social welfare policies.

Finance Minister Gunnar Sträng concluded that if Swedish workers were going to have the social programs they wanted, they would have to pay for them through increased taxes. By this point, Ministry of Finance officials were committed to promoting Swedish capital in the international marketplace and saw no alternative but to revive the consumption taxes that they had earlier repealed. These elites understood that if the Swedish welfare state were to grow, Sweden would need to shift its tax burden towards consumption taxes and social insurance charges. The fundamental economic problem with direct income taxation was the same problem that had confronted consumption taxes several decades before, namely, that at a certain level you cannot increase rates and generate more revenues. If marginal tax rates on income were to

exceed 80 percent, for example, people would either stop working and/or investing or they would leave the country. Neither scenario would be good for the economy, jobs or the working class. In response to these fiscal realities, the Ministry of Finance concluded that they would have to reintroduce a consumption tax.<sup>11</sup> Consumption taxes were not preferred in this case because of their direct effect on consumption – rather they were seen as a way to raise revenue and this was deemed more important to the government than the short term dampening effects this tax would have on consumption.<sup>12</sup> Because the Social Democrats were philosophically committed to redistributive policies and because he had specifically argued that the SAP should *lower* taxes paid by the working classes, Sträng had to clear several hurdles before introducing a general consumption tax. Consumption or sales taxes are clearly regressive. Sträng had to convince his working-class base that *they* needed to pay higher taxes if they wanted to receive more social welfare programs in the future. Swedes, like citizens everywhere, believe that they pay too much in taxes and that the rich do not pay enough; if the government needs more money for social programs, why not tax the rich more? In public opinion polls taken at the time, it was clear that the majority of voters—and even stronger majorities of Social Democratic voters—opposed the sales tax.<sup>13</sup>

Sträng was undeterred by these political problems. He strongly believed that a large welfare state was in the interests of the working class and that the working class would have to pay for it if the capitalist economy were to remain internationally competitive. He launched a vigorous "education" campaign and personally attended local party and labor union meetings around the country in order to convince the Social Democratic base of the need for a new sales tax. In 1959, when he felt that he had generated sufficient support, he moved to introduce the new tax in parliament.

Once introduced, the government increased the 4.2 percent sales tax almost immediately. From the start, nearly all parties understood that the sales tax would become a major revenue source in the long run. Why? Because it is a "hidden tax" that is much easier to increase than income or profits taxes.

In 1970 the sales tax was converted to the Value Added Tax (VAT) for reasons of administrative efficiency. Whereas a sales tax is added at the point of retail sale, the VAT is integrated into the price of goods. Those involved understood that the move would make it even easier to increase this revenue source in the future. Consequently, the VAT has grown from 10.3 percent of total tax revenue in 1970 to 17.7 percent in 2001.<sup>14</sup> As in other European countries, it is a major source of income.

One should not assume that these tax increases have always been uncontroversial. In fact, each major attempt to increase the general consumption tax has met with considerable opposition from both the Left and the Right. The Left (especially the unions) has opposed increases on the grounds that the tax is regressive and places an uneven burden on those least able to pay. The Right has consistently opposed consumption tax increases not because of their effects on consumption but because these taxes generate revenue too easily. The Right (even in Sweden) is philosophically opposed to growing the welfare state: "hidden" taxes enable this growth. At each of these junctures, various Social Democratic governments have met the objections of the Left by balancing tax increases with increases in specific programs meant to offset the burden shouldered by the poor in society. To address the concerns of the Right, governments have simply argued that it is better for Swedish industry to increase taxes on consumption than to increase income and profits taxes, and that increasing the public debt is not an option.<sup>15</sup>

Of course, consumption taxes have only been one revenue instrument in the Swedish

government's arsenal. We have emphasized the consumption tax here, but many of the dynamics discussed above can be applied to income and social security taxes as well. Again, with the exception of profits taxes, most taxes in Sweden are high compared to those of other OECD nations. The bottom line is that Swedes believe that taxes should be used not as instruments of *direct* redistributive policy but rather as a means to generate revenues for social programs. Thus, all taxes should be levied in ways that generate the most amount of revenue with the least amount of social and economic disruption. The Swedish elite have concluded that to the extent the government wishes to intervene in society and the economy, it should do so through direct public spending. In short, it is more economically efficient and socially just to directly subsidize individuals' incomes than to create a distortional tax system.

#### *Sin taxes*

This is not the whole story. Even though the general trend has been towards a decline in taxes on specific goods and services, there has also been strong and consistent pressure to increase taxes on certain items—not so much for their revenues as for their regulatory effects on consumption. One of the curious effects of Sweden's system of proportional representation has been that the relatively smaller parties will sometimes have more political influence than one might expect given their small size. This is because their votes in parliament can be crucial to holding a coalition together. This has particularly been the case with respect to the traditional Farmer's Party (now Center Party), which has occasionally supported the Social Democrats in exchange for support from farmers and other groups that espouse traditional values. Many of the "traditionalists" in Scandinavia have been strongly anti-alcohol, and the government has accommodated their preferences by increasing taxes on alcohol. Clearly, these groups wanted to

increase taxes on alcohol (and tobacco) precisely because they hoped these taxes would discourage consumption. The Social Democrats, however, were less less concerned with these issues, but clearly enjoyed the revenues that these taxes would bring in.<sup>16</sup> Consequently, Sweden (along with its neighbor Norway) has long had the distinction of having the heaviest liquor taxes in the world. As anyone who has spent time in these countries knows, a bottle of vodka costing eight dollars in the United States costs over 40 dollars in Sweden. Over time, these taxes (and the state liquor stores that have a monopoly on liquor sales) have become important sources of revenue in their own right. In recent years, the Social Democrats have also accommodated the demands of younger “green” interests in society by introducing “green” carbon taxes. In 2001, excise taxes made up 3.5 percent of GDP (down from 6.7 percent of GDP in 1965) (see Table 2).

### *Summing Up*

With the exception of taxes on "sinful products," the politics of consumption taxes has not really been about consumption in Sweden—at least not directly. Instead, as we have tried to show, policy makers have thought of consumption taxes as a means to generate revenues which could then be redistributed back to taxpayers in the form of either direct or indirect subsidies. Although we have not seen specific discussions of these policies in such terms, the Swedish welfare state has effectively redistributed consumption. The system takes more from the rich than from the poor, since the rich consume more. Public spending, meanwhile, favors those at the lower end of the income scale in that the poor are provided with health care, public education and other “goods” that they cannot afford to “buy” themselves. There is, in short, a close and dynamic interrelationship among consumption, consumption taxes and social welfare benefits in

Sweden that will no doubt persist in the future.

### **Taxing Consumption in Japan**

Japan offers an interesting comparison to Sweden for a variety of reasons. Japan, like Sweden, has had a strong commitment to economic equality since World War II. It has also been dominated by a single political party for most of the past five decades. In terms of tax policy outcomes, however, Japan is the virtual opposite of Sweden. Japan has the lowest overall tax burden in the OECD today. It also has very low (regressive) consumption taxes and very high (progressive) corporate profits taxes compared to other advanced nations. This is surprising when we consider that Japan has pursued a policy which discouraged consumption in favor of stimulating household savings for most of the postwar period.<sup>17</sup> In the pages that follow we attempt to make sense of these curious facts.

As in Sweden, the key to understanding Japanese policy outcomes lies in the particular structure of the country's political institutions. First, under the old multi-member district system, the political balance of power in the Japanese Diet strongly favored the countryside in that rural electoral districts were given three to five seats without much correlation to population size. Rural areas tend to have far fewer citizens per district than urban centers. They also tend to have populations that are considerably older and poorer than those of cities and that are dominated by small and/or traditional producers.<sup>18</sup> Although the electoral reforms of 1994 redressed some of the worst of these inequities, the fundamental problem of under-representation of the cities persists today. This has contributed to a tax system that excessively favors rural citizens and small businesses.

Second, pre-1994 electoral rules encouraged politicians to run for office as semi-independent political entrepreneurs. In this system, politicians were primarily responsible to their home electoral districts rather than to the parties to which they nominally belonged. In many ways the electoral incentives facing Japanese politicians are quite similar to those facing American political elites.<sup>19</sup> Consequently, the parties (and the LDP in particular) were little more than groups of politicians who were committed more to the needs of their constituents than to specific ideologies or political agendas. In this ideological vacuum, national bureaucrats tended to assume ultimate responsibility for the details of policy making.

Japan's political institutions have had enormous consequences for consumption tax policy and the structure of the Japanese welfare state. Faced with these electoral realities and a broad national consensus in support of strong, successful industries, bureaucrats established a system that uses the economic wealth generated by Japan's successful international firms to subsidize the interests of the rural voters and small businessmen who make up the electoral core of the LDP.

Whereas the dominant political party in Sweden has been ideologically committed to promoting long-term social and economic equity, the LDP has been driven almost entirely by short-term electoral incentives. In both cases, bureaucrats (especially in the ministries of finance) have had to balance the demands of different interest groups as represented by elected politicians. In Sweden, bureaucrats have convinced politicians of the need to sacrifice short-term benefits in favor of longer-term structural change. Japanese officials, however, have been far less successful in this regard.

### *Japan's Postwar Tax Policy*

At the end of World War II, American reformers set out to "modernize" Japan's tax system. The Shoup Commission, led by US fiscal policy expert Carl Shoup, believed that social equity was necessary for the development of a successful democracy in Japan. The commission therefore pressed for the adoption of the "Ability to Pay" principle, in which those with higher incomes would pay higher rates of tax. The commission also believed that consumption taxes were inefficient and unfair and that they should be avoided in almost all circumstances.

The Japanese Ministry of Finance (MOF), which was searching for ways to fuel economic reconstruction, had other ideas. The MOF could not depend on income tax revenues given the poverty-stricken state of ordinary citizens, industrial stagnation, and the fact that a burgeoning black market made some incomes nearly impossible to pinpoint. Instead, the ministry believed that indirect taxes could provide government with a lucrative and immediate source of revenue.<sup>20</sup> In 1948, the MOF imposed a type of general sales tax called a "Transactions Tax." But the tax was soon scrapped following opposition from small firms that feared increased governmental interference in their affairs, and from the Shoup Commission itself, which viewed the tax as a violation of the equity principle.<sup>21</sup> After failing to introduce a broad-based consumption tax, the MOF increased taxes on specific goods—particularly luxury goods. In this way, it hoped to raise revenues while assuaging the Shoup Commission's commitment to progressive taxation.<sup>22</sup> But in incorporating new items into the tax net or increasing the rates of existing taxes, the MOF faced strong opposition from small business groups that feared an increase in their tax burdens. These groups successfully pressured their Diet representatives not to impose taxes on new items and not to increase tax rates.

While the MOF struggled to raise revenues over the next several years, politicians not

only opposed its efforts, but offered all manner of tax breaks to their constituents. They also demanded substantial spending increases—particularly for programs that would alleviate the economic and social plight of Japan's rural (and declining) communities. In 1957, finance officials attempted once again to introduce a general sales tax, only to meet with insurmountable resistance from small producers, retailers and rural interests.

A key point to note here is the lack of strong political leadership in Japan. No one has the ultimate political authority to balance costs against benefits for the budget as a whole. Nor does Japan have an equivalent to Sweden's Gunnar Sträng—someone who can bring diverse interests together and convince them of the need to make short-term sacrifices for long-term gains. As we have seen, Japanese politicians are primarily concerned about the immediate interests of their constituents and have almost no incentives to promote the longer-term interests of the nation as a whole. Although the MOF often took on this responsibility, its policy prescriptions were usually rejected by shortsighted elected officials.

The conflict between the MOF and the Diet was further complicated by the growing influence of the Ministry of International Trade and Industry (MITI) during the early postwar period. Not surprisingly, the MITI saw tax policy as a potent instrument for directing the economy. At first, the MITI attempted to manipulate taxes in order to promote targeted industries and firms early in their life cycles, and the MOF tolerated this strategy.<sup>23</sup> By the mid-1950s, however, its tax policies also embraced costly subsidies for ailing industries and regions.<sup>24</sup> Although the MOF had been increasingly dissatisfied with its rival's policies, the newly-formed Liberal Democratic Party endorsed the MITI's backward-looking approach to taxation since it reinforced the party's efforts to consolidate its base of support among farmers and the petite bourgeoisie.<sup>25</sup>

### *Economic Growth as a National Goal*

As Japanese administrators obsessed about economic growth during the 1950s and 1960s, ordinary consumers strived to assume American lifestyles. The media bombarded consumers with information about consumer durables such as refrigerators, vacuum cleaners, washing machines, television sets and cars. Domestic firms advertised these products with catch phrases like "The Three Sacred Treasures", "The First Year of the Electrification Era" and "The First Year of the Motorization Era." Consumers were encouraged through public education and tax incentives to save for major purchases of consumer goods.<sup>26</sup> At the same time, the government facilitated investment in plant and equipment by providing firms with low-interest loans funded by public savings, while mass production and rapid innovation led to "economies of scale" and large price cuts for durable goods.<sup>27</sup> As Garon points out in this volume, however, there is a trade off between savings and consumption. In this case, Japanese citizens were essentially told "Save now. But later."

As incomes rose and living standards improved, social class distinctions dissolved and the populace increasingly thought of itself as middle class. Rural areas suffered, however, as economic rationalization spurred a massive movement of labor away from agriculture and traditional industries towards the large, export-oriented manufacturing firms of large cities.<sup>28</sup> In its attempts to redistribute the benefits of increased national growth and shore up its traditional base of political support, the LDP expanded public works projects in rural districts. Travelers from crowded cities like Tokyo or Osaka are often surprised to find large but deserted highways, bridges and tunnels in Japan's outlying areas. These facilities were built not to alleviate any real traffic burden but to benefit Japan's powerful local construction industry and to secure

employment in rural areas by using tax revenues earmarked for road construction. There may be no better example of the inherent producer bias of Japanese public policy.

As the economy evolved and the LDP grappled with declining popular support levels, the party began to gradually incorporate workers into its base of political support. This pro-labor orientation was consolidated in the LDP's "Labor Charter (1966)," which promoted full employment, better working conditions and enhanced social welfare.<sup>29</sup> Later, the LDP's "Report on the Circumstances of the LDP (1969)" encouraged the party to engage labor in more dialogue. Accordingly, labor participation in the policy making process increased during the early 1970s and the unions grew more demanding of government.<sup>30</sup>

The 1973 oil crisis dramatically altered the focus of Japanese politics. For one thing, it transformed budgetary politics from a positive-sum to a zero-sum game. As a result, the LDP could no longer rely on automatic revenue growth—generated by bracket creep and economic expansion—to fund public programs. At the same time, unions and big business interests were starting to bristle after years of footing the national bill for social and economic subsidies. It is one thing to subsidize others while one is quickly becoming richer; it is quite another when subsidies force the payee to make sacrifices.

In response to this new political reality, big business and moderate labor unions joined forces to prevent further expansion of the welfare state.<sup>31</sup> During the early high growth years, many corporate managers had come to regard corporate taxes no so much as "expenses" as profit allotments earmarked for the advancement of the public good. But by the 1970s business interests feared that increased public sector growth would inevitably mean increased corporate taxes—even as profit margins fell. Thus, big business became deeply skeptical of public sector growth and demanded administrative reform and fiscal restraint.<sup>32</sup>

We saw in the Swedish case how labor union elites came to accept increases in their own tax burden *in exchange for* social welfare and social safety-net programs. In Japan, in part because private sector unions were organized inside companies (the so-called “enterprise unions”), workers in large successful firms were able to extract from their employers generous benefits, including lifetime employment, housing subsidies, health care, and bonus and retirement payments. The Japanese firm, in short, had become the employee's welfare state. Japanese big businesses gave their workers added incentives to place their trust in the company by linking salaries to total corporate sales.<sup>33</sup> For as long as big businesses continued to prosper, therefore, these workers neither needed nor wanted an expanded public welfare state. To complicate matters, labor was politically weak. Whereas Swedish unions were organized by craft at the national level and had strong confederal leadership, Japanese worker interests were divided along vertical lines. In Sweden, unions fought for the rights of all workers (and thus consumers) because they represented nearly all workers (and thus consumers). In Japan, union elites had strong incentives to negotiate for the interests of their workers primarily at the firm level. These structural differences encouraged Japanese labor to see its interests more narrowly than Swedish labor.

But the internationalization of the Japanese economy and the first oil crisis encouraged the private-sector union leaders (*Dômei*, the International Metalworkers' Federation- Japan Council (IMF-JC) and the Council for Policy Promotion Unions (CPPU)) to moderate their demands and to participate in political negotiations with the LDP. Their strategy was to maintain real wage levels through income tax cuts and an anti-inflation policy, and they were willing to restrain their nominal wage increases to ensure employment. Public sector unions (*Sōhyō*), however, were not so accommodating. Since they did not feel the pressures of international

competition, they advocated high wage increases and demanded improvements in welfare policy. Since the mid-1970s, however, the once-strong leftist union leadership of *Sōhyō* has withered away and has been taken over by the private-sector union leaders because of both external and internal factors of labor movement.<sup>34</sup> Since Japanese workers employed in large, successful firms received higher wages than those outside the economically successful "core," they paid higher taxes. The government then redistributed this income to small business owners, farmers and rural workers. The inequity of this situation was exacerbated by the "open secret" that wealthy farmers and small business owners rarely paid taxes. Urban workers soon resented what they perceived to be an unfair tax system. Whereas Swedish unions regarded public spending as a mechanism for increasing the consumption levels of the workers and the poor, Japanese unions saw public spending as subsidies to the unproductive (but politically powerful) rural and small business interests.

At this time, the LDP's traditional supporters were facing international pressures to liberalize the domestic economy, including the agricultural and large retail sectors. The LDP had no choice but to respond to such pressures, and tried to secure the support of private sector unions as it did so. This enhanced the labor-management coalition's influence, spurred the decline of the left within the labor movement, and helped weaken opposition to administrative reform from both the bureaucracy and *Sōhyō*. It was also at this time that Prime Minister Nakasone put forth his own proposals for administrative reform, first as the minister of the Administrative Management Agency and then as prime minister.<sup>35</sup> Among his objectives was the introduction of a consumption tax. This proved to be an onerous task, however, given the conflicting demands of the LDP's traditional supporters, on the one hand, and the labor-management coalition, on the other.

*The Long Road to a Consumption Tax (VAT)*

In the context of labor's resistance to higher income taxes, MOF officials increased their efforts during the 1970s to introduce general consumption taxes that would be more evenly distributed across society. Like their Swedish counterparts, they recognized that consumption taxes were necessary components of a more stable financing system in the context of increasing demands for government spending. Unlike the Swedes, however, Japanese officials could not find a strong political ally to help fight for this new tax. Instead, they faced resistance from small businesses, workers, middle-income housewives and the politicians who represented them.<sup>36</sup> Women's groups were particularly vocal in their opposition to the consumption tax, arguing that it was unfair to tax items that consumers needed and used. It would be far more equitable, they believed, to tax luxuries while leaving the ordinary consumer's hard-earned cash alone.<sup>37</sup>

Despite the public's opposition, MOF officials intensified their pressure on LDP elites to introduce a general consumption tax. They eventually convinced Prime Minister Ohira Masayoshi, himself a former MOF official, to sponsor a general consumption tax proposal in the months leading up to the 1979 general election. This was a big mistake for the LDP. Public opposition to the tax swelled immediately, the LDP did poorly in the election, and a general consumption tax was shelved. The MOF then turned its attention to spending cuts—at least for the time being.

Japan clearly faced a trilemma: The fiscal realities of a maturing welfare state conflicted with the political resistance to increased income and profits taxes, which in turn conflicted with the Diet's proclivity to increase subsidies for Japan's least productive sectors and regions. To

cope with this trilemma, the MOF tried to change the understanding that commodity taxes are a kind of luxury tax by broadening the list of taxable items to include word processors, fax machines, copy machines, personal computers, and other office equipment. Despite these changes, its attempt to introduce such a tax in 1984 failed on the heels of strong opposition from related industries and their politicians. And so, the MOF redoubled its efforts to introduce the broad-based consumption tax, believing that once introduced it could be increased without too much opposition from industry and politicians.<sup>38</sup>

In defiance of his promise during the 1986 election not to introduce a general sales tax, Prime Minister Nakasone succumbed to pressure from the MOF and proposed a major tax reform package that offered income tax cuts in exchange for a general sales tax. Fearing that the MOF would increase the profits tax to finance income tax cuts (as it did in 1984), big business supported the proposal in the hopes of avoiding possible tax hikes in the future.<sup>39</sup> In the face of strong opposition from the opposition parties and a voter backlash in local elections, however, all seven of Nakasone's bills failed to pass.

In the midst of a mushrooming budget deficit, MOF officials grew increasingly frustrated by the Diet's inability to exercise fiscal discipline and continued to press for a broad-based (universal) consumption tax. Eventually, they convinced key LDP members that the current tax system, which relied heavily on income taxes, could not be sustained given Japan's rapidly ageing society. Japan, they argued, had to make a very difficult choice: introduce a consumption tax or scale back the social security system—a system that was of particular benefit to the LDP's more traditional constituents.

The MOF's tax crusade touched the population's heartstrings. By this point, most middle-class consumers were feeling anxious about their retirements. A 1988 NHK opinion

survey revealed that approximately half the population agreed that a general consumption tax was necessary given Japan's demographic circumstances. Respondents also stated that correcting inequities in the tax system should be settled before a consumption tax was introduced.<sup>40</sup>

Prime Minister Takeshita Noboru, a former LDP tax expert with a history of cooperating with MOF officials, finally agreed in 1988 to introduce a three percent consumption tax, effective in April 1989. Unfortunately, the proposed tax package offered income tax cuts that surpassed in value the projected returns from the consumption tax. The package also increased public spending for the poor and the elderly. These two items were designed to alleviate the regressive nature of the consumption tax and to obtain the support of the two centrist parties, the Komeitô and the Democratic Socialist Party.<sup>41</sup> The bill also contained loopholes for small businesses that simply exacerbated the inequity problem. Since small companies would be permitted to pocket taxes collected from consumers, the tax effectively functioned as a direct subsidy of small business by consumers. Not surprisingly, consumers—led by the housewives associations—vehemently opposed the new tax.<sup>42</sup>

The political struggle surrounding the final stages of the decision-making process intensified as thousands of consumers took to the streets in protest. Despite these developments, the Diet passed the tax package. Takeshita, who was also under siege in the wake of the Recruit Stocks-for-Favors Scandal, was forced to resign in April 1989. While many agreed with the principle of a consumption tax *in order to finance a more secure retirement system in the future*, few voters liked what the Diet had passed. As before, salarymen and their families would be subsidizing small companies, farmers and, in this case, the self-employed. They were furious. In July 1989, the LDP was decimated in the upper-house election.

By the early 1990s, Japan was in political and economic crisis. The enormous economic "bubble " had finally burst and the economy needed restructuring. To combat the recession, the government introduced a series of income and corporate tax cuts and increased public works spending. Then, in 1994, Prime Minister Hosokawa Morihiro proposed raising the consumption tax rate to seven percent and renaming it the "National Welfare Tax." Revealed to the public at a spur-of-the-moment midnight press conference, the proposal accommodated the demands of big business groups, the MOF, and the MITI by exchanging income and corporate tax cuts for consumption tax increases. But as a result of vehement opposition from the Social Democratic Party of Japan (SDPJ, formerly the Japan Socialist Party), which threatened to leave the coalition if the increase were introduced, an embarrassed Hosokawa was forced to withdraw the proposal. In keeping with the demands of small business groups, the SDPJ supported income and corporate tax cuts financed by public debt, rather than the consumption tax.<sup>43</sup>

But the pressure to restructure the Japanese tax system was still on. In 1995 Hosokawa's successor, Prime Minister Murayama Tomiichi of the SDPJ, introduced income tax cuts and, in a complete reversal of his party's previous stance on the issue, raised the consumption tax from three to five percent, effective in 1997. The government had originally intended to raise the consumption tax to seven percent, but this was scaled back in response to intense opposition from consumers and small businesses. One percent of the consumption tax was to be automatically transferred to local government authorities as part of a general devolution of the MOF's power.

When all was said and done, the government increased the general consumption tax not to finance the welfare state but to compensate for income and corporate tax cuts.<sup>44</sup> The government had embraced the neo-liberal economic philosophy that tax cuts for business and

high-income earners would stimulate the economy. But the strategy backfired. Fearing that the government could not be trusted with their retirement funds, consumers began saving more and spending less. Meanwhile, tax revenues continued to decline, the budget deficit soared, and the economy slipped into recession.<sup>45</sup>

### Consumption Taxes and the Future of the Japanese Welfare State

For over a decade, Japanese finance officials have continued to press for increases in the consumption tax. But Diet members have refused to comply for fear of further alienating Japanese consumers. There are signs, however, that these political dynamics may be changing. Today, the government, along with the Government Tax Commission, is once again thinking about raising the consumption tax. Faced with a budget deficit of over 6 percent of GDP and a total government debt of nearly 170 percent of GDP, it goes without saying that Japan is in dire need of new revenue sources.<sup>46</sup> Fortunately, the government now has support for a consumption tax hike not only from the MOF, but also *Keidanren*, Japan's largest and most influential business federation, and *Rengô*, the leading labor federation. Determined to shift the burden of welfare policy from the private sector to the public sector, *Keidanren* supports consumption tax hikes earmarked for pension benefits. *Rengô* supports consumption tax increases because it wants to keep pension benefits at current levels but is opposed to increases in social security and/or income tax increases. MOF, for its own part, continues to insist on securing stable general revenues by increasing the consumption tax or, failing that, lowering the minimum income levels subject to income tax. Leaders from *Keidanren* and *Rengô* recently asked Prime Minister Koizumi Jun'ichirô to launch discussions with business and labor leaders about the future of the welfare state and the tax system, but no steps have been taken toward that goal as of

this writing.

Despite these positive changes, Japan still lacks the political advantages that Sweden enjoyed four decades ago. Swedish elites operated within a political-economic climate of high growth and confidence in government and within a set of political institutions that facilitated conciliation and compromise. Conversely, while all indicators suggest that the Japanese economy will improve in years to come, there is no reason to expect that the high growth rates of the 1960s will return. More important, the government does not have the support of its citizens; ordinary Japanese continue to believe that political elites are untrustworthy and that the political process is rigged in favor of producers. Finally, despite the electoral and political reforms that were introduced a decade ago and the reorganization of government ministries and agencies in 2001, those favoring comprehensive economic and fiscal reform, including Koizumi, do not have the wherewithal to build a political coalition in support of change. For as long as these conditions persist, it is unlikely that fundamental tax reform will occur anytime soon.

## **Conclusion**

In this chapter, we have demonstrated that consumption tax policies in Sweden and Japan have followed quite different patterns. By the mid-20th century in Sweden, the Social Democratic Party concluded that it should defy the Left's historic opposition to regressive taxation and raise consumption taxes in order to finance a generous welfare state. An egalitarian society, they believed, could be had through an extensive social welfare system, while the regressive effects of consumption taxes could be overcome by direct public subsidies to those in need. Although Swedes did not speak of it in these terms, the result of this policy was a positive

redistribution of consumption. In Japan, by contrast, the conservative government has been unable and/or unwilling—at least until recently—to increase consumption taxes over the opposition of consumers and small producers. As a result, the government has failed to raise the revenue needed to fund an expanded social welfare state. The weakness of the social welfare state has in turn contributed to consumers' distrust of the government's ability to use their tax money wisely as well as deep suspicion of any tax changes that might increase the burden on lower income groups.

In contrast to Sweden, Japanese consumption taxes have been used to shape economic outcomes in favor of producer groups rather than to improve the welfare of ordinary consumers. And to the extent that consumption has been redistributed, it has been through a net transfer of income and wealth from the productive sectors of the economy to the less competitive small business and agricultural sectors. The fiscal consequences of these political circumstances are clear. As Japanese society ages, more and more individuals will stop paying income taxes and place increasing demands on the welfare state. Without major new sources of revenue, Japan's fiscal future looks grim indeed.

Our case studies show quite clearly that while these taxes clearly have effects on consumption behavior, they have rarely been effectively used in this regard. Instead these policies are more accurately seen as the product of a broader set of political and economic agendas.

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<sup>1</sup> OECD, *Taxing Consumption* (Paris: OECD, 1988), 22-25.

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- <sup>2</sup> Vito Tanzi, *"Globalization and the Future of Social Protection"*, January 2000, International Monetary Fund, (2000), 1-22.
- <sup>3</sup> Personal income tax accounted for an average of 26.5% of total tax revenue in 2001. Corporate profits taxes accounted for 9.4% and social security charges an average of 25.1%. OECD, *Revenue Statistics, 1965-2002* (Paris: OECD, 2003), Tables 11, 13 and 15.
- <sup>4</sup> Sheldon Garon and Mike Mochizuki, "Negotiating Social Contracts," in Andrew Gordon, ed., *Postwar Japan as History* (Berkeley: University of California Press, 1993).
- <sup>5</sup> Ernst Wigforss, *"Skrifter and Urval, Vol. III, Financeministern" (Writings and Selections, Volume III, The Finance Ministry)*, Tiden, (1980), .
- <sup>6</sup> Olof Ruin, "Patterns of government composition in multi-party systems: the case of Sweden", *Scandinavian Political Studies* 4, (1969), 71-87.
- <sup>7</sup> Sven Steinmo, *Taxation and Democracy* (New Haven: Yale University Press, 1993), 179-184.
- <sup>8</sup> Enrique Rodriguez, *"Offentlig inkomstexpansion (The expansion of state revenues)"*, Gleerup, (1980), .
- <sup>9</sup> Sven Steinmo, "So what's wrong with tax expenditures: a re-evaluation based on Swedish experience", *Journal of Public Budgeting and Finance* (1986), .
- <sup>10</sup> Lars Magnusson, *"Sveriges ekonomiska historia"(Swedish Economic History)*, Tiden/Athena, (1997), 526 s..
- <sup>11</sup> Enrique Rodriguez, *"Den Svenska historien (Swedish tax history)"*, Liber Laromedel, (1981), .
- <sup>12</sup> Donald Hancock, *"Sweden: the politics of post-industrial change"*, The Dryden Press, (1972), .
- <sup>13</sup> Bo Särilvik, "Party Politics and Electoral Opinion Formation," *Scandinavian Political Studies*, vol.2 (1967):171.

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<sup>14</sup> OECD, *Revenue Statistics, 1965-2002*, Table 29.

<sup>15</sup> Thomas Frazen, "Skatternas effect pa arbetsviljan (Taxation's effect on the willingness to work)", *Oversyn av skatte systemet (Overview of the tax system)* 91, (1977), 357-396.

<sup>16</sup> Enrique Rodriguez, "Offentlig inkomstexpansion (The expansion of state revenues)", Gleerup, (1980), .

<sup>17</sup> See Garon's chapter in this volume.

<sup>18</sup> Andrew DeWit and Sven Steinmo, "Policy Vs. Rhetoric: The Political Economy of Taxation and Redistribution in Japan," *Social Science Japan Journal* 5, no. 2 (2002):159-162.

<sup>19</sup> See Cohen chapter in this volume.

<sup>20</sup> Kurt Steiner, *Local Government in Japan*, (Stanford: Stanford University Press, 1965), 265; Hiromitsu Ishi, *The Japanese Tax System*, 3<sup>rd</sup> ed. (Oxford and New York: Clarendon Press, 2001), 264.

<sup>21</sup> See General Headquarters Supreme Commander for the Allied Powers, *Report on Japanese Taxation by Shoup Mission*, vol.2 (September 1949):166; Miyajima Hiroshi, "Kansetsu-zei to fukakachi-zei" [Indirect Taxes and Value Added Tax], Nihon sozei kenkyû kyôkai, ed., *Shaupu kankoku to wagakuni no zeisei* [The Shoup Report and the Japanese Tax System] (Tokyo: Nihon sozei kenkyû kyôkai 1982), 280-281.

<sup>22</sup> For a discussion of this era in Japanese public finance, see Yoshida Shintaô, "Zeisei kaikaku to kansetsu zei" [Tax Reform and Indirect Taxes], *Keizaigaku ronshû* 19, no. 6-7 (1950):94-108; Takeo Suzuki, *Gendai nihon zaiseishi* [A History of Public Finance in Contemporary Japan] (Tokyo: Tokyo daigaku shuppankai, 1960),4:372-373; Takagi Katsuichi, "Shaupu kankaku to kansetsu zei" [The Shoup Recommendations and Indirect Taxes], in Ide Fumio, Obuchi Toshio,

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Chôgorô Ishimura, and Nakamura Kazuo, eds., *Zaisei no genri to genjitsu* [The Principle and Practice of Public Finance] (Tokyo: Chikura Shobô, 1986), 182-192.

<sup>23</sup> See Yoshida Shintarô, “Shaupu chihô zeisei no seiritu to kaitai” [The Establishment and Dismantlement of the Shoup Local Tax System], in Fujita Takeo kyôjû kanreki kinen ronshû kankô kai, ed., *Sengo chihô zaisei no tenkai* [The Development of Postwar Local Public Finance] (Tokyo: Nihon hyôronsha, 1968), 116, 123.

<sup>24</sup> See Nobuhiro Hiwatari, *Organized Markets and the Restrained State: Institutions for Industrial Policy, Incomes Coordination, and Political Quiescence in Postwar Japan* (PhD Dissertation, University of California, Berkeley, 1989), 67-68; Noguchi Yukio, *1940nen taisei: saraba senji keizai* [The 1940 Regime: Good-Bye War Economy], 2<sup>nd</sup> ed. (Tokyo: Tôyô keizai shinpôsha, 2002), 117-122.

<sup>25</sup> Garon and Mochizuki, “Negotiating Social Contracts,” 152.

<sup>26</sup> Sheldon Garon, *Molding Japanese Minds: The State in Everyday Life* (Princeton: Princeton University Press, 1997), 154-157.

<sup>27</sup> Maki Atsushi, *Nihonjin no shôhi kôdô* [Japanese Consumer Behavior] (Tokyo: Chikuma shinsho, 1998), 78-82.

<sup>28</sup> Yoshikawa Hiroshi, *Kôdo seichô: Nihon wo kaeta 6,000 nichi* [High Economic Growth: 6,000 Days That Changed Japan] (Tokyo: Yomiuri shinbunsha, 1997), 184-185.

<sup>29</sup> Garon and Mochizuki, “Negotiating Social Contracts,” 160.

<sup>30</sup> Hiwatari, *Organized Markets and the Restrained State*, 54; Ikuo Kume, *Disparaged Success: Labor Politics in Postwar Japan* (Ithaca and London: Cornell University Press, 1998), 116; Yohikawa, *Kôdob seichô*, 185.

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<sup>31</sup> Kume Ikuo, *Nihongata rôshi kankei no seikô* [The Success of Japanese-Style Labor-Management Relations] (Tokyo: Yûhikaku, 1998), 190-195; Ito Mitsutoshi, “Daikigyô rôshirengô no keisei” [The Formation of the Business-Labor Alliance], *Leviathan 2* (Spring 1988):59-66.

<sup>32</sup> Ito, “Daikigyô rôshirengô no keisei,” 61-62.

<sup>33</sup> Hiwatari, *Organized Markets and the Restrained State*, 40-43.

<sup>34</sup> In addition to external factors of gaining power of centrist parties and the disillusionment with socialism, there were internal changes in labor movement. The new issues of structurally depressed industries, tax cuts, and the like which could not be dissolved at the company level required unions to participate in political negotiations with the LDP. *Sôhyô* was strongly restricted its bargaining with the government by criticism from the leftist unions, whereas the private-sector union leaders did not have internal opposition against pursuing policy benefits within the existing political system as they have not had such leftist party. In addition, they could develop this strategy relatively easily because they had experiences of the participation of labor in the management decision making within the company in the 1960s. As the private-sector unions gained considerable policy victories of tax cuts, anti-inflationary policies and securing jobs, they succeeded in strengthening their position in the labor movement. See Tsujinaka Yutaka, “Kyuchi ni tatsu rôdô no seisakukettei [Policy decision by labor in crisis],” in Nakano Minoru, eds., *Nihongata seisakukettei no henyô* [Transformation of Japanese policymaking] (Tokyo: Tôyô keiazai Shinpôsha, 1986), 289-290, Kume, *Disparaged Success*, 141-142.

<sup>35</sup> Kume, *Disparaged Success*, 192-194, 203-204.

<sup>36</sup> For the best discussion of the politics of the VAT in this era, see Junko Kato, *The Problem of*

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*Bureaucratic Rationality: Tax Politics in Japan* (Princeton: Princeton University Press, 1994).

See also Junko Kato, *Regressive Taxation and the Welfare State* (New York: Cambridge University Press, 2003).

<sup>37</sup> Ozaki Mamoru, *Zaisei seisaku e no shiten* [A Viewpoint to Fiscal Policy], (Tokyo: Okura zaimu kyôkai, 2001), 309-311.

<sup>38</sup> Kishiro Yasuyuki, *Jimintô zaisei chôsakai* [The LDP's Tax Commission] (Tokyo: Tôyô keizai shimpôsha, 1985), 1-9.

<sup>39</sup> Otani Hirochika, "Atsuryoku dantai no taiô [The Responses of Pressure Groups]," in Uchida Kenzô, Kanazashi Maso, and Fukuoka Masayoshi, eds., *Zaisei kaikaku wo meguru seiji rikigaku* [Power Politics Over Tax Reform] (Tokyo: Chûô kôronsha, 1988), 102-103.

<sup>40</sup> Okuma Sadao, "Fukôhei zesei/shôhizei ni kibishii hyôka: zaisei kaikaku chôsa kara" [Criticisms of Policies for Correcting Inequitable Taxes and the Consumption Tax], *Hôsô kenkyû to chôsa* 38, no.9 (September 1988):9.

<sup>41</sup> Mizuno Masaru, *Shûzei kyokuchô no 1,300 nichi* [1,300 Days as Chief of the Tax Bureau] (Tokyo: Okura zaimu kyôkai, 1993), 261-367.

<sup>42</sup> Yokoyama Shigeru and Kawano Hiraku, "Jimin antei tasû/ shakai yakushin no haikei; dai 39kai shûgiin senkyo" [Background of the LDP's Stable Majority and the JSP's Progress: From the Survey of the 39th Lower House Election], *Hôsô kenkyû to chôsa* 40, no.5 (May 1990):9.

<sup>43</sup> Hiwatari Nobuhiro, "Zaisei seisaku" [Fiscal Policy], in Hiwatari Nobuhiro and Miura Mari, eds., *Ryûdôki no nihon seiji* [Japanese Politics in the Era of Political Mobility] (Tokyo: Tokyo daigaku shuppankai, 2002), 208-209.

<sup>44</sup> Unlike their Swedish counterparts, Japanese governments have consistently increased taxes on

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*sake* and tobacco not so much for their regulatory effects on consumption as for their revenues.

<sup>45</sup> See Kato, *Regressive Taxation and the Welfare State*, 181.

<sup>46</sup> Koizumi has promised voters that he will not increase the VAT for as long as he is prime minister. Many believe, however, that the VAT will be substantially increased after Koizumi leaves office.