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Taxing Problems; Japan

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ABSTRACT

Most Japanese have long given up waiting for Junichiro Koizumi to achieve anything bold. On July 9th, parliament made a mockery of yet another of the prime minister's cherished causes, by passing a version of his postal-reform plans that fell far short of encouraging private competition.

FULL TEXT

Koizumi goes into battle again

MOST Japanese have long given up waiting for Junichiro Koizumi to achieve anything bold. On July 9th, parliament made a mockery of yet another of the prime minister's cherished causes, by passing a version of his postal-reform plans that fell far short of encouraging private competition. The mighty post office has resisted a necessary shake-up.

But the compromises and failures have not stopped Mr Koizumi and his team from churning out other reform ideas, while billing each new proposal as another sweeping change. The prime minister's latest scheme for revamping the economy, unveiled as part of a broader economic plan last month, is tax reform.

Mr Koizumi hopes to have detailed proposals ready for parliament by the end of this year. But first he must resolve disputes between the tax committee of his Liberal Democratic Party (LDP), which wants to grant new tax breaks for corporate backers, and the finance ministry, which is keen to shore up revenues in the face of rising debt and ratings downgrades. Mr Koizumi has braced himself for these battles by proposing to do a little to meet the demands of each advisory group.

He does want to grant more tax breaks to Japanese businesses, especially the precious few that invest a lot and make a good profit. At 3.4% of GDP, corporate taxes yield revenues that are close to the OECD average. But because many Japanese companies report little or no profit, the government is getting its take from imposing high taxation rates on a relatively small number of successful firms.

Heizo Takenaka, Mr Koizumi's economy minister, reckons that cuts in tax rates for such firms would lower revenues by up to Yen1.6 trillion (\$13.5 billion). Given Japan's public-debt worries, the government must offset this somehow, but despite Mr Koizumi's push to rein in public works, the prospect for filling the gap with spending cuts are "limited", the minister says. The plan calls for the cuts to be offset by higher taxes on unprofitable companies and households.

Some 70% of Japanese companies, mostly small firms, at present pay no tax. Although technically unprofitable, many firms shield their income by means of generous loopholes. Mr Koizumi aims to tax such things as rents, wages and other expenses. This would eliminate many loopholes, stress economic activity over profits, and generally put a degree of pressure on inefficient companies.

Personal income taxes in Japan, at 4.8% of GDP, are less than half the OECD average (the government gets

relatively more revenue from taxes raised to provide social security services). Although Japan's top tax rates are stiff, lower-income households fare relatively well. Mr Koizumi would like to bring down the thresholds for the lower tax brackets. He would also like to overhaul inheritance taxes, which keep savings trapped in the housing sector by discouraging families from selling.

Mr Koizumi's supporters liken these efforts to those of Margaret Thatcher and Ronald Reagan, on the ground that the tax changes will boost productivity. Though such comparisons exaggerate the scope of the plan, the prime minister's proposals would on the whole promote more efficiency. Allowing breaks on investment might not be terribly clever, given that Japanese managers tend to over-invest and ignore profitability. But reducing the burden on vibrant firms, while making life tougher on the zombies, is nevertheless a step in the right direction. Or it would be, if he actually does it. If he cannot defeat his opponents in the LDP on other issues, can Mr Koizumi really take on working-class families and small firms?

DETAILS

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