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Consumption tax decision sets stage for fall fireworks

Key takeaways

- Prime Minister Takaichi Sanae announced her intention to submit a bill mandating a reduction of the consumption tax on foodstuffs to 1% for two years during the autumn Diet session.
- Takaichi decided on the tax cut despite the inability of the National Conference on Social Security, established by the prime minister to build a multi-party consensus around the proposal.
- The tax cut has attracted criticism from both opposition parties and Liberal Democratic Party (LDP) lawmakers, concerned about its impact on the government's finances amidst Takaichi's fiscal plans, ensuring that fiscal policy will be at the center of Diet deliberations during the forthcoming session.

Prime Minister Takaichi Sanae announced on Thursday, 30 July that her government will submit legislation implementing a consumption tax cut during the autumn extraordinary session of the Diet. She has decided to move forward despite the inability of the National Conference on Social Security to reach a multi-party agreement on the Liberal Democratic Party's (LDP) proposal to reduce the consumption tax on foodstuffs to 1% for two years while providing additional subsidies to low-income households for the remaining 1% rate.

This decision does not come as a surprise. The prime minister had given no indication that she was prepared to walk back her commitment to the tax cut, described as her "long-cherished wish." Given the strength of her commitment to this plan, it would have been difficult for Takaichi to shelve this proposal in favorable political conditions. Now, with her approval ratings declining sharply, the political costs could be even steeper, and if anything, the prime minister likely views delivering on this campaign pledge as an effective means of reviving her flagging fortunes. As Takaichi said in her press conference Thursday announcing the decision to proceed, “We take the public’s high expectations for the realization of [the tax cut] seriously.”

Nevertheless, in contrast to earlier this year, when virtually every party was competing to offer some kind of consumption tax cut proposal during the general election campaign, the political environment around the tax cut has changed, as suggested by the national conference’s failure to reach a consensus. In general, recent polls have shown that public support for the final version of the consumption tax cut proposal is lower than it had been in late 2025 and early 2026, when there were solid majorities in favor of either temporarily or permanently cutting the tax on foodstuffs. While polls show that pluralities continue to favor the tax cut, the margin between those in favor and those opposed has narrowed. Whether as a cause or an effect of the shift in public opinion, opposition parties are now opposed to the tax cut. In a recent Diet debate, Democratic Party for the People (DPFP) leader Tamaki Yūichirō, whose party ran on an across-the-board consumption tax cut to 5%, implored the prime minister to be open to changing her mind in response to what he has called “a decidedly inflationary environment.” Furukawa Motohisa, who represented the DPFP in negotiations on the national conference, warned that the prime minister could be inviting something “worse than the Truss shock” in a television appearance Thursday.

This decision is the latest example of the prime minister’s talking about wanting to build multi-party consensus only to proceed with her own priorities when negotiations failed to deliver the outcome she wanted, which could influence future negotiations with opposition parties, still necessary given the government’s lack of an upper house majority. Takaichi’s decision may also have foreclosed the possibility of bringing the DPFP into the coalition; Tamaki said Thursday that Takaichi’s decision revealed that there is a significant gap on fundamental issues between the DPFP and the LDP.

Unease about the consumption tax cut extends to the LDP itself, where fiscal hawks have been increasingly vocal about the risks of Takaichi’s tax plan, given that the government has not outlined how it will pay for the JPY 10tn in foregone revenue over the two years the tax would be in effect. As former foreign minister Iwaya Takeshi suggested at a meeting of the LDP’s general affairs council Wednesday to discuss the tax plan, there is a risk that if the tax cut erodes market confidence in the government’s finances it could lead to further yen weakness, exacerbating the inflation that the government is pursuing the tax cut to alleviate. In her Thursday press conference, Takaichi addressed this issue head on, suggesting that there should be adequate offsetting revenue from non-tax sources – including the Foreign Exchange Fund Special Account (FEFSA) and payments from independent administrative corporations – that will forestall the need for bond issuance. Meanwhile, she promised that the consumption tax on foodstuffs will snap back to the current 8%, signaling that the restoration of current rates will be automatic rather than contingent on economic conditions. The tax cut, she has argued, will be a “bridge” to the introduction of an earned income tax credit in two years. (Of course, the opposition has also argued that for the many who will not benefit from the new tax credit the reversion to 8% will effectively be a tax hike.) Takaichi’s tax cut decision could also influence the forthcoming cabinet reshuffle. While

Takaichi may seek to recruit more loyalists whom she can rely on to sell the bill, doing so could leave her fiscal hawk rivals out of office and free to criticize her policies. For example, Kōno Tarō, a once and possibly future leadership contender, openly announced his opposition to the tax cut on Thursday. Obuchi Yūko's highly publicized departure from the LDP tax commission to protest the tax cut likewise widens the fiscal policy cleavage within the party.

The upshot is that by deciding to proceed with this tax cut, Prime Minister Takaichi has raised the stakes for the autumn Diet session. The consumption tax cut will be the legislative centerpiece of the session, and, having disregarded the deliberations of the national conference, she will still have to find an opposition party willing to smooth the bill's passage through the upper house. In the meantime, this bill will effectively ensure that Takaichi's approach to fiscal policy will be the central issue of parliamentary deliberations, with interest rate and exchange rate movements, the Bank of Japan's (BOJ) policymaking, and the drafting process for Takaichi's revolutionary FY2027 budget likely providing the government's critics with additional grist for their opposition to the tax cut. In short, as suggested previously, Takaichi may get the consumption tax cut – which she pushed the LDP to campaign on as part of a populist bidding war with other parties – but getting it implemented may require significantly more political capital than the prime minister anticipated when she embraced it as the centerpiece of her government's efforts to provide relief from the rising cost of living.

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