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LDP signs off on tax cut, but broader fight is just beginning

Key takeaways

- With the Liberal Democratic Party's (LDP) formal approval, the Takaichi government has approved a policy of cutting the consumption tax on foodstuffs.
- At every step in the approval process, the proposal faced open opposition from LDP fiscal hawks and opposition parties have promised to fight the plan in the Diet, suggesting that opposition to Prime Minister Takaichi Sanae's fiscal plans is only growing.
- The intervention with the United States to strengthen the yen may already be backfiring on Takaichi, insofar as it has led to greater domestic and international scrutiny of the impact that the consumption tax cut and other Takaichi policies could have on the yen's value.

The Takaichi cabinet approved on 5 August a basic policy of cutting the consumption tax on foodstuffs to 1% effective April 2027 as a bridge to the introduction of a refundable tax credit in 2029. The cabinet's approval will set the process of preparing legislation for submission to the Diet during the forthcoming extraordinary session.

However, while the cabinet's approval positions Prime Minister Takaichi Sanae to realize a key plank of her electoral platform and deliver a benefit she argues will help households struggling with rising costs, the process of securing the Liberal Democratic Party's (LDP) approval for this policy – as well as the response of opposition parties to the policy – affirms that delivering the first-ever consumption tax reduction could come at an extraordinary political cost for the prime minister.

The political costs were apparent immediately after she announced on 30 July that her government would pursue the tax cut even without a consensus in the National Conference on Social Security. Although the LDP ultimately signed off on the tax cut, the party's decision came only after dissent within the LDP's tax commission and at a joint meeting of the tax commission and the social security committee forced the debate to continue into this week. Onodera Itsunori, head of the tax commission, admitted that a majority of the commission was against the tax cut. Then, when the LDP's general affairs council, which must approve all government policies unanimously, voted to approve the tax cut, nine of twenty-five council members skipped the vote, including former tax commission chair Miyazawa Yōichi, effectively a protest vote given the council's unanimity rules. (Blocking the plan would have effectively been an act of rebellion that even the dissenters were not prepared to take.) In short, the LDP's fiscal hawks are increasingly comfortable voicing their discomfort with the prime minister's approach to fiscal policy.

The extent of dissension within the LDP may encourage the opposition parties to resist more strenuously. Democratic Party for the People (DPFP) leader Tamaki Yūichirō has already said that the tax cut should be the central issue of the forthcoming legislative session. No opposition party has signaled that it is prepared to negotiate with, let alone support the tax cut, suggesting that its passage through the upper house is far from guaranteed. The government could still pass the tax cut by having the lower house overrule the upper house, but the opposition parties will be incentivized to prolong debate, hold off a vote, and make the prime minister address the many questions critics have raised about her plan. She will likely have to do so even as senior members of her own party – including former prime ministers and cabinet ministers – openly question the wisdom of the policy.

The timing of the consumption tax decision, coming on the heels of the joint US-Japan foreign exchange intervention and increasing US scrutiny of Japan's macroeconomic policies has given Takaichi's opponents within the LDP and the opposition parties significantly more ammunition in challenging the prime minister. Critics have been quick to note that insofar as the tax cut could erode confidence in the yen and the Japanese government bonds, it could have effects that make conditions worse for Japanese households. The prime minister has repeated her promise that the tax cut will not be funded with new bond issuance, but the government has still not provided details on how to fund the tax cut and Finance Minister Katayama Satsuki has said that a plan for funding the tax cut will not be provided until mid-December as part of broader budget deliberations.

The upshot is that fiscal policy is emerging as Takaichi's biggest vulnerability heading into the final months of the year. With the government's still having to finalize the terms of the tax cut legislation and prepare the 2027 budget – in negotiation with the LDP – the prime minister has made her approach to fiscal policy the overriding political issue for the foreseeable future – and her government's decision to work with the US to strengthen the yen has only intensified the scrutiny of her fiscal policies as US authorities have made little secret of their desire to see Japan pursue policies that could reverse the structural decline of the yen. While some sympathetic news outlets have suggested that Takaichi's ability to get this policy through the LDP and cabinet is indicative of her strength, the fact that she had to overcome vocal opposition from senior lawmakers to get support for a policy that was effectively a key plank of the party's manifesto in an enormous electoral victory only six months ago speaks to her vulnerability. If markets sour on her policies and the opposition parties score points arguing against Takaichi's fiscal program, the prime minister will find herself increasingly friendless, with plenty of senior LDP leaders having already signaled that they will not be disappointed to see Takaichi fail to realize her ambitions.

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