

# How Did Koizumi Cabinet Change Japan?

## Assessment of Koizumi's Economic Policies & Preview of Abe's Economic Stewardship

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The administration of Koizumi Junichiro, who handed the post of prime minister to Abe Shinzo in September 2006, carried out important reforms in many aspects of its economic policies during the five years it held the reins of government starting in June 2001. Some yielded results but others that remained incomplete were passed over to the Abe Cabinet. Focusing on macroeconomic management, this article is designed to examine the distinctive features of the Koizumi Cabinet's major economic measures and look into the Abe administration's economic policy management it inherited from the previous Cabinet.

### Three Keywords

First of all, I would like to see what sort of fundamental ideas there were in the Koizumi Cabinet in conducting its policy management. In this regard, Koizumi put very clear-cut keywords to use in displaying the direction the economy should aim for. The following three are the principal phrases he used.

The first phrase Koizumi employed is "no growth without reform." There are two ways to interpret his pithy expression in economic terms. One is that it demonstrated his way of thinking mirroring the approach taken by practitioners of supply-side economics instead of those of demand-side economics.

Economic policies can roughly be divided into those that work on the demand side through such measures as an increase or decline in public-sector investment and a tax hike or reduction, and those designed to work on the supply side by enhancing production efficiency through such steps as deregulation. Instead of backing up the demand side, Koizumi adopted the policy of reforming mechanisms and organiza-

tional structures in areas such as the monetary, fiscal and public sectors. It is believed that the policy was aimed at enhancing economic growth by heightening the efficiency of the distribution of resources from the supply side.

The second interpretation is that he displayed his idea that he would "not take stimulus measures from the demand side just because the economy is bad." Generally speaking, short-term economic fluctuations are reckoned to be determined by a rise and a fall in demand while long-term economic changes are decided by how the supply side is put in order, and therefore, the economy at hand will not turn for the better unless demand-stimulating measures are taken. If that was the case, Koizumi's words meant that "the economy might be bad and painful for a short period but will rebound in the long run if the government continues to sustain its structural policy." In other words, it was believed that he appealed to Japanese people to be ready to bear the pain resulting from his reform initiatives.

The second phrase he used was "let the private sector do what it can." Again, it is possible to interpret it in two ways in terms of economics. It indicated the Koizumi Cabinet was geared for "smaller government," according to one interpretation. As was seen in his move to privatize the country's postal services, Koizumi's fundamental philosophy was to make the size of the public sector as small as possible and utilize the private sector.

Another interpretation is that Koizumi placed importance on the market mechanism. Generally, the private sector's efficiency leads to growth in profit but the public sector tends to fall behind in achieving the efficiency because profit does not have any direct

connection with it. It was due to this reason that he laid emphasis on the private sector.

The third phrase was "let local governments handle what they can." Needless to say, this referred to his idea of decentralization. The central government took the leadership in the days after World War II and led the country by formulating policies. The central government's initiative worked effectively until the 1970s when the country was in the stage of catching up with others and it had the precise goal of attaining it. However, as the economy matured, there was a diversification of people's sense of value, leaving their requests for government services to varied selections. Such a development, then, led to a rise in the number of areas with the task of decision-making resting with local governments close to residents.

This also can be interpreted to mean that Koizumi expressed his view on the "principle of subsidiary" in terms of economics. This idea is that "individuals should deal with what they can and that regional communities should step in when individuals cannot carry out the task. When communities find it difficult to perform, local governments come in to cope with it. The central government takes over the job after local governments fail to do so." The principle calls for the central government to intervene only as a last resort.

### Results Emerge Near End of Tenure

Under the basic principles mentioned above, the Koizumi Cabinet conducted a variety of economic policies. I will mention their distinctive features centering on macroeconomic management. First, I will give a brief sketch of the

## Japan's economic performance vs. OECD average

(%)

		1996-2000 Annual average	2001-2005 Annual average	2006	2007
Real GDP growth rate	Japan	1.3	1.3	2.2	2.0
	OECD average	3.3	2.1	3.2	2.5
Nominal GDP growth rate	Japan	0.4	-0.1	1.2	2.2
	OECD average	6.8	4.7	5.5	4.8
Rate of price increase (personal consumption deflator)	Japan	-0.6	-1.3	-0.9	0.4
	OECD average	3.5	2.3	2.2	1.0
Nominal rate of increase in per capita wage	Japan	-0.4	-1.0	0.6	1.5
	OECD average	3.9	2.7	4.1	3.6
Ratio of fiscal deficit to nominal GDP	Japan	-6.1	-6.8	-4.6	-4.0
	OECD average	-1.3	-2.9	-2.0	-2.0
Ratio of primary balance to nominal GDP	Japan	-4.4	-5.4	-3.2	-2.5
	OECD average	1.6	-0.9	-0.2	-0.1

Note : 1. Based on OECD "Economic Outlook" in December 2006. However, the latest reports are used for Japan's GDP statistics.  
2. Figures for 2007 are based on OECD projections.

economic situation in the country before and after Koizumi became prime minister. The *table* shows the performance of key macroeconomic indicators in Japan as compared with average figures of other advanced countries (based on OECD averages) between 1996 and 2000 – immediately before Koizumi was named prime minister – followed by the 2001-2005 period when he headed the government, and the latest years 2006 and 2007 (based on OECD projections). The following points can be seen from the *table*.

First, the Japanese economy was in extraordinarily bad shape before Koizumi took over the government. The economic growth rate was sluggish, registering an average 1% rate during the 1996-2000 period, or less than half the OECD average.

Secondly, the nominal growth rate was extremely low, in the neighborhood of zero. As a result, something hardly seen before emerged in the economy, with the nominal growth rate becoming smaller than the real one. Generally speaking, the nominal growth rate is higher than the real rate, which discounts price increases. However, the nominal rate has been lower than the real one in recent years due to price declines. This is the third characteristic. Let me take up the rate of increase in the personal consumption deflator of

gross domestic product (GDP) in place of the consumer price index (CPI) for the sake of an international comparison. The deflator showed negative growth for most of the 1996-2000 period, indicating a deflationary condition.

Fourthly, there was sluggishness in nominal wages. The average wage per worker was in negative growth during the period under review. The condition in which nominal wages fell intermittently was a phenomenon virtually unseen in the country in postwar years or in other key industrial countries.

Fifth and finally, the country's finances deteriorated at the time. During the 1996-2000 period, Japan remained in the worst situation among economic powers in the ratio of fiscal deficit to nominal GDP. More specifically, the first step toward improving the sustained fiscal deficit is to attain equilibrium or post a surplus in the primary balance, or the balance between general expenditures – which exclude the cost of debt servicing – and tax revenues. This is because the ratio of outstanding government debt to nominal GDP will remain unchanged and no fiscal collapse will ensue if the primary balance stays in equilibrium and if the nominal growth rate and long-term interests remain equal. However, the ratio of the primary balance to nominal GDP registered 4.4% in the red, which

was the worst among industrial countries.

Such an abnormal economic performance failed to make any remarkable improvement while the Koizumi administration steered the country, but rather the declines in prices and nominal wages exacerbated from the time the prime minister assumed power. However, considerable progress was made in economic performance in 2006, the last year of Koizumi's premiership. All economic indicators improved from the average recorded during the 2001-2005 period. Yet the indicators were still aberrant compared with the OECD averages. The macroeconomic policy management undertaken by the Koizumi Cabinet apparently began to show its results at last near the end of its term but the severe situation still continued.

### Policy Precedents Overturned

How, then, did the Koizumi Cabinet wrestle with the difficult economic conditions? It grappled with them quite differently from the way previous administrations did. The main variations are the following three steps.

Firstly, the Koizumi Cabinet stopped taking discretionary fiscal measures that its predecessors had executed for policy-related changes in revenue and expendi-

ture according to economic conditions. It established a policy of monetary measures in coping with short-term economic activity and supply-side structural reform for long-term economic expansion.

While the economy was in the doldrums in the 1990s, the government used fiscal tools to boost the economy with stimulus packages 12 times from 1992 onward. The cost of these stimulus programs amounted to ¥135.4 trillion in a simple total sum, including ¥52.3 trillion in an increase in public investment and ¥17.4 trillion in tax breaks. However, the government's fiscal deficit magnified one-sidedly even though it implemented such large-scale fiscal measures. Thus, the Koizumi Cabinet discontinued using fiscal policy for economic stimulus in 2002.

On the other hand, it placed great expectations on the monetary policy of the Bank of Japan. Of course, the BOJ independently manages its monetary policy centering on the manipulation of short-term interest rates. But the government continued to clearly express its expectation for an easier monetary policy. The central bank responded by continuing its "zero-interest policy" in which it kept short-term interest rates as low as possible. Furthermore, it maintained a "quantitative monetary easing policy" as its policy goal by keeping the balance of current accounts held by financial institutions at the central bank at specified levels and continued to boost credit supply.

And the Koizumi administration's policy for economic growth centered on structural reform. Specifically, it carried out speedy disposal of bad loans based on strict assessment of lending, the promotion of deregulation aimed at reforming various government regulations in a way matching changes of the times, and the privatization of public enterprises such as postal services and Japan Highway Public Corporation. It is probably appropriate to say that such measures were designed to enhance the efficiency of the supply side over the long run by making the most of the vitality of the private sector and the market mechanism in a broad sense.

In this manner, the economy has been on the ascent since 2002 despite the fact that the government did not use any fiscal policy tools such as public invest-

ment to stimulate demand. However, as it is common sense in industrial nations that monetary rather than fiscal policy should be employed for boosting the economy, Japan's policy management until then had been "out of date." The Koizumi administration finally corrected the absurdity.

Secondly, his Cabinet strove for a reduction in the fiscal deficit by cutting back on expenditure.

Japan's fiscal deficit had increased to a critical level in and after the 1990s, as shown by the *table*. Everyone recognized that the deficit had to be scaled back to a sustainable level. Roughly speaking, there are three ways to reduce a fiscal deficit. One is to raise the economic growth rate and increase tax revenue. Another way is to trim expenditure, and the third way is to boost revenue through a tax hike. Needless to say, the first means of raising the growth rate is the most desirable of the three ways. However, as mentioned before, the Japanese economy had been sluggish since the 1990s both in nominal and real terms. It was impossible to expect the fiscal deficit to shrink via economic growth.

How, then, did the successive administrations grapple with this problem? The 1996-98 Cabinet of Prime Minister Hashimoto Ryutaro poured its energies into fiscal reconstruction and severely reined in spending. It raised the consumption tax to 5% from 3% in April 1997. However, as recession began in 1997, the Cabinet made a complete policy change and cut taxes in an effort to stimulate the economy at the end of the year. The action resulted in a decline in tax revenue. The Cabinets of Obuchi Keizo and Mori Yoshiro that followed the Hashimoto administration almost abandoned fiscal reconstruction and tax hike policies, and adopted the path of increased expenditure and more tax cuts for the sake of shoring up economic activity. As a result, the fiscal deficit became more serious when Koizumi took over the Cabinet from Mori.

Against such a background, the Koizumi Cabinet adhered solely to the policy of carrying out fiscal reconstruction through spending cuts. Koizumi himself demonstrated that his goal during his tenure of the premiership was

not to raise the consumption tax and that he would seek equilibrium in the primary balance by the early 2010s. He reduced spending to attain his goal.

Thirdly, Koizumi changed the mechanism of deciding government economic policies. He capitalized on the Council on Economic and Fiscal Policy and boldly changed the process of economic measures drawn up by previous Cabinets. The council was established in 2001, comprising 11 members. In addition to the prime minister who is the chair of the council, the members included key Cabinet ministers, the governor of the Bank of Japan and four people from the private sector. Its task was "to discuss important matters concerning economic and fiscal policies." Koizumi made the most of the council, asking private-sector members to submit ground plans for discussion and establishing a way of displaying a fundamental direction in top-down decision-making based on the discussion. The important point was the establishment of the prime minister's strong leadership.

And, under such strong leadership exerted by the prime minister, it became a customary practice for the council to compile a "basic policy concerning economic and fiscal management and structural reform" around June every year. Subsequently the Cabinet worked out measures on budget formation along the council's basic policy line and executed economic policy management.

## ■ Abe's Economic Management

The Koizumi Cabinet's economic policy management gradually showed its effect. The growth rate rose slightly and the rate of increase in prices finally approached the positive realm in 2006, the final year of his Cabinet. The fiscal deficit also decreased. However, none of them could be said to have improved to satisfactory levels. Many problems in macroeconomic management were handed over to the Abe Cabinet. As it has not been long since the Abe Cabinet was inaugurated, there is a dearth of material on the characteristics of its economic policy and others, including its evaluation. However, the following may be cited.

Firstly, the priority of economic mea-

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tures in the Cabinet policy management seems low compared with that of the Koizumi Cabinet. Since he assumed office, Abe has been directing his energies into such issues as a revision to the Constitution, education reform and Asian diplomacy. Thus far, he has not launched conspicuous measures with regard to economic policy.

One reason for this is that it is not necessary for him to be sensitive to economic policy because the economic condition has considerably improved. The economy has been lengthening its long boom period that started in early 2002. Corporate earnings have sharply improved. The fiscal deficit, too, has steadily been changing for the better. The government said it would train its sights on achieving a surplus in the primary balance by fiscal 2011. If the current trend continues, it will bring about the state of affairs that will make it possible for the government to achieve its goal considerably sooner than the target year without resorting to any tax increase.

Secondly, there appears to be a little difference between the Abe and Koizumi administrations in the idea of economic expansion. Koizumi said there would be “no growth without reform” as he was believed to have placed emphasis on reform instead of growth. The phrase he mentioned did not mean he looked for “reform for the sake of growth” but had a nuance that “reform is necessary more than anything else and that the economy will move upward as a consequence if reform is carried out.”

Against such an idea, Abe seems to lay stress on economic expansion itself. His Cabinet put together a document titled “The Path and Strategy of the Japanese Economy” in January this year demonstrating its basic way of thinking for the future. It was an attempt to show the form of new economic growth through innovations. Specifically, it said Japan could expect to post a growth rate of about 2% in real terms and the upper range of the 3% level (3.5-3.9%) in nominal terms.

Thirdly, there is a difference between the Abe and Koizumi administrations in tackling the problem of disparities in income between the rich and the poor. The question of economic unevenness surfaced as a major policy issue for dis-



The question of “disparities” was one of hot campaign themes in the unified local elections held in April, arousing further public interest in the issue which the Abe administration is seeking to resolve.

cussion in the closing days of the Koizumi Cabinet around the spring of 2006. Opposition parties criticized the Koizumi Cabinet’s reform measures, declaring the strong would get stronger while the weak would be abandoned and the income divide widened if it carried through the market mechanism. Koizumi unfurled the debate to the extent of “What’s wrong with having gaps?” and indicated it was natural to have a certain degree of inequalities.

The Abe Cabinet took up the disparity issue more as a policy problem than the Koizumi Cabinet. With the election for the House of Councillors to be held in the summer of 2007, the prime minister may have been concerned about a possible negative impact on the ruling coalition of the Liberal Democratic Party and its partner New Komeito if his Cabinet took a posture of disregarding the matter in question. But Abe’s Cabinet seems seeking to tackle the issue through economic expansion. A special team formed by the Cabinet studied it and announced a “Strategy to Raise the Level of Economic Growth” in February this year. Its objective is to boost the foundation of economic expansion, raise the income of all working people and their living standards, and prevent the income divide from being fixed.

Many people are apprehensive about

numerous pending problems that are being put off while the Cabinet is going ahead with such policy management. For example, there is a problem of giving a concrete form to fiscal reconstruction. It is insufficient for the Cabinet to merely realize the level of equilibrium in the primary balance to restore financial soundness. It must further reduce the ratio of government debt to nominal GDP. It is in all probability impossible for the Cabinet to lower the ratio simply by attaining economic growth and cutting back on spending, and some sort of tax hike will be necessary. However, this matter will be procrastinated upon until the fall of this year or later. Reform of the social security system is also important. According to new population estimates released last December, the birthrate is likely to fall faster and the population to gray faster than anticipated previously. For this reason, reform of such programs as the pension and health care schemes will become inevitable. They, too, are due for study in the future.

The Abe Cabinet’s posture on its economic policies is likely to be called into question as various economic factors evolve in the months ahead. **J.S**

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