

D PJ-led Government's Economic Growth Strategy

By Hideo KUMANO

The Japanese economy has been stuck in a state of stagnation for a long time. Japan's growth rate continued to fall short of the world's average level in terms of gross domestic product (GDP) in real terms for as long as 17 years from 1992 to 2008. This dishonorable record seems likely to continue for the time being. (Chart)

The reason the Japanese economy still lingers low is that any challenge for bringing about a change is always daunted by the enormous cost of adjusting conflicting interests. It is generally considered that competition is hampered by vested interests wielding tremendous power. Such a restriction on competition makes it extremely difficult to raise new industries and alter the conventional flow of business.

The 2009 Nobel Prize in Economic Sciences was awarded to Oliver Williamson, known for his advocacy of the "Transaction Cost Economics." This economic theory, also called the economics of organization, is designed to study activities which tend to obstruct the workings of market mechanisms. The Japanese market is considered to be marked by such huge cost of adjusting conflicting interests – namely, enormous transaction cost – that market mechanisms cannot function smoothly.

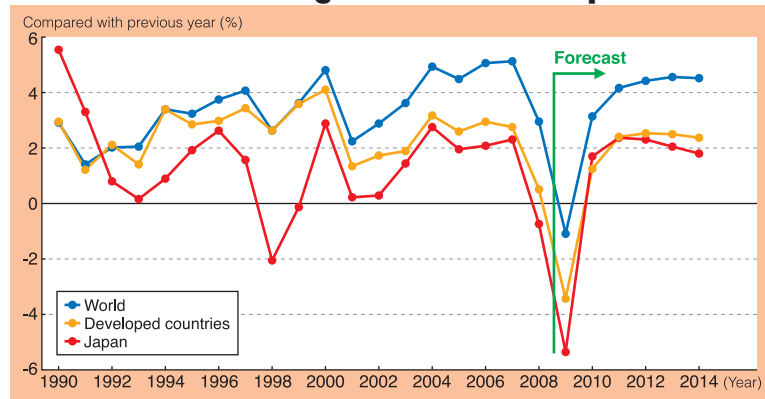
What Is DPJ Government Going to Do?

The above-mentioned view is nothing new. When a trade conflict flared up between Japan and the United States in the latter half of the 1980s, critics stressed that "the Japanese market is closed," noting that Japan's distribution market is open to question in that imports do not increase. Even today, it is pointed out that foreign direct investment in Japan remains at a low level.

From the early 1990s when the prolonged stagnation started, it was repeatedly said that the Japanese economy required structural reform. As for macroeconomic policies, Japan's monetary policy has already used up the trump card of interest rate reduction, whereas its fiscal policy is straitjacketed by heavy debt stemming from the overuse of funds. The Japanese economy has already come to such a pass that macroeconomic policies alone cannot suffice to achieve structural reform of the Japanese economy.

Then what should be done? It is imperative for the government to undertake activities for the positive reform of economic mechanisms. To cite a recent example, many Japanese felt that an opportunity for such a structural change was in the offing when then Prime Minister Junichiro Koizumi began to push ahead with structural reform in 2001. Under the slogan of "a shift from the public to private sectors," the Koizumi government set about restricting intervention in private business and went on to criticize those people who sought to adhere to the conventional system as "resistant forces." It not only

CHART
Trends of economic growth rates in Japan & world



Source: International Monetary Fund

brought heavy pressure to bear on financial institutions to dispose of their burden of nonperforming loans but also strongly demanded that private enterprises, shackled with excessive debts which could not be disposed of due to the difficulty of adjusting conflicting interests, embark on a determined effort to reconstruct themselves.

Nevertheless, the structural reform, promoted by the Koizumi government and its successors, was frustrated by mounting resistance from opponents. The Democratic Party of Japan (DPJ) took exception to the structural reform on the grounds that it would widen economic disparity among the general public. Eventually, Taro Aso, who headed the last Liberal Democratic Party (LDP) government as party president, was forced to completely reexamine the structural reform. He injected enormous amounts of funds into the Japanese economy without hesitating, incurring a heavy fiscal deficit. Even so, people were disappointed with the LDP government, opening the way for the establishment of the present DPJ-led administration.

The DPJ-led government declared a complete departure from the LDP policies and set out to achieve a new administration led by politicians rather than bureaucrats. However, the DPJ, while voicing opposition to the structural reform of the Koizumi government, has also explicitly declared its intention to boldly change Japan's economic system. Moreover, the DPJ-led government, while adding to the already swollen fiscal deficit through large-scale tax cuts, promised in the party's election campaign, is also advocating a drastic reduction in the existing fiscal expenditures as a means of raising funds for tax cuts. Thus, the ideal new system envisioned by Prime Minister Yukio Hatoyama is actually close to the structural reform of the Koizumi government.

The most aggressive proponent of reform within the DPJ is Land, Infrastructure, Transport and Tourism Minister Seiji Maehara. He has expressed himself in favor of changing Haneda airport into a round-the-clock international hub for air traffic and promoting the "open sky" policy. He also intends to go ahead with the unification/abolition

of air routes linking local airports on the basis of rehabilitation of the cash-strapped flag carrier Japan Airlines Corp. (JAL). Besides, he is also set to decide on the suspension of the Yamba Dam project in order to undertake a review of dam construction projects, which are considered symbolic of mammoth public works programs.

Maehara's stance of reform arises from the idea of halting public works projects that cannot serve the purpose of enhancing the productivity of the Japanese economy and focusing investment in the construction of public infrastructure that can better conduce to economic growth. Regarding airport improvement as well, Maehara seeks to develop Haneda as a core airport capable of ensuring much greater convenience for air transport and better coping with severe competition from major airports in the rest of Asia.

As every Japanese traveler on domestic flights knows, timetable books available at airports are all as thick as 60 pages. Yet most travelers look at only eight pages for departures from Tokyo and Osaka. The remaining 52 pages deal with deficit-ridden air routes. It is clear to everybody that there are too many provincial airports in Japan.

The transport policy of the DPJ-led government, it may be said, not only holds out full possibilities for economic growth, but is also fraught with contradictions. Regarding highway networks in Japan, the DPJ's election campaign platform pledged to waive expressway tolls except in urban centers. This pledge, along with the promise of tax cuts, represented a strong appeal to the voting public. However, it left unanswered how the DPJ would raise funds for expressway maintenance and construction after the abolition of tolls. The campaign manifesto also called for a 25% cut in greenhouse gas emissions by 2020 from 1990 levels. Nevertheless, the proposed toll-free expressway system will result in increased automobile exhaust fumes, making the achievement of the greenhouse gas reduction target very doubtful.

What is truly required in present-day Japan is to introduce a "road pricing" system into the highway network of Tokyo. If relatively high tolls are imposed on the Metropolitan Expressway and other congested highway routes, the use of automobiles can be limited to transport that contributes to generating greater benefits for economic growth. It is said that the road pricing system has developed in Singapore and London. Likewise, the elimination of traffic congestion through the collection of tolls will prove conducive to economic development. Too low tolls entail traffic jams. This is an elementary piece of knowledge in economics. But politicians are scarcely conscious of economics. It appears that the DPJ advocacy of toll-free expressways has delayed the introduction of a road pricing system into Tokyo by more than 10 years.

The history of Japan's transport system shows the development of three networks – air, rail and road – without mutual coordination. But if the DPJ-led government comes up with a reasonable design for the domestic transport networks as a whole, Japan will be able to achieve a society of high-speed mobility by making the most of its limited terrain. If Haneda is used as a hub airport for easy access to tourist resorts throughout the country, it will become possible to push ahead with the DPJ policy of invigorating personal consumption as a leading country thriving on tourism.

Henceforth, attention will focus on whether or not Maehara and other reform-oriented DPJ Diet members will steer resolutely for such growth strategy. The DPJ consists of people representing various interests, just like the LDP. There is the great possibility that if DPJ politicians who are inclined to reform try to adjust conflicting interests among their fellow politicians in the future, such moves will be thwarted by stiff resistance. In that event, it will become a decisive factor whether or not Prime Minister Hatoyama, who doubles as DPJ leader, can exercise strong leadership to overcome such resistance.

DPJ's Present Policies

In the House of Representatives election held in August 2009, the DPJ pledged reduction in the tax burden on households as part of its campaign manifesto and successfully took over the reins of government. It explained that rather than giving economic stimulus to corporations, tax cuts for households, limited to specific purposes, would help invigorate consumption. The government budget for fiscal 2010 embodying election campaign pledges centers on three cores – (1) a monthly per capita child-rearing allowance of 13,000 yen for children up to the junior high school age (to be raised to 26,000 yen in fiscal 2011), (2) a tuition-free system for public senior high schools and (3) the abolition of tolls for expressways.

Yet these measures for reducing the tax burden on households are not regarded as a sufficient stimulus that can markedly accelerate Japan's economic growth. This writer estimates that those measures will add 0.26 percentage point to the real growth rate for fiscal 2010. Tax cuts are either partially offset by the abolition of the existing tax exemptions and allowances or earmarked for savings, detracting that much from their effect of generating demand. The economic effects of tax reductions for households are also considered to be limited when it comes to facilitating the creation of employment.

The DPJ's election campaign pledges represented a mere collection of policy menus already made known while the party was out of power and, given the DPJ's switchover to a party at the helm of government, some of the policies would appear insufficient. After the DPJ came to power, many corporate managers exchanged views with DPJ members, enabling the party to gradually accumulate knowledge of exactly what corporations want to see in the interests of promoting economic growth. By the end of 2009, the government decided its budget for fiscal 2010 and unveiled an outline of strategic measures for faster economic growth.

As for the upcoming schedule of Japan's political world, the next House of Councillors election is slated for July 2010, making it almost certain that the DPJ will come up with a new campaign manifesto. In the lead-up to that stage, attention will be focused on how the DPJ will put the finishing touches on specifics of its growth strategy. **JS**

Hideo Kumano is chief economist, Dai-ichi Life Research Institute Inc., specializing in financial policy, fiscal policy and exchange markets. Previously, he served at the Bank of Japan.