What Is DPJ's Philosophy Behind Its Economic Policy?

By Seki OBATA

The Democratic Party of Japan (DPJ), which won the election last summer, focused on policy differences from the Liberal Democratic Party (LDP) that had substantially monopolized political power for the last 50 years. The DPJ proved popular in the election as Japanese voters began to feel their power for the first time and finally capitalized on that power.

DPJ's First Policy Keyword: "Consumers"

The DPJ's economic policy is not well understood by the media or economists, many of whom find it even confusing and misleading. Take, for example, the process in the choice of the top leader for the postal service body, a seriously controversial matter. It was confusing and eventually Financial Services Minister Shizuka Kamei – also in charge of postal services – made the choice even though he is the head of another political party (a partner in the DPJ-led coalition government) rather than someone from the DPJ itself.

The essence of the DPJ's economic policy consists of three factors. The first keyword is "consumers." The party's policies are consumer-oriented. The most typical is a child-rearing allowance which is intended to support families with children by giving them 26,000 yen per month per child. This policy features two factors. The first is the amount: it is a quite large amount of transfer under Japanese standards. The other factor is "cash": the government doles out cash to households.

Why does the DPJ want to directly transfer cash to each household? Because it is direct. If the LDP wanted to implement a similar family-supporting policy, it would opt to build new facilities such as day-care centers to accommodate children. The LDP's policy would contain expenditure to build new facilities.

This contrast displays one of the policy differences between the DPJ and the LDP. It is also a good example of "from concrete to human beings," one of the DPJ's most famous buzz-phrases in its election manifesto. The DPJ's cash transfer plan is directly targeted at human beings – consumers.

The direct cash transfer to consumers is efficient in three dimensions. The first one is that it is efficient as an effective "bribe." Consumers love cash more than anything else when it comes to a transfer. If the LDP were to build a building as a transfer of benefit to voters, they would have the opportunity of employment, but half the fiscal expenditure might spill over to foreign countries through procurement of materials. Cash transfer is the best way to maximize the net benefit to consumers.

The cash transfer is good not only for consumers as beneficiaries but also for economists as analysts of macroeconomic efficiency. If the government gave cash to consumers, they would spend this cash in the way they want. That is, they would choose a product or service that they think is the best among available options. This consumer choice would make the relevant market more efficient. Companies as manufacturers or service suppliers would do their best to attract consumers, which would improve the quality of the product or service as well as decrease its cost. This is a textbook case of "the market mechanism" that economics claims should be the main force to increase the economic welfare of people in a capitalist economy.

If you look at the mechanism of supporting families with children through public works spending, as taken by the LDP governments in the past in Japan, you would see the policy call for establishment of standards for facilities to accommodate children, and bidders would be invited to build them based on the standards. Consumers could not choose service suppliers by themselves. They would have to take

GDP components in major OECD countries

	Japan	United States	Germany	Britain	France	Japan's desirable targets
Growth rate	2.1	2.6	2.2	2.6	2.1	1.5~2.0
Consumption/GDP	57.0	70.0	59.1	65.2	56.9	60.0
Private investment/GDP	15.1	10.2	10.8	9.8	11.1	10.0
Current surplus/GDP	3.7	-5.7	5.3	-3.4	-0.9	2.0
Gov't expenditure/GDP	22.6	19.0	20.1	22.9	27.0	25.0
Public investment	4.6	3.2	1.4	1.8	3.3	2.0
Long-term interest rate	1.7	4.8	3.8	4.5	3.8	4.0

Source: Economic Outlook, OECD.

the service supplied by the companies chosen by the government.

Which mechanism is better? If the government had the ability to judge which company is the best supplier for consumers, then the mechanism adopted in the past would be better. But if you believe the story that economists have told us for more than hundreds of years, the market mechanism is better than the government's central-control mechanism. The consumer has three advantages over the government: a stronger incentive to judge the quality of the service supplied, better information on the service because the consumer faces the service and its supplier directly, and better information about the preference of service users because the consumer himself or herself is *the* user. These are the core elements of the competence of the market mechanism.

Therefore, contrary to the impression against the DPJ, its government is more market-oriented than widely believed. Indeed, many DPJ policies can be regarded as oriented to the market mechanism. Or, to put it more accurately, the DPJ is more reluctant to intervene in the economic decisions of people. Another DPJ policy to be noted in this connection is one calling for direct income compensation for rice farmers, which is a mechanism to avoid disturbing prices in the domestic agricultural market. The past LDP governments tried to maintain the price levels of many agricultural products through price support – direct buying, supply control, or production control. Those mechanisms directly disturbed market prices. The new mechanism proposed by the DPJ in their manifesto will stabilize the income of farmers, which will directly improve their economic welfare and decrease their uncertainty and anxiety. Therefore, the mechanism that the DPJ is going to introduce can be seen as more efficient and more market-oriented.

Shifting Away from Supporting Suppliers

The argument above that the DPJ directly focuses on consumers suggests another important aspect of the DPJ's economic policy. Although the DPJ did not recognize this point consciously, the party departed from its former policy structure – a shift away from supporting suppliers, companies in most cases, to supporting the demand side. According to past experience, supporting the demand side would not work in an depressed economy because consumers would not spend money even if the government transferred cash to them through tax reduction or through direct cash compensation.

Instead, supporting the supply side, i.e. companies, by giving an incentive to invest in R&D or simply awarding public works projects would help the economy recover through increased employment and income. This route would be efficient to revive the economy if companies are efficient organizations. The reason is that this route would bring forth everything: employment, effective demand through investment and consumption, and, therefore, reviving companies as well as workers and consumers. Moreover, it is a faster way for money and jobs to reach consumers because the government could use the incumbent companies, which means the government need not establish new organizations and wait for entrepreneurs to start up new companies to hire workers.

Today, however, we are not sure if the incumbent companies are efficient. They might just lean on the government through their established connections, i.e. lobbying. Therefore, the government might want to use the more direct mechanism to reach consumers, or voters, in order to get a more efficient route of access to them. To skip the inefficient companies that might waste most of the resources transferred from the government, it would prefer the directly transfer of cash to consumers.

Even to keep employment, the government would not want to depend on large companies. For instance, the government would not want to rescue companies from bankruptcy because it could not trust those companies which might be so inefficient as to go bankrupt. The fact that companies could not generate profits means that they would not generate employment as well.

DPJ's Second Key Policy Phase: "Cutting Waste"

The second keyword for the DPJ economic policy is "cutting waste." The DPJ claims that the LDP wasted taxpayer money on public works and on the bureaucracy when it was in power. The DPJ asserts that the LDP and bureaucrats colluded and helped each other. For instance, bureaucrats proposed a draft budget in which tax money was used to build bridges, roads, buildings, dams, and so on. Through those expenditures, LDP members made voters and construction companies in their electoral districts happy. Diet members would get votes or donations in exchange for pork-barrel money. On the other hand, bureaucrats would parachute into government-linked organizations after their retirement in exchange for their help for Diet members of the LDP. They use organizations outside the government but stay inside their inner circle. Most organizations are owned or controlled by the government, but are not officially governmental ones. Their expenditures are outside the government budget and, therefore, scrutiny by the Diet was lax.

The DPJ claims that it will slash all of them. First, it says it will cut most spending on politically motivated public works because most works are wasteful and useless. Second, it will cut the organizations mentioned above. Abolishing these semigovernmental organizations will save taxpayer money since those organizations indirectly get funding from the government or governmental organizations. Third, by abolishing these organizations, the DPJ can also slash jobs that bureaucrats would get after retirement in the so-called *amakudari* (parachuting) practice.

Prohibiting *amakudari* was on the election campaign agenda last summer. Although all parties opposed *amakudari,* the DPJ's plan was the most comprehensive. It pledged to prohibit all *amakudari* (even though this promise was broken after the election by appointing a former senior Finance Ministry official to the top position of the postal service agency). Moreover, the DPJ said that prohibiting *amakudari* would bring about substantial saving of tax money.

This point was important because in the DPJ's election manifesto many policies they promised needed a large amount of budget spending. For instance, the child-rearing allowance program is projected to cost more than 5 trillion yen. Therefore, the DPJ needs budget resources to finance the policy. However, tax revenue has been so sluggish that the DPJ could not finance any policy program without cutting expenditures budgeted during the days of LDP rule. However, cutting budget spending is not harmless. It means that some voters will lose benefits from the budget.

The DPJ had two ways to go: pursuing greater efficiency in spending to maximize the effect of spending, thus cutting budget allocations by the past LDP administrations and instead implementing new policy programs with more direct transfer of revenue to voters as explained before. The other way is to maximize acquisition of votes by keeping all budget expenditures intact. The latter is definitely better in terms of political gains, but only if possible. The DPJ chose to try to get all votes. They kept most former spending programs because some voters benefit from them.

This forced the DPJ to find funding sources to finance its economic policy. It was in this connection that the DPJ emphasized the merit of abolishing *amakudari* as one way to find new funding sources. Slashing the top job positions that had been occupied by former bureaucrats would give the DPJ just a small amount of sources to finance its policies. But abolishing semigovernmental organizations themselves would generate substantial savings because the LDP while in power used these organizations to transfer funds to the parties that had supported the LDP and thus these transfers would be open to termination under the DPJ administration.

Furthermore, and more importantly, *amakudari* abolition would change the whole mechanism to support the relationship among politicians, bureaucrats and businesses. They used to help one another by using semigovernmental organizations and their expenditures. Most organizations had not faced any tough competition with rival companies to get contracts during the era of LDP reign. Moreover, these organizations often used companies in the private sector to contract out their orders from the then LDP administration. Through this process, the price of a service or product would have been inflated, or at least would have been left higher than what might have been fixed through competitive bidding among businesses.

Therefore, if the DPJ-led government abolished semigovernmental organizations and got rid of the connections among the three bunches of players, then procurement costs would be much lower. For instance, in the case of spending for the maintenance of highways, not only competition among companies would decrease the cost, but also the new government would not want to do maintenance work as much, which had been overdone by the government in the LDP era in order to keep the good relationship among the three groups of players.

Third Key Policy Phase: "New Small Government"

This example revealed an important aspect of the DPJ's economic policy. Its focus is on saving, not on spending. It implies that the DPJ prefers "a new small government" to a large government, contrary to the impression shared by the media and economists. This is the third key factor to understand the DPJ's economic policy. The new small government can be paraphrased as a "qualitatively small" government. The phrase "qualitatively small" means that the DPJ prefers to keep away from economic decisions in the private sector – consumers as well as corporations – rather than controlling the private sector.

The notion of a "qualitatively small" government is consistent with the former two factors. Consumer-oriented policy implies the market-oriented policy cited before, which leads to less intervention in the decisions of economic entities. The child-rearing allowance is a good example of this argument. The size of transfer would be larger, then the total budget size would be larger, but the coverage of government decisions or intervention would be much smaller because the new government would not want to have a relationship with corporations. The government would not choose service suppliers qualifying for quality standards set by itself. Rather, consumers would directly evaluate the quality of the service.

"Cutting waste" more directly means a smaller government. Abolishing semigovernmental organizations would decrease the total size of the government, that is, the consolidated government size would be smaller. Moreover, this new smaller government would also be "qualitatively" small because the interdependence among politicians, bureaucrats and businesses would disappear. The market economy would get much simpler under a "qualitatively small" government. The costs of products, services and all other things would get lower. This would help consumers survive in the depressed economy today.

One presumption exists behind these three factors. It is that the era of solid economic growth is over. Therefore, demand stimulation would not be sustainable. Rather, restraining government expenditures would make the economic decisions of consumers and corporations more efficient, which can be supportive for economic sustainability under the constraint of limited resources in the long run.

Put in another way, the "quantitative" economic growth era is over and it is a "qualitative" economy era. To improve the lives of consumers, the government has to improve the efficiency of the economy. Also, consumers would benefit not only from the flow, or income, but also from the "stock" or what has been accumulated. It is also now a stock era. Consumers would want to enjoy a society with better stock. What is the stock? First, it is the social infrastructure, but it also includes society itself. The government would emphasize the unity and dignity of society, something similar in this sense to what US President Barack Obama has portrayed.

More importantly and directly, however, the government will have to more efficiently use the stock, especially the financial wealth of Japan. This is important to finance the DPJ's income-distribution policy. Therefore, the DPJ is expected to try to improve the financial market and the financial management of households as well as the government itself in the near future. JS

Seki Obata is associate professor, Keio Business School. A former Finance Ministry official, he was assistant professor, Hitotsubashi University, in 2001-2003 after obtaining a Ph.D. in economics from Harvard University.