

Japanese Economic Policy & Politics

By Kensuke Karube



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Four years have passed since the birth of so-called Abenomics, the economic policy of Prime Minister Shinzo Abe. Barring exceptional cases such as the debate over the introduction of the consumption tax, economic policy is usually talked about during election campaigns in abstract terms such as “economic recovery” and “upgrading welfare”. However, Abe won a majority in the House of Representatives while making monetary policy, a subject in which voters have minimal interest, the linchpin of his election platform. And in the Trans-Pacific Partnership negotiations, he headed the first Japanese administration in history to successfully navigate its way to a major trade deal under a single Cabinet minister.

History tells us that there is a positive correlation between the ability of a regime to execute policy and its political capital. The four years of Abenomics have reconfirmed this rule, but the administration is unique in its simultaneous achievement of three feats: shedding reliance on the bureaucracy in policymaking, placing a policy that is on the fringes of Japanese academia at the core, and unifying national interest in international trade negotiations by exerting the political power to coordinate interests within his own party. This calls for a review of the relationship between economic policy and politics in Japan.

Contentious Monetary Policy

“Never forget that the Abe administration came to power in an election in which monetary policy became a subject of contention for the first time in the election history of Japan.” These are the words of Nobuyuki Nakahara, a former member of the Bank of Japan policy board and one of the intellectual driving forces behind the Abe administration. Indeed the December 2012 House of Representatives election was exceptional. Abe, then as now the leader of the Liberal Democratic Party (LDP), unveiled an election platform with an economic policy that was singularly focused on monetary policy, claiming that “the Bank of Japan can underwrite construction bonds as they are issued.”

Monetary policy had not been a focal point of elections till then because a central bank is a distant presence for voters and because monetary policy does not directly affect the taxpayers’ wallets, among other reasons. Another likely reason for the reluctance to

refer to monetary policy during elections is the premise that a central bank is independent of the government. Under the old Bank of Japan Act, the government of Japan used to have the power to dismiss the governor of the BOJ and broad authority to issue orders regarding its activities. In the 1980s, the government pressured the BOJ to conduct monetary easing, which wound up producing a real estate and stock market bubble. The Bank of Japan Act was amended in 1998, and it came to be well accepted that the central bank should keep the government at arm’s length.

However, Abe placed monetary policy, an issue that is farthest from the minds of the voting public and at worst could invite criticism of “impinging on the independence” of the BOJ, at the forefront of his election campaign, and repeatedly used the phrase “ambitious monetary easing” during and after the election. The market responded to this, sending stock prices soaring and weakening the yen even before the December 2012 election.

Waseda University Professor Masazumi Wakatabe, who supports monetary easing of a “different dimension” and has given Abe advice on economic policy on several occasions, says the following:

“In 1992, Arkansas Governor Bill Clinton won the US presidential election based on economic policy. I don’t know why Mr. Abe had the same idea, but I’m guessing that he is pragmatic and understands that the economy is important. The state of the economy and social security top the public opinion polls. There is little change to this. Mr. Abe formulated his policies on this basis. In other words, he must have been faithful to the basics.”

The election that Prof. Wakatabe had in mind was the 1992 US presidential election. It is not easy to draw a simple comparison, given the differences between the US presidential system and the Japanese parliamentary system, but the campaign slogan of the Democratic Party’s Clinton camp is well known: “It’s the economy, stupid!” This campaign slogan is usually translated into Japanese along the lines of something like: “Of course the focus of this election campaign is the economy.” In essence, it probably means that the biggest point of contention in this election is the state of the economy and that it should be pushed to the forefront of the campaign. President George H. W. Bush had failed in managing the economy, which was in the doldrums at the time.

Clinton’s campaign strategy succeeded, propelling him to victory

in the presidential election. The economy hummed along after he entered the White House. As seriously mired in sex scandals as he was, he still managed to finish out his eight years as a two-term president. As 2012 drew to a close, Abe's campaign strategy likewise began and ended with "escaping deflation and monetary easing". To mimic Clinton's slogan: "It's monetary policy, stupid!"

The Japanese economy had already been in a deflationary state during his first, one-year term as prime minister in 2006-07, but that Abe administration did not prioritize fighting against it. However, the second time around he decided to concentrate on fighting deflation and pour resources into the cause. He judged that he could make it the focus of the election without concern over the independence of the BOJ since the public's attention was focused on the economy.

The victorious Abe made his "Three Arrows" the centerpiece of Abenomics. The first arrow is monetary policy. Abe at the time repeatedly talked of a "bold monetary policy". The actual policy has mirrored the intentions of the prime minister after former Vice Minister of Finance for International Affairs Haruhiko Kuroda was appointed governor of the BOJ, setting a 2% "price stability target" to be achieved "over two years or so" among other things.

The second arrow launched was fiscal policy in the LDP (and, yes, Keynesian) tradition of boosting the economy with public expenditures when there is insufficient demand. The Ministry of Finance mustered just enough resistance to have the second arrow named "flexible fiscal policy", not something in the order of "bold" or "massive". But the FY2012 supplementary budget that immediately followed reached 20 trillion yen in terms of the cost of the projects.

The third arrow was dubbed "growth strategy". It was perceived as supply-side economics, mainly deregulation, and labor market reform and agricultural reform formed the core. Abe sought the conclusion of negotiations for the Trans-Pacific Partnership (TPP) agreement as a high-profile outcome — one that has now become difficult since the United States dropped out.

One mainstream economist at the time memorably wondered: "Is Abenomics really an economic policy? Is the theory behind the reflationary school one that says anything goes if it works on people's expectations?" If there was little to connect the arrows theoretically, Abenomics still managed to become the talk of the town, helped along by the catchy "Three Arrows" hook.

Abe's Trade Policy

The election of Donald Trump as the next president of the US means there is little chance that the TPP, which had been placed at the center of the "third arrow" growth strategy, will ever come into force. However, the negotiation process itself became a deeply meaningful one for Japan.

It had not been clear till then who was responsible in Japan for trade negotiations. Sometimes, the minister for foreign affairs would take the lead in meetings but the minister of trade, economy and

industry would represent Japan in other meetings, while the minister of agriculture, forestry and fisheries would come to the forefront when agricultural issues were being discussed. This state of affairs prevailed in almost all postwar trade negotiations.

Why was this the case? It was because the Japanese government could not make up its mind until the national bureaucracy and the ruling LDP had finished reconciling the interests involved. On a serious issue like opening the Japanese market to rice imports, the intentions of the ministry of agriculture, forestry and fisheries and the agriculture and fisheries "tribe" Diet members and agricultural organizations behind them, took precedence, and the other ministries and agencies were not allowed to put a word in. As for multilateral trade negotiation rounds and the like, which cover many sectors, all the ministries and agencies merely made pitches for their respective interests, making it impossible to construct strategies that took the overall national interest into consideration and included decisions on what to take and where to yield. A senior official in the ministry of foreign affairs who has been involved in trade negotiations says the following:

"We held a meeting in Seoul to discuss a free trade agreement between Japan, China, and South Korea. There were Japanese participants at the vice minister level from three ministries: the Ministry of Foreign Affairs, the Ministry of Economy, Trade and Industry, and the Ministry of Agriculture, Forestry and Fisheries. China and South Korea were represented by a single official each, so it was embarrassing to see the three Japanese representatives stepping up to the podium one after the other. We also had to ask the hosts to make arrangements for meals for three representatives. I was angry at having to supplicate for something like this."

But this was not the case with negotiations under the Abe administration. This time, Toshiaki Amari, the minister of state for economic and fiscal policy, was put in sole charge, over agriculture, automobiles — the whole package. This was the first time in Japanese postwar history that a single politician had led the negotiations for every sector across all ministries and agencies in trade negotiations. Amari, who eventually had to give up his ministerial assignment due to a political financing scandal, once said while he was still minister:

"Why did we succeed in constructing this system? It was because Prime Minister Abe is powerful. On one occasion, Mr. Abe said to the other ministers: 'Please consider the words of Mr. Amari as my words.' After that, all the ministries and agencies started to work together in the best interests of Japan regardless of where the vested interest of their own ministry or agency lay."

This is standard practice in other countries. The US has its trade representative, while a single commissioner is in charge of trade policy in the European Union. They are exclusively responsible for trade negotiations in all sectors for their respective constituencies. The reason why negotiations with Amari alone became possible was that it was the prime minister himself who used the power of his

regime to reject the construction of the negotiating framework under the initiative of the bureaucracy and to keep an eye on potential resistance from special interests.

Postwar History of Japan's Economic Policy

A look at the postwar history of Japan's economic policy shows that the bureaucracy has played a critical role in the decision-making process. When President Richard Nixon eliminated the convertibility of the US dollar just as postwar reconstruction in Japan had run its course, and later when the oil crisis brought soaring oil prices that punctuated the end of the era of rapid growth, it was the bureaucracy that came to the rescue of the politicians time and again.

For example, in the wake of the Nixon shock in August 1971, the decision to “keep the markets open” and transition to a currency float despite being criticized that “the nation is suffering losses” were decisions made by the Ministry of Finance. Then Prime Minister Eisaku Sato was not totally unversed in economic policy, but he did appear to have managed his administration on the shoulders of the bureaucracy.

Prof. Wakatabe says: “It is impossible to ignore the role of the bureaucracy when considering who is determining national policy for Japan. Politicians took the lead during the chaos of the years immediately after the war, but Prime Minister (Hayato) Ikeda was the last of the line. From Prime Minister Sato on, politics and the government became as one, and the bureaucracy gained power. Mr. Abe thinks that there is no alternative but for politics to lead, but this is very personalized, not institutionalized.”

The LDP is a political party that was created by the Conservative Merger of 1955 between the Liberal Party and the Democratic Party. It included many conservatives who were fixated on an “independent constitution” since the merger had been strongly motivated by the need to respond to the rise of socialist forces.

Given this founding story, the two major schools of thought on economic policy since the 1970s — emphasizing redistribution among the people or focusing on free markets and minimizing government intervention — did not clash directly within the LDP. If the leader of the party of the moment adopts neoliberal policies that win the support of the public, the party will follow him. But it is a party whose politics are rooted in the special interest-oriented method of bringing as much of the budget as possible to their local constituencies and supportive industries.

Prof. Emeritus Masanao Ito at the University of Tokyo, who is an expert on economic history, has the following to say:

“Extensive knowledge of laws and systems is an extremely important quality for a Japanese politician. The politician needs to know where the system can be tapped for money. The politician did not need to know economic theory; it was the politician's knowledge of how the system worked that really mattered.”

The politicians who were “well-versed in systems and laws” to

whom Prof. Ito points built tight relationships with a bureaucracy that was also “well-versed in systems and laws” in order to use the latter as its source of knowledge and ideas. This was also the source of the power that enabled the LDP to maintain dominance for so long after the war.

In order to maintain power through the Japanese parliamentary system under a medium constituency system with three to five House of Representatives members per electoral district, it was essential not only to gain the support of the Japanese public but to also come out ahead in the power struggle within the LDP. It was necessary to that end for the prime minister to put forth specific policies as rallying points. For Prime Minister Nobusuke Kishi, this took the form of the amendment of the Japan-US Security Treaty; for Sato, it was the reversion of Okinawa.

The same holds true for economic policy. More often than not, policies are adopted not because they correspond to the ideals that politicians have held close to their hearts over the years but as the result of calculations that they could be instrumental in maintaining political power.

In the postwar years, the Income Doubling Plan under Ikeda is a famous example of an LDP administration that placed economic policy front and center. However, this “policy” was more of a catchphrase to boost public morale at the dawn of the “economic miracle” of the era of rapid growth, and consisted largely of social and public infrastructure projects. Prime Minister Zenko Suzuki did promote a policy of “fiscal reconstruction without tax hikes” but his administration was too brief to leave an impression. It was left to Prime Minister Yasuhiro Nakasone to be remembered as the prime minister in the post-miracle era who put a specific economic policy at the core of his agenda in order to extend his regime — a neoliberal economic policy focused on deregulation.

Serving as prime minister from 1982 to 1987, Nakasone made a powerful push for a Japanese version of the neoliberal economic policy focused on deregulation that was sweeping the world at the time. Those were the times when Prime Minister Margaret Thatcher in the United Kingdom and President Ronald Reagan were at the forefront of the global trend that sought to minimize government intervention and let the markets do the rest.

But in Japan's case, the Ministry of Finance had enormous powers over the financial sector, for example, and the most trivial matters, such as opening a new branch, were rigidly regulated. There was no way this could actually be deregulated right away. This is when Nakasone focused on the privatization of Japan National Railways and the Nippon Telegraph and Telephone Public Corporation. He set up an advisory council entitled the Second Ad Hoc Commission on Administrative Reform, which he used to establish and execute his policies. Prof. Ito explains that “In the past, basic policies were formulated under the collaboration of politicians, the respective bureaus in the Ministry of Finance, and the Keidanren committees. But (Nakasone's) resort to the Ad Hoc Commission on Administrative

Reform put an end to this process.”

However, the bureaucracy later managed to regain its powers, and a look at the subsequent economic policies of LDP regimes shows that many of them lacked focus, as can be seen from examples such as the “Asset Doubling Plan” (Prime Minister Kiichi Miyazawa), “Six Major Reforms Including Structural Fiscal Reform” (Prime Minister Ryutaro Hashimoto), and “Rich Country, Strong Morals” (Prime Minister Keizo Obuchi). It was not until Prime Minister Junichiro Koizumi’s “Privatization of Japan Post” that the Nakasone game plan of finding a weakness to make a breakthrough was revived.

Policymaking Free from Bureaucratic Influence

Monetary policy is supposed to be difficult for voters to understand. Then who were the people who plotted to set monetary policy as the focus of the election? Not the bureaucracy. It was the advisors who now support Abe who did it.

It has often been the case that politicians would publicly promote policies after listening to the views of academics and former bureaucrats, who were in turn engaged in policymaking as government policy council members or as appointees to the Cabinet Office. But in 2012, as he faced a general election, Abe doubled down on his reliance on his economic advisors, including Etsuro Honda, a former Ministry of Finance official, Dr. Koichi Hamada, a Tuntex emeritus professor at Yale University, and Nobuyuki Nakahara, a former BOJ Policy Board member. These advisors claimed that the greatest challenge facing the Japanese economy was overcoming deflation and that prices would rise if the BOJ established an inflation target and flooded the market with money. Hamada had repeatedly claimed in his books that this reflation theory was widely accepted in economics but appeared to be on the fringes when it came to mainstream economics in Japan.

The reason why Abe adopted this line of thought was the understanding that the monetary policy of the BOJ had not worked at all and instead had pushed the Japanese economy against the wall over the “Two Lost Decades”. He appeared to have acquired this perception as he assumed various senior government positions including a turn as deputy chief Cabinet secretary. Through his contacts with advocates of a reflationary policy, he came to the conclusion that the BOJ was wrong.

A little later, these private-sector economic advisors had a powerful influence on the choice of successor to BOJ Governor Masaaki Shirakawa. It has usually been the case that a former official from the Ministry of Finance or BOJ is appointed governor of the bank. The ministry had been pushing Toshiro Muto, a former vice minister at the ministry who had previously served as a deputy governor at the BOJ. Instead, it was the private sector advisors who managed to have Haruhiko Kuroda appointed, a proponent of reflationary policy despite being a former Ministry of Finance official.

This decision-making process is typical of the shift away from the

bureaucracy of the last two decades. Abe is handling his associates like US “political appointees” giving them titles like “Special Advisor to the Cabinet” and drawing them deeply into the policy-making process.

What stands out at the same time is the decline of the Ministry of Finance. The ministry had ruled over the national bureaucracy as first among equals with its grip on the national budget, but it has been unable to make its presence felt under the Abe administration. Take the consumption tax, for example. The ministry has been dying to raise the consumption tax rate to 10%, but Abe ultimately decided to postpone it. In the Japanese politics of the past, it would have been difficult for a prime minister to ignore the wishes of the Ministry of Finance, but Abe is charting a course on economic policy on its own against the background of high public support.

Executing Unorthodox Policies

It is natural to fight an election on economic policy if many Japanese voters think it is of primary importance. But in order to pursue an economic policy as a politician who has decided to shed the protective shield of the bureaucracy, it becomes necessary to put together a brain trust consisting of a small number of experts. Abe did this. Having observed the Democratic Party regime that immediately preceded him make the mistake of insisting too much on politicians taking the lead that it alienated the bureaucracy, Abe has adopted a policymaking style in which he carefully maintains control over the bureaucracy while making key policy decisions by himself together with a small group of close advisors.

The economic policy that forms the core of Abenomics and the reconciliation of interests among the ministries and agencies that was demonstrated during the TPP negotiations are not difficult when the prime minister has momentum. This is totally different from the US system where a seemingly powerful president is tied down by the constitutional balance of powers.

The prime minister in a parliamentary system is powerful. In the LDP, factions continue to lose power while it has become increasingly difficult to create separation through policy choices, and the adoption of a system of single-seat constituencies and proportional representation in the House of Representatives in 1994 has made election results volatile, making it easier to secure big majorities in victory. Even if the winning party’s percentage of votes is less than 50%, they could get an overwhelming majority of seats. These and other factors make it possible for the prime minister to implement unorthodox policies as long as he/she maintains the administration on an even keel.

Whatever one’s assessment of the policies themselves, the four years of Abenomics are a testament to this. **JS**

Kensuke Karube is executive writer/chief commentator for Jiji Press, a major Japanese news wire service based in Tokyo.