

The Lessons of the Koizumi Administration

By Takemori Shumpei



JAPAN'S ex-Prime Minister Koizumi Junichiro seemed to care so little about staying in office. Is it because he has accomplished his stated objective of “structural reform”? At the end of the day, what did he truly mean by “structural reform”?

■ The Struggle to Achieve Reform

I think that his idea of structural reform has changed three times; there has been Structural Reform I (2001-02), Structural Reform II (2003-04) and Structural Reform III (2005-06). In his first year in office Koizumi made the following statement at the Genoa Summit in 2001, which clearly characterized the idea of structural reform I: “No recovery without structural reform! If the Japanese economy recovered without structural reform, nobody would care about reform.” At this early stage, his program was rather obscure yet one thing was clear: if anything, the program had to be a polar opposite of a Keynesian type fiscal stimulus. In order to mark that contrast, Koizumi portrayed his idea as if he were a disciple of the Austrian school of economic thought with the philosophy that bankruptcy and unemployment are indispensable for an economy to reinvigorate itself.

It was, however, only in his second year in office that Koizumi came up with the specific Austrian policy program. He interpreted structural reform as a hard-landing approach to the bad loans problem of the Japanese banking sector. Following this idea of the leader, the then Minister for the Financial Services Agency, Takenaka Heizo, announced a leveling up of the inspection standard regarding the bank balance sheets, which included the abolishment of the generous treatment of deferred tax assets. This naturally caused panic in the Japanese banking sector. Deprived of the generous treatment for deferred tax assets, their “capital adequacy ratios” would plummet to such a low level that they would be obliged to beg for governmental assistance for survival.

Although the reaction of the Japanese banking sector was just as it was expected to be as the outcome of their hard-landing approach, seeing precipitous drops in stock prices as well as significant rises in the risk premiums of the banks’ bonds, and seeing finally a sign of a major economic recession in the making, Koizumi and Takenaka relented. That was the end of the Austrian experiment in Japan.

Learning a lesson from the failure of Structural Reform I, Koizumi launched Structural Reform II in 2003, which had

the diametrically opposed purpose of stimulating the Japanese economy. To be sure, it was not a typical Keynesian policy package of budgetary stimulus. Yet, it was undeniably a policy package which aimed to give a short-term stimulus to the Japanese economy.

There were two policy pillars in Structural Reform II. One was a massive foreign exchange intervention from 2003-04 in order to prevent a precipitous appreciation of the yen. There are two remarkable facts about this intervention. One is its scale: the volume of the intervention, ¥33 trillion, is unprecedented in the history of mankind. The other is the fact that the Ministry of Finance (MOF) was entirely supported by the Bank of Japan in conducting the intervention. It was so-called non-sterilized intervention in which the volume of base money rises hand in hand with that of dollar purchases by the MOF.

The second policy pillar of Structural Reform II was the rescue of troubled major banks, such as Risona bank, the capital adequacy ratio of which had fallen below the minimum level required by banking regulations. There was a notable feature about the rescue operation of Risona bank. Conducted in the spring of 2003, it was a complete giveaway to the shareholders of the virtually bankrupt bank. When the government injected public money into Risona, the existing stocks were redeemed at the pre-crisis stock price level, although Risona, as it turned out by the examination of its balance sheet after the rescue, had negative capital so that the existing stocks should have been treated as worthless pieces of paper. The market, of course, liked the way the Japanese government generously treated the shareholders of a bankrupt financial institution: The stock prices of the Japanese banks jumped up. It was a classic case of moral hazard.

Since Japan has been experiencing one of the longest-running economic recoveries since 2003, one can argue that Structural Reform II was a success. To repeat the main point again, it was a stimulus policy package without the standard Keynesian prescription. Yet paradoxically, Koizumi's popularity started to wane from around 2004, the year in which the recovery became obvious. His party, the Liberal Democratic Party (LDP), lost one election after another in 2004.

What happened? Japanese voters started to sense that his rhetoric of structural reform was just rhetoric and there was no substance in his political slogans. Therefore, in order to prove that his reform was for real, Koizumi had to give a more specific and concrete meaning to the idea of structural reform.

In this context, it is interesting to compare Koizumi's handling of political slogans with that of his predecessor, Hashimoto Ryutaro, who held office from 1997-98. A political slogan of the Hashimoto administration was "structural reform of the budget" and faithful to that slogan he conducted ill-fated tax increases amounting to ¥9 trillion

in 1997 and wrecked the recovery of the Japanese economy. In contrast, the political slogan of the Koizumi administration was simply "structural reform."

■ Postal Privatization

Until 2004, it had been a wise idea of Koizumi to leave his slogans purposefully vague. His policy operation has not been tied down by slogans so that he kept a free hand all the way through. But people started to ask the fateful question: "Is your structural reform just a gimmick? What exactly is it?" So he had to provide a specific proposal for the conduct of economic policy.

Thus began Structural Reform III. This was the phase in which Koizumi finally made clear that his structural reform focused on the postal services. To this day, it is not clear if the postal-services reform was the first priority for the Japanese economy. And one can argue that Koizumi's reform plan on this matter is unsatisfactory, especially in its failure to propose a drastic reduction of redundant postal workers. It was, however, a political masterpiece. Since his reform plan generated enough dissident voices inside his own party and since, foolishly enough, the opposition party, the Democratic Party of Japan, sided with the dissident voices within the LDP rather than with Koizumi, he could make the general election of September 2005 into a referendum on reform. The Japanese voters ardently supported Koizumi on this occasion, giving him a historic victory because they had been waiting for a long time for the chance to change Japanese politics in favor of reform.

Thus as of September 2005, Koizumi obtained a mandate for reform. With an absolute majority in the House of Representatives he could have accomplished as much reform as he wanted. He passed the postal reform bills but that was it and then he left office.

Why did Koizumi want to leave the scene so early? My guess is that he ran out of ideas. During his term, he did invent a terrific policy to get the Japanese economy out of the long-running recession. Only for this reason, he must be ranked above the ten Japanese prime ministers who preceded him. But he was definitely not a visionary politician. Look at the way he waited for four years until he began his drive to privatize the Japanese postal services. And once that reform is carried out, there isn't any reason for him to linger on.

So much for Koizumi. His successor, Abe Shinzo, will be in an enviable position at the initial stage of inheriting Koizumi's legacy: the mandate that the Japanese public gave Koizumi for reforms. But Abe must have a specific reform proposal ready when he starts running the government and must implement it quickly, otherwise the mandate will soon evaporate.

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