

A Repeat of Hashimoto's Failures?: The Course of the Koizumi Cabinet's Structural Reforms

By Sasaki Takeshi

ACCORDING to polls carried out after last year's general election, support for the Koizumi Cabinet is eroding. The main factor for this appears to be the unpopularity of the administration's policy of dispatching the Self-Defense Forces (SDF) to Iraq. To be sure, the decision to send the SDF to Iraq is not one that would raise public support. On the contrary, depending on future developments, it is possible that there will be even greater damage to the cabinet's support ratings.

However, what is important in predicting trends is the evaluation of the process and the results of the various domestic reforms. As I indicated in the previous issue, the results of the election of the Liberal Democratic Party's (LDP) chairman and the general election showed that reform is no longer a matter of mere rhetoric but a matter of implementation. Prime Minister Koizumi Jun-ichiro had gained support from the Japanese people by criticizing the old LDP factions who have attempted to impede his reform programs, but those forces have lost political influence. It is no longer possible for Koizumi to depend upon such politically luxurious tactics. The previous arrangement of pro-reform versus anti-reform forces has collapsed, and the focus has shifted to the substantive issue of how actual reform will be implemented. The issue is the direction of those reforms and the situation of the economy.

The Japanese economy has recovered to a certain extent and, specifically in manufacturing industry, it is possible to confirm in actual figures that structural reform is yielding results. Japanese domestic demand still lags under the specter of deflation and the recovery can hardly be called robust, but supported by the favorable economic conditions in the United States and China, the official perception is that Japan is more or less on the road to recovery. There is no doubt that this is a typical overseas demand-

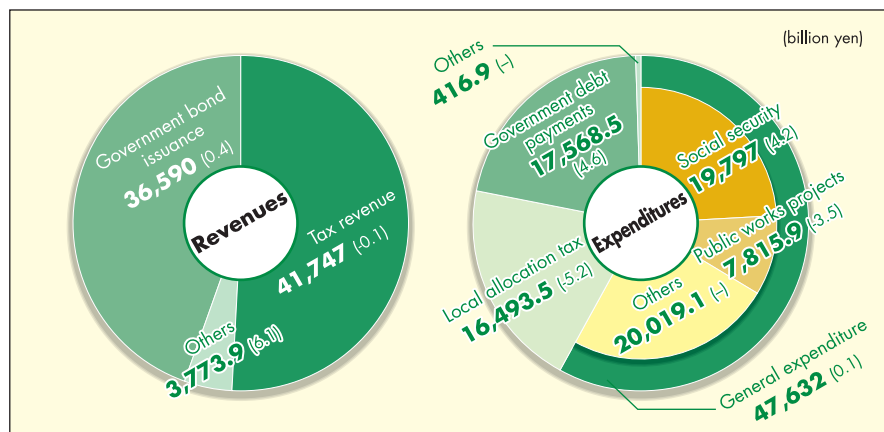
fueled type of recovery. The government also said that the moment is gradually approaching when the Japanese economy will be released from the burden of non-performing loans and the deflationary spiral which it has long suffered from. In point of fact, the Japanese stock market began to show a degree of recovery in 2003. It should not be forgotten that this kind of declaration of economic recovery is frequently referred to as a preliminary to the reforms aimed at restoring a balance between income and expenditures by means of tax increases and policies of fiscal retrenchment. The common consensus is, however, that when one looks at the Japanese economy as a whole, a large number of small and medium-sized businesses are still in bad shape and, with the exception of such areas as Tokyo, economies in other areas remain in a critical condition.

Since the collapse of the Hashimoto Cabinet in 1998, successive Japanese cabinets have basically expended the majority of their energies in preventing the nation's economy from declining even further. The Obuchi Cabinet, which accumulated massive debt as it desperately attempted to stimulate the economy, is a case in point. Both the Mori and Koizumi cabinets have taken a different line by relying not on macroeconomic policies but rather on microeconomic restructuring. The policies of the latter have not only resulted from the politicians' conscious decisions but have been formed because Japan was confronting a very serious financial deficit. As a consequence, stock prices at one point plunged to 50% of their previous highs, job losses rose dramatically and the structure of the society, which in the post-war years was based on the middle class, was in actuality being dismantled. This is why it is said that the improvement in the economic situation has not been a result of the policies adopted by the Koizumi Cabinet but rather has come about independently of those policies.

Now that structural reforms have brought about certain results in the private sector, reform in the public sector is up for discussion. Over the past few years, the burden of reform within the public sector has been born by local governments, and there has been a continued effort to rebuild an effective administrative structure within the constraints of the resources available. That the so-called manifestos appeared in regional governments is related to trial reforms in the local governments. While talk of reform continues in the central government, the reality of the situation has been that reform has become a kind of game played by the ruling parties and the bureaucracy. For example, it has not been made completely clear why the privatization of the Japan Highway Public Corporation (JH) and three main postal services (postal service, postal savings and postal life insurance) – which to date has been considered the centerpiece of the Koizumi Cabinet's reforms – are of such great significance. Frankly speaking, these two issues are essentially related to factional issues within the LDP. The view that Koizumi assaulted the JH and postal services because those were the power bases of the factions opposed to him was widely accepted within political circles. By discussing in public how the enormous organizations ought to be organized and operated, the anti-Koizumi forces were at a single stroke weakened. Once this goal was achieved, it became necessary to consider precisely what the reform issues were.

In terms of the structural reform of the public sector, one is instantly made aware of the problem of the issuance of an enormous quantity of government bonds, amounting to 44% of national revenues. It is said that the sum of the central and local governments' debt amounts to ¥5.63 trillion (about \$53,000 billion) for every Japanese. When the economic situation improves somewhat, the government tends to take Ministry of

Figure 1 General Account for Fiscal 2004: ¥82,110.9 billion (0.4)



Note: The numbers in parentheses show the rate compared to the previous fiscal year. (%)

Finance (MOF)-led fiscal retrenchment measures by increasing the burden on taxpayers and cutting expenditures. The Koizumi Cabinet has made it a policy goal to reduce the accumulated public debt and achieve fiscal balance, a policy that finds favor within the MOF. However, to raise taxes and increase the burden for expenses related to social security/welfare without taking full account of the economic circumstances is highly dangerous. The Cabinet of Hashimoto Ryutaro, declaring a recovery of the economy, raised the consumption tax by 2% in 1997 and this caused the economy to stall. This led to the cabinet's resignation in the following year. The draft budget for fiscal 2004 beginning in April includes plans to increase pension premiums and an increased tax for those receiving pension benefits. Predictions are being made that this will lead to a disruption of business and a repeat of the mistakes that brought down the Hashimoto Cabinet.

The framework of Japan's revenues and expenditures is shown in Figure 1, with the structure of expenditures fixed by the existence of the bureaucracy. The fact that an effective re-evaluation of the situation has not taken place is held to be a major problem. Coming under particularly severe criticism in recent years is the issue of public works projects, and doubts have been raised about the ripple effect of such projects on the economy. The privatization of the JH has been raised as a trump card to play in solving the public works problem, but this reform, as a result of Koizumi's decision, appears likely to end up in a form that will not displease the members of the Diet who are influential in the administration of the highways. In the midst of all this, there is a considerable probability that the chronic increase in social security expenditures and a broad program of tax increases in the future will have serious political consequences.

The decision to increase the burden

born by individuals and enterprises for the payment of pension premiums has brought a sharp reaction, and it is highly probable that the issue of the burden created by social security expenses will remain a serious one. That is to say, anxiety and distrust of the current public pension system among the people has assumed serious proportions, and the number of non-subscribers as well as the number of subscribers who have not made payments is rapidly increasing. (In 2003 these two groups together reached a total of approximately 4 million.) If we add to these two groups those who have received an exemption from making insurance payments, the "hollowing out" of the system becomes extremely grave. That distrust of the system is increasing the speed of this hollowing out is quite apparent.

Moreover, there is an actual increase in the number of people who are unable to make their payments due to the worsening of the economy. If the government does not take responsibility for this problem of the system and does not take effective measures to deal with it, and merely employs a policy of "collect insurance premiums wherever I can," it will surely encounter criticism from both businesses and labor unions.

To date, the public opinion concerning increasing the burden accompanying the social security system has been comparatively generous. This is because individuals and businesses have had a degree of economic leeway. However, during the past few years, businesses have come under pressure to restructure, and

in the midst of global competition, they have begun to respond more radically toward this kind of burden. Individual savings rates are down and inevitably money that has been set aside as savings has been broken into as a means of surviving the severe conditions of making ends meet. New measures to increase the tax-burden on pensioners will inevitably be a considerable blow to older people. It would appear that Japan's politicians and bureaucrats depend excessively on the belief that the Japanese people will not take resolute political action. But there is no guarantee whatsoever that such political passivity will last forever. This may be the year when their preconceptions are decisively proven false.

Serious reform is finally coming up for implementation, at a time when the Japanese people are losing an economic margin. Under favorable circumstances, if the government had the ability to manage skillfully and promptly, then reform could take place with little struggle. But if the situation comes to resemble major surgery being carried out by quack doctors, there is an actual danger that Japan's political system will lapse into chaos. Given the way the compiling of the new budget went, one cannot entirely eliminate the possibility that such confusion will occur. **JS**

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