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A Change of Direction (2)

The DPJ's transformation accelerates. Can Japan once again position itself for growth?

The Democratic Party of Japan has selected Naoto Kan as its leader. Kan's election as party president brings an end to the confusion of the Hatoyama administration as well as fears of an ineffective government led by a provisional administration that would have replaced Kan. At last, the Japanese public has received its long-standing wish of having long-term leadership. This single event will probably have a positive effect on the stock market and the economy. But Kan's election has an even more significant meaning: the defeat of Ichiro Ozawa, who had pledged to adhere to the DPJ's manifest, signals a rapid transformation of the DPJ. Enacting measures to bolster the economy is the most urgent issue right now. But building a new geopolitical regime is an even more important task. Establishing this regime will once again position Japan for growth.

(1) The DPJ's transformation signals the start of a new political system

The Kan administration, which assumed power after the Hatoyama administration ran aground, switched to a realistic flexible approach to governing (Note 1) as a stopgap measure. Ichiro Ozawa opposed this shift and stubbornly insisted on adhering to the party's manifest. However, the conventional DPJ was based on idealistic beliefs about socialism that were similar to the stance of the Socialist Party during the 55-year period of two-party system in Japan. This position is extremely detrimental to the Japanese economy and Japan's ability to compete. Examples include the refusal to place importance on Japan's alliance with the U.S.; an anti-business stance; opposition to liberalism; opposition to globalization; a lack of emphasis on growth strategies; a commitment to distributing resources to people in need and others; creating a big government that throws out money with no regard to deficits; and other policies. Now the Ozawa position of following the manifest has been rejected with excellent timing. This will enable the Kan administration to achieve an even more dramatic shift in its policies.

Twisted politics is leading to adoption of opposition party policies

In this respect, the twisted politics phenomenon (the situation where nothing except the budget can be approved without the consent of the opposition party) in both Japan's upper and lower houses is an extremely fortunate occurrence. The opposing Liberal Democratic Party (LDP) and Your Party have veto power. As a result, the DPJ will be forced to adopt policies that are the exact opposite of its established party line. For example, the DPJ must prioritize the Japan-U.S. relationship, enact pro-business policies and place more importance on economic growth. All of these policies are good news for Japan's economy and markets. Twisted politics, in which the opposition parties have more power than the ruling party, brought about by Japanese voters is very likely to end up as a wise decision that will trigger a major shift in Japanese politics by transforming the DPJ.

Note 1: Although the Hatoyama administration was created by the public's desire for reforms, the actions of this administration were exactly like the irresponsible opposition party policies during Japan's 55-year period of two-party system. But after assuming power, the Kan administration has brazenly shifted course with remarkable speed. He has started talking to the Keidanren, ending the "cold war" that began when Keidanren cut off ties to the DPJ because of its anti-business stance. Learning a lesson from the Hatoyama administration's mistake, Prime Minister Kan made a statement recognizing the importance of the Japan-U.S. alliance immediately after his election. In addition, he submitted concrete proposals for tax reforms and a corporate tax rate reduction to 25%. Furthermore, Prime Minister Kan unveiled a growth strategy, although in a stopgap manner, which was something that the previous administration overlooked. On the other hand, he appears to have killed postal system reforms, such as renationalization of the postal system and a hike in the limit on deposits, that the DPJ and The People's New Party had agreed to enact. The DPJ has also given up on reforming the Worker Dispatching Law, which had the strong backing of the Social Democratic Party, terminated full-amount child allowance payments and started taking other steps to correct the previous administration's anti-business and money-spending policies. Moreover, borrowing a page from the Liberal Democratic Party's policies, the DPJ has proposed raising the consumption tax to 10%. These changes brought about by the Kan administration are what Ozawa has been criticizing.

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The stage is set for the next generation of policymakers

The gap between the ruling and opposition parties will narrow and there will no longer be any points of contention. Japan has many issues that everyone agrees are urgent. For instance, (1) ending deflation and returning to growth; (2) enacting administrative reforms; (3) reforming government finances and creating a plan to reduce the national debt; and (4) rebuilding Japan-U.S. ties to reflect globalization. Politicians must have the ability to take forceful actions in a unified manner by discarding petty differences in opinion. But past financial crises must not be forgotten. There was another upper and lower house twisted politics situation during the 1998 financial crisis. At that time, as the opposition party, the DPJ under Kan's leadership refused to make finance a political issue. The financial crisis was resolved and financial system reforms enacted by a new generation of policymakers. Among them were Nobuteru Ishihara, Yasuhisa Shiozaki and Yoshimi Watanabe of the LDP and Yukio Edano and Motohisa Furukawa of the DPJ. Today, Edano is the DPJ secretary-general, Ishihara is the LDP secretary-general and Watanabe leads Your Party. All three are new-generation policymakers. There are hopes that this powerful coalition of policymakers will draw on their knowledge to use unexpected measures to break out of the current political situation.

Learning from the success of Mitterrand's socialist administration

The level of the Kan administration's skills will determine whether or not this transformation can take place. We can probably learn a lesson from the success of the administration of Francois Mitterrand in France. Early in the 1980s, soon after the Socialist Party's Francois Mitterrand was elected president, the party pursued socialistic idealism by proposing many anti-market policies. The government wanted to nationalize industries, increase taxes on companies and wealthy individuals, pay supplements to people with low incomes, and take other actions. But these socialistic policies slowed economic growth and sparked inflation. Therefore, the government abandoned these ideas and moved in precisely the opposite direction by adopting liberal policies like cutting taxes and social benefit payments. Following this shift, France's economy staged a prolonged recovery. Finally, President Mitterrand named conservative Jacques Chirac prime minister to establish a conservative-reform alliance (Column by Jun Sakurada in July 10 Nikkei Sangyo Shimbun). Japan today is very similar to France at that time. Depending on the skill of Prime Minister Kan, Japan may be able to repeat the success of the Mitterrand reforms.

The historic role of the DPJ

There is no need to delve deeply into lessons learned from the Mitterrand administration. One way to enact economic reforms is to give power to a leftist, anti-business administration. But history has shown again and again that it becomes extremely easy to shift policies if one of the most powerful opponents of these policies becomes an individual who enacts policies. In Japan, it was the former anti-foreigner faction brought about the Meiji Restoration and opened Japan to the world. In the U.S., it was an administration of the Republican Party, which was strongly opposed to communism, that restored relations with China and negotiated an arms reduction treaty with the Soviet Union. Japan needs to be guided by true pro-business policies and a commitment to liberalism and market economies. But this cannot be accomplished by the LDP, which is weakened by suspicions about its established interests and influence peddling. I think that history tells us that a DPJ that has altered its stance and earned the trust of the Japanese public can make these changes.

(2) The key is Japan's position as globalization advances

Globalization places restrictions on political options

Globalization is forcing the DPJ to redefine its party line starting with the most fundamental points because countries worldwide have much less latitude concerning the selection of political options. No one can deny this historic fact that occurs the global economy becomes more unified and the international division of labor advances. Both the affluent consumer-based life styles of industrialized countries and the appearance of newly emerging countries are the gifts of globalization. Companies benefit because globalization (1) creates enormous growth opportunities in emerging countries, (2) generates extra earnings by enabling companies to use very cheap labor, and (3) produces many opportunities for investments. In every country, companies with a global perspective are at the center of growth sectors. However, the citizens of a country have no freedom of choice as long as companies and individuals target big opportunities on a global scale. In the past, governments used models aimed at internal economic development by enacting protectionist and anti-globalization policies. But today, nation-states that were established in the 19th century have become largely ineffective in the face of global economic integration. We live in an age where companies and people can choose countries. Options for governments around the world have become much fewer as a result. The critical issue for every government is determining how to use national security, democracy and market economies to give its companies and citizens an advantageous position to compete globally.

Japan is a frog in a well

Small countries like Hong Kong, Singapore, Dubai and South Korea have adapted to globalization with relative ease. But larger countries, just as large ships, have difficulty changing course. Among these countries, Japan has fallen the farthest behind. International competition used to involve companies. But international competition today is a matter of companies vying for the best positions in the global economy. We are in an age where countries are no longer bashful about taking pro-business actions that create a competitive edge. For instance, countries are enacting favorable corporate tax laws, offering benefits for industrial business sites, keeping exchange rates at advantageous levels, and using exports of government-backed projects.

Relationship with the country that has decisive supremacy

The relationship with the U.S., which leads the world economy, is the most critical factor with regard to adapting to globalization. There are two reasons. First, U.S. leadership will become even more necessary as globalization advances. Even as emerging countries grow and establish a greater economic presence, there will be no change in the supremacy of the U.S. Second, the increasing strength of China is a latent threat to the U.S. and globalization. In the near future, there will be an even greater need for an alliance between Japan and the U.S. to quell the Chinese threat.

Geopolitical factors that control the strength and weakness of Japan today

The history of modern-day Japan is defined by its geopolitical positioning. During the 60-year period between 1867 and the end of the 1930s, Japan staged remarkable growth on a scale that is rarely seen in the history of the world. The obvious reason is the establishment of a modern nation following the Meiji Restoration. But this country was rejected during the late 1930s and 1940s. Then Japan faced enormous difficulties after losing the war. During the 40-year period between 1950 and 1990, Japan staged yet another miraculous recovery with rapid economic growth. Making this possible was the security agreement between Japan and the U.S. Since 1990, the Japanese economy fell into a prolonged downturn on a scale that has rarely been seen. I believe this downturn is associated with a shift in the Japan-U.S. security treaty. Until 1990, the Japan-U.S. security agreement served as the nucleus of measures to protect the Far East from communism. This is how Japan was raised to become the world's second most powerful economy. But the world order changed in the 1990s with the collapse of the Soviet Union and communism. The end of communism also eliminated the role of the Japan-U.S. security partnership.

But the Japan-U.S. alliance has remained despite the loss of its role. I think this is because of a major shift in the strategic significance of the alliance. For the U.S., the significance of the alliance with Japan was its "capping-the-bottle" function, which means preventing Japan from becoming a nuclear power or a major military power. At the same time, from an economic standpoint, there were concerns starting in the late 1980s about Japan's growing economic threat. There was a crisis mentality in the U.S. due to fears about Japan's economy causing the U.S. economy and industries to weaken if nothing was done. People believed that the Japanese economy had an unfair advantage by using factors not linked to capitalism to become more competitive. Such factors include a strong bureaucracy, a business-friendly regulatory system, the use of corporate groups and other affiliations, and a system of financing that was backed by real estate. This led to the "Japan is different" belief that pointed to the need to have Japan alter its unique characteristics so that Japanese and U.S. companies could compete on a level playing field.

In response to massive pressure, Japan's economic policies were at the mercy of U.S. demands starting in the late 1980s as Japan acceded to almost all U.S. requests. Therefore, the Japan-U.S. security bottle cap function had a significant influence with regard to U.S. economic strategies targeting Japan. During the two decades since 1990, Japan's economy has been stagnant as the country suffers from what is called the "Japan disease." I believe this happened because of economic pressure from the U.S. along with the unusual strength of the yen.

The emergence of China and need to rebuild the security alliance

In 2010, though, there is once again an increasing need to reevaluate the Japan-U.S. security treaty. We are increasingly hearing people say that "China is different" just as they did during the 1990s about Japan. The world fears that China will exert a destructive power on its neighbors in the near future on a scale much greater than Japan had at the end of the 1980s. China's GDP (\$4.8 trillion in 2009) is about the same size as Japan's and one-third the size of the U.S. GDP. At the current growth rate, China's economy is very likely to surpass the U.S. economy within 10 years. China's growing presence is certain to be a disruptive factor for the world in terms of many current issues: market-based economies, democracy, the rule of law, rights of financial assets, and rights of holders of intellectual property. As the world leader, the U.S. cannot allow these disruptions to occur. Furthermore, China's strength is derived from growth with a structure that is more dependent than Japan on overseas technologies, capital, markets and other resources. That means China's economic growth is very much like enjoying a "free lunch."

Building a new geopolitical regime holds the key to Japan's resurgence

If China is to be held back and pressured to enact reforms on its own, the clout of Japan as a neighboring country must grow in order to maintain a suitable balance. Japan's extended economic stagnation has caused many people in Japan to lose faith in capitalism and market-based economies. But there would be widespread instability in East Asia if Japan started to drift. This is why achieving the resurgence of Japan's economy is also an urgent matter for U.S. as the global leader. This economic resurgence would further reduce the likelihood of another period of unusual strength for the yen to penalize Japan. Consequently, we can now say that the era that began in 1990 of using the Japan-U.S. security agreement to "cap the bottle" has ended.

As a result, geopolitical factors and the power game of the U.S., which have held the key to Japan's long-term prosperity, are about to become favorable for Japan for the first time in 20 years. There is no doubt that the Japanese economy has an excellent chance to break away from deflation and the extended slump. The U.S. has been very patiently going along with the confusing actions of the Hatoyama administration. The only explanation for this patience is that the U.S. has reaffirmed the importance of the Japan-U.S. security arrangement because Japan will once again play a key role in preserving the stability of East Asia. From this standpoint, Japan is currently at a turning point in its political regime that happens only once every few decades. History is creating a need to rebuild the Japan-U.S. alliance. This may be the perfect opportunity for modern-day Japan to enter its third period of remarkable progress. What will Japan do with this opportunity? The answer will depend on the skill of the Kan administration.

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