

Abe's BY RICHARD KATZ New Power

Can he keep it? How will he use it?

The ruling Liberal Democratic Party of Prime Minister Shinzo Abe triumphed in Japan's July 21 Upper House election. The LDP won 64 percent of the seventy-three district seats at stake and 38 percent of the forty-eight proportional representation (PR) seats. Its district seat performance was the best since the LDP split in 1993. In fact, the opposition was so divided that in the winner-take-all district seats, the LDP was able to convert just 43 percent of the district votes into 64 percent of the seats—a record gap between seats and votes.

The consequence is the possibility of the strongest government in years. First, Abe has ended the “twisted Diet” that has prevailed since 2007, that is, control of the more powerful Lower House by one party and the Upper House by other parties. Hence, opposition parties cannot do to him what the LDP did to the Democratic Party of Japan governments of the past three years, which is to use the Upper House to block legislation and make Japan virtually ungovernable. Second, the only strong opposition party, the DPJ, is decimated, and there is no other in the wings. The decades-long dominance of the LDP seems to have been restored—for now. However, the fundamental conflicts of interest among the LDP's assorted constituencies caused

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by Japan's economic stagnation make us doubt that this can be a permanent return to one-party democracy.

Finally, Abe now has the chance of becoming only the third Prime Minister since 1972 to serve more than two and a half years. The next Upper House election is not until summer 2016 and the next Lower House election can be delayed until December 2016. If the fates are kind to him, Abe could serve a legal maximum of six years.

ABE'S "CAPTAIN HOOK" PROBLEM

All this raises the questions of how much power Abe really has, how he will use it, and how long he can keep it.

Abe's popular support is "a mile wide and an inch deep." The Upper House victory did not reflect a flood of enthusiasm. Rather, it was a combination of three factors. First was hope for what "Abenomics" might do for the economy, despite lots of disagreement with Abe's other policies. Second, few voters turned out (the third lowest on record), which usually helps the most organized parties (such as the LDP, the LDP-allied Komeito, and the Communists). Finally, support for both the center-left opposition and right-wing opposition parties collapsed. Virtually the entirety of the LDP-Komeito seat gain came from thirty-one mostly rural prefectures that contain just 32 percent of the Japanese population.

Abe's main problem is the same as Captain Hook's: a ticking clock. If, in six months or a year, the percentage of people saying they personally feel benefits from

Abenomics has not improved from today's 13 percent, or if many people feel they are worse off, then Abe's support will drop like a rock. For example, despite all the headlines about big companies paying higher bonuses, in June real wages for all workers were 0.2 percent lower than they were a year ago.

The clock has already started ticking. Even polls by *Sankei*, the most pro-Abe of the major dailies, show a steady decline in Abe's support from a peak of 70.4 percent in mid-March to a still-healthy 57.8 percent by July 28. Disapproval has risen from 18 percent to 29 percent. In the *Mainichi* poll of July 29, Abe's approval rating was down to 55 percent.

Moreover, support for Abe's individual policies is a lot less than support for him. Just 47 percent in the *Sankei* poll approved of his economic stimulus measures and just 44 percent of his foreign policies. In a Kyodo poll, voters opposed Abe's plan to restart nuclear reactors by 58 percent to 32 percent. Only 20 percent told *Sankei* that the LDP won because voters approve of it, versus the 77 percent who said it was because the opposition parties were so unattractive. Only 26 percent told *Mainichi* they support raising the consumption tax this April.

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Dubious Power Base

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—R. Katz



Shinzo Abe:
Lacks strong opposition.

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ABE'S HEAD OVERRULES HIS HEART—FOR NOW

Abe and his aides all recognize that Abe does not have the mandate to do what he'd really love to do on foreign policy, "patriotic education," constitutional revision, and worshipping at the controversial Yasukuni Shrine. The common phrase in Japan is that he is still "hiding his true colors." To get that mandate, he needs to continue prioritizing the economic recovery.

For example, Abe did not go to the Yasukuni shrine on August 15, the day of Japan's surrender in 1945, and does not plan to go himself on any other day in the medium-term. Such visits outrage China and South Korea because Yasukuni enshrines the souls of hundreds of World War II war criminals along with nearly three million ordinary soldiers, and because the associated museum justifies Japan's aggression in World War II and earlier. Washington, too, has pressed him not to go.

Beyond that, Abe does not want a big flap over Yasukuni to interfere with other security issues close to his heart, including establishing a body like the U.S. National Security Council in Japan, and creating a consensus for reinterpreting Article 9 of Japan's constitution to allow previously prohibited postures, such as collective self-defense. Nor does he want tension with China to stop the normalization of economic ties that were so badly damaged by Chinese riots and boycotts over his

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predecessor's nationalization of the Senkaku islets, which are controlled by Japan but also claimed by China.

For the same reason, Abe and his aides say that, while he will continue efforts to create a consensus to revise the constitution, he knows it is premature to actually submit any revisions. According to *Asahi*, Abe has told aides that it will take six years to amend the Constitution and so he needs two full three-year terms (until late 2018) to do that.

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Why screw up his chance to create a legacy by premature moves based on sheer emotion?

ABE'S TAX CONUNDRUM

Abe's next big decision concerns the consumption tax. He is under a lot of pressure from both the Ministry of Finance and the Bank of Japan to follow the schedule set out in the 2012 law, that is, to raise the consumption tax from 5 percent to 8 percent this April and then to 10 percent in October 2015. Abe has also pledged to reduce the combined national and local budget deficit by more than 3 percent of GDP in the next two years. It will be very hard to do that, and even harder without a tax hike.

Abe says he will make the decision in September, after the April-June GDP numbers come out. They are now predicted to show GDP rising at a 3.5 percent annual rate. That will make it easier for the Ministry of Finance to insist that the economy is strong enough to absorb the hike.

If Abe does not raise the tax on schedule, the Ministry of Finance and Bank of Japan claim that bond markets will rebel, which will cause interest rates to spike and torpedo the recovery. We believe this is just another phony scare story since Japan finances almost all of its debt by itself. It need not fear the kind of capital flight that flooded Greece.

While this alarmism worries non-economist Abe, he does not trust the bureaucrats when they tell him that raising the tax will do minimal economic damage. The Bank of Japan says that, even with the tax hike, real GDP will grow 1.3 percent in fiscal 2014 (which begins in April), down from a consensus estimate of around 3 percent this year. However, forty-one private economists surveyed by the Japan Center for Economic Research predict growth will really be just 0.57 percent.

Abe well remembers that bureaucrats gave Ryutaro Hashimoto similarly rosy forecasts to get him to raise the tax from 3 percent to 5 percent in April 1997 and to cut spending. The combination of these moves and the banking crisis sent the economy into its worst postwar recession until the most recent one. Fifteen months after the tax hike, Hashimoto was out of office.

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The consumption tax remains political arsenic. The DPJ’s passage of the hike was a major factor in its loss of power in the December Lower House elections and its decimation in the July Upper House elections. In a recent *Mainichi* poll, only 26 percent supported raising the tax next April, while 36 percent said the increase should be delayed and 35 percent said the tax should not be increased at all.

To help him decide, Abe is turning to his private economic advisors, including Yale professor Koichi Hamada. The latter proposes that the tax be raised 1 percentage point a year for the next five years. Others suggest going ahead with the tax hike, but offsetting it with more spending to prevent a European-like recession borne of austerity.

Some LDP bigwigs, including Economic and Fiscal Policy Minister Akira Amari, openly oppose postponement. Others, such as Chief Cabinet Secretary Yoshihiko Suga, are reportedly urging either postponement or some offset with greater spending. Financial markets currently expect Abe to implement the hike.

Whichever Abe does, if things go south, that could derail his dreams of a six-year reign.

BROKEN (THIRD) ARROW

Abe’s biggest problem is putting some meat on the bones of his “third arrow” growth strategy. The announcement he made in a June 5 speech was so devoid of content that the stock market fell 4 percent and even some of Abe’s own advisors, such as Hamada and Rakuten CEO Hiroshi Mikitani, gave it poor grades (60–70 percent and 75 percent, respectively). Like Chico Marx in *The Cocoanuts*, Abe had plenty of nice-sounding numbers but no means to turn them into reality.

One such number was raising real growth to 2 percent a year over the coming decade. But since 1991, Japan has never achieved even a five-year period of 2 percent real growth.

Another number was doubling the annual creation rate of new firms from 4.5 percent of existing firms to 10 percent by 2020. The highest rate Japan ever achieved was 5.9 percent during the 1970s. Achieving this would

go a long way toward making Japan more vibrant, but the means proposed—an increase in government loans—is rather pathetic. Moreover, in order for new firms to enter, old firms have to die in order to release resources, such as skilled labor and management. So unless one finds ways to increase the exit rate of old firms, and address the resulting social dislocation, it is chimerical to expect a surge in vibrant new firms.

Yet another number is doubling the cumulative stock of foreign direct investment by 2020. Yet that would just raise the stock to around 6 percent of projected 2020 GDP. That is still far below international standards (for example, Korea’s 12 percent in 2012).

We could go on, but you get the picture.

Some of Abe’s goals are far from impressive. He wants to raise nominal business investment to ¥70 trillion over the coming three years—but that’s still down 11 percent from the peak rate of ¥78.5 trillion in the last quarter of 2007. Even this, says Abe, would require investment-oriented tax cuts. Hardly seems like much bang for the buck.

Some optimists hope that Abe will make bolder moves now that the election is over. Perhaps. But his decision to indefinitely postpone talk of raising the starting age for social security bespeaks a fear of challenging key voting blocs.

Moreover, some of the proposals touted as reform would either be useless or, worse yet, hurt growth. For

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example, corporate leaders are seeking big income tax cuts and claim this would spur investment. In reality, it would just add to the mountains of cash already lying fallow in corporate treasury vaults or being used to fund overseas acquisitions. The Ministry of Finance has suggested that an investment tax cut would be more likely to help investment, while costing a lot less in lost revenue.

More critically, big business is also asking for a change in the laws to overturn court rulings that make it nearly impossible for firms to engage in mass layoffs until they are at death's door. This could initially affect an estimated four to five million redundant workers. Now, it is certainly necessary to create a more fluid labor market. The problem is that Japan's labor market is so rigid that it is difficult for mid-career people who lose their job at one firm to get a comparable job at another. So how will these laid-off workers get reabsorbed? If they don't, mass layoffs will just add to unemployment and put downward pressure on wages and consumer spending. But not one word has been said by Abe's team about the latter issue.

Some economies such as the Scandinavians spend 1.5 percent of GDP on "active labor measures" to help people move from job to job via retraining and matching employers with job-seekers. But Japan spends only 0.25 percent of GDP, less than any other country except the United States, and is not likely to spend more, since halving the budget deficit in two years has now become Abe's "second arrow."

Then there is the critical link between Japan's demographic crunch and the rise of low-paid "irregular" workers (part-timers and temporaries) to one-third of the labor force. Japan's low fertility rate (1.41 children per woman in her lifetime when 2.07 is needed for zero pop-

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ulation growth) not only causes population decline, but also a decline in the ratio of workers to retirees. This wreaks havoc with the government budget as well as living standards. And the budgetary strain worsens with each passing year.

There are a number of reasons for this. But let's consider just two. Nearly 70 percent of men in their thirties with full time jobs are married, but the rate falls to a mere 24 percent among irregular workers in the same

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age group. Twenty percent of men were not married as of age fifty in 2010, up from just 5.6 percent in 1990. Projections are that by 2035, the percentage of those who will never marry will reach 30 percent for men and 20 percent for women. *Asahi* comments, "To stop this trend, it is vital to guarantee stable employment to young people." Yet, there is not a word in Abe's "third arrow" about this fundamental issue.

People tell pollsters that they'd like to have 2.5 children, but they can't afford to. Six of ten people told the Cabinet Office that "it costs too much money to raise and educate children." One reason is that, among thirty rich OECD countries, Japan comes in dead last in public spending on education, but is the fourth highest in private spending. Families have to spend so much because the government spends so little. As a result, people have fewer children. Again, not a word about this in Abe's "third arrow." On the contrary, when the DPJ government tried to provide free high school tuition at public schools, the LDP called this wasteful spending.

A "third arrow" that turns out to be false advertising will disillusion foreign investors with a longer time horizon more than the hit-and-run hedge funds. That, in turn, will damage the stock market, whose rise has been so important to the popular image that Abe knows what he is doing. Most of the buying of Japanese stocks since Abe's ascension has been by foreigners; Japanese individuals and institutions have been selling.

CYCLICAL RECOVERY, NOT A STRUCTURAL ONE

Japan appears to be going through a typical cyclical recovery that just happens to coincide with the rise of Abe. How long that cyclical recovery lasts is anyone's guess, especially if it faces the headwinds of rising taxes and falling government spending. But there is nothing in Abenomics to turn this into a structural revival that raises the long-term rate of growth. As this becomes manifest, Abe's approval ratings will drop. How long this will take is also anyone's guess. ◆