



The First 150 days under the DPJ Administration

~Can Japan be reformed?~¹

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1. Japan's Challenges and Election Results

Almost 150 days have passed since the triumph of DPJ (Democratic Party of Japan) in the general election in August, 2009 when the new ruling party was born for the first time during these past 50 years. The supporting rate for the Hatoyama administration dropped from more than 60% in the early days to less than 50% as of late, which means that the euphoria surrounding the administration's creation has dwindled. What happened in these 150 days ?

After the bubble burst in the early 90's, a gloomy feeling spread over Japan due to a prolonged economic recession, albeit some small economic cycles. Thus, the voters' choice in the general election was "to change the administration", and they manifested strong opinions of "No" towards the traditional Politic-Bureaucratic-Industrial triangle, a system completed by LPD (Liberal Democratic Party) and its politics which lasted five

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decades since World War II.

The voters expected DPJ to reform the political system which has been outdated under the long lasting LDP administration, and to draw an adequate road map towards solving the various issues which Japan is now confronting, such as (1) an aging society and a declining birth rate, (2) critical fiscal conditions, (3) economic operations under crisis and deflation, and (4) revitalizing the rural economy.

2. The issues expected to be addressed during the first 150 days of DPJ

● Reforming the Political System

The voters expected DPJ to reform the political system by abolishing vested rights and making the political funds transparent. However, they were very much disappointed to realize that DPJ was not different from LDP as contravention of “Political Funds Control Act” was found for some of the DPJ leaders.

As for the reform of political decision making systems which used to heavily rely upon bureaucrats, some improvements were made in that bureaucrats are banned from presenting at the Diet sessions or press conferences. Ministers, state secretaries and parliamentary vice ministers take the lead in practical aspects. Nonetheless, the politicians who are not specialists of any specific field cannot always control successfully. A good system should be established in the future where professional bureaucrats work together efficiently with politicians.

There is a criticism that the budget screening process resulted in marginal improvements of available fiscal resources, contrary to our expectations. Nonetheless, it is fair to say that this new process brought much transparency to public budgeting, which used to be made behind closed doors. In fact, many people think highly of this new system since the budgetary process became transparent. This process should be further enhanced to expand the scope and review the projects periodically.

● Examining DPJ’s governing capability: for both domestic and foreign issues

Under the catch copy of “Shifting resources from concrete to human beings”, many of the existing public works have been frozen and, as a result, the FY 2010 budget for public works decreased by JPY 1.3 trillion from the previous year.

The issues on the ailing Japan Air Lines ended up filing the Corporation

Reorganization Law after many twists and turns. Many loose ends, however, still exist, and it is too early to consider the case closed.

As for the issue of relocating the US Air Force base in Okinawa, a.k.a. The Base Futenma relocation issue, there have been discrepancies among the statements made by senior governmental officials, which created tensions with the US. There is a possibility that the situation could get much more complicated since the newly elected mayor of Nago City is against the relocation of the base to his city. The Hatoyama Administration emphasizes the importance of the Japanese relationship with Asia such as An East Asian Community Initiative. There are concerns, however, regarding the stability of the US-Japan relationship which is the very basis for the entirety of East Asia. On the other hand, Japanese relationships with China and Korea seem better than before when LDP was in power. In fact, Premier Hatoyama expands his diplomatic activities by making frequent state visits to Asia, including India.

Many issues make many of us nervous for Hatoyama Administration's governing capability as the ruling party. It may be, however, too early to determine in light of the fact that the change of regime has happened for the very first time in the past 50 years. On the other hand, though, nothing has yet been done even after 150 days to draw a road map for the next four years under their administration or to address the issues adequately. A prompt response is strongly expected.

3. Comparison between DPJ's Manifesto and Budget Plan for FY 2010

It was a rough passage for the FY2010 budget plan, which was finally approved by the Cabinet at the end of December, 2009. Many debates were made to include the items stated in the Manifesto as much as possible. Also, the issue of how to allocate resources was another conundrum.

As one of the measures to address an aging society with a declining birth rate, the monthly child care allowance of JPY 13,000.- per child will be provided to households, regardless of their gross annual income, as stated in the Manifesto. The part of necessary resources will be, however, compensated by local autonomies and corporations. Free high school tuition is also scheduled to materialize as stated in the Manifesto. Nonetheless, no concrete plans nor deregulations have been prepared to foster the service industries related to education, medical and child care, to well prepare for the society with an aging population and a low birth rate. People are left with a strong impression that DPJ is scattering cash recklessly for the purpose of securing their seats in the next

election.

Among other policies, for example, the abolition of temporary taxes including the one for gasoline, has been criticized not only from the fiscal point of view but also from the environmental view point, and ended up with the partial reduction of motor vehicle weight tax. The plan to abolish highway toll fees has experienced significant shrunk, and as a result, it can no longer be expected to be economic stimulants in the FY 2010 budget.

Comparison between DPJ's Manifesto and Budget Plan for FY2010

(Unit: JPY Trillion)

	Budget Plan	Manifesto
Addressing ageing society and declining birth rate		
Child care allowance	1.7	2.7
Free high school education	0.4	0.5
Enhancement of health care services	0.4	1.2
Counter measures for deflation		
Reduction of gasoline tax rate*	0.2	2.5
Promoting employment	0.017	0.3
Elimination of highway toll fees	0.1	~1.3
Household income support for agriculture	0.6	~1.0
Grand Total	3.1	7.1

*Reduction of motor vehicle weight tax (national tax) by only 50%

(Sources: "Highlights of the Budget for FY2010" by Ministry of Finance, Japan)

4. Towards fiscal reconstruction

The report on DPJ's policies titled INDEX 2009 states that "DPJ will bring fiscal primary surplus at both the national and local levels, and reduce the debt balance over GDP to achieve healthier fiscal balances". The Manifesto more concretely stated that they will be able to produce a new fiscal resource of the amount of JPY 16.8 trillion over the next four years, by rearranging the total budget of JPY 207 trillion, including the special accounts, and also by eradicating unnecessary expenditures. The review process of general accounts has partially been finished under the budget screening process, but they could classify only JPY 2 trillion as an unnecessary expenditure despite the original estimate of saving JPY 7 trillion. The review process of special accounts is scheduled to

begin before the end of this year, but so called “hidden treasure” in the special accounts is a one-time-treatment only, and we may not expect that it will last forever.

The budget plan for YF2010 drafted by the government shows the total amount of JPY 92.3 trillion and a general expenditure of JPY 53.5 trillion, which has become the largest in history. However, if this is compared with the post adjustment plan for FY 2009 of a total amount of JPY 102.6 trillion, the total amount for FY 2010 draft is JPY 10 trillion less and this could be a downward pressure for macro-economy. Because of the economic downturn, the tax revenue was about 19% less than the original budget plan for FY2009. As to the Japanese Government Bond (JGB), the total issuing amount increased by JPY 10 trillion from the original plan for FY 2009, which was to cap at JPY 44 trillion, the same level as the primary adjustment in FY2009. The total issuing amount of JGB exceeded the total tax income, and the dependency rate reached its highest of 48% among original budget plans in the past. The fiscal primary balance is now in a deficit of JPY 23.7 trillion. In other words, the fiscal reconstruction is still a long way ahead.

As a result, the long-term debt amount will be JPY 862 trillion or 181% of GDP as of the end of FY 2010. This figure could be the highest among the other nations. When we look at the results of the budget screening process, it is clear that the reduction of waste has limitations, and that the projects stated in the Manifesto after 2011 can not be sufficiently funded. From now on, discussions on increasing the consumption tax, which is unpopular among the people, will be unavoidable.

DPJ seems to explore a different direction from a “small government” presented by the former Premier Koizumi, however, it does not mean that the people approved DPJ to select the direction of “Good Welfare: High Burden”. The picture we now see is increasing deficit in the society of “Medium Welfare: Low Burden”, and those burdens are forwarded to the shoulders of future generations. As society rapidly ages, the burden increase for social security related costs will be inevitable, and once we miss the right timing to start taking care of this issue, the reconstruction will be even more difficult. Immediate establishment of an action plan for the fiscal reconstruction is absolutely necessary.

Comparison of Budget Plans for FY 2010 and FY2009

(Unit: JPY trillion)

	FY 2009	Primary Adjustments	Secondary Adjustments	FY2009 after Adjustments	FY 2010
Revenues					
Tax Revenues	46.1		-9.2	36.9	37.4
Other Revenues	9.2	3.1	0.0	12.2	10.6
Government Bond	33.3	10.8	9.3	53.5	44.3
Total	88.5	13.9	0.1	102.6	92.3
Expenditures					
National Debt Service	20.2			20.2	20.6
Local Tax Allocation	16.6	0.0	-3.0	13.6	17.5
General Expenditures	51.7	14.7	7.4	73.9	53.5
Reduction after Primary Adjustments			-2.7	-2.7	
Reduction after other Adjustments			-1.5	-1.5	
Total	88.5	13.9	0.1	102.6	92.3

Sources: "Highlights of the Budget for FY2010" by Ministry of Finance, Japan

5. Basic policies for new growth strategies

Tax increases are not sufficient for the fiscal reconstruction. Revenue increases by economic growth will be extremely important. The APEC Leaders Meeting held in Singapore last November made a statement that APEC will promote trade liberalization in the Asia-Pacific region, structural reformations in respective economies and cross-border coalition under the slogan of "Balanced Growth", "Inclusive Growth" and "Sustainable Growth".

In December last year, Hatoyama Administration announced "New Growth Strategy (Basic Policies) Toward a Radiant Japan" in which the Administration aims to increase nominal economic growth to over 3% and real growth to over 2% during the next ten years, to increase the nominal GDP to JPY 650 trillion by 2020, and to reduce the unemployment rate from the current 5.2% to the 3% - 4% range. The average nominal

and real growth rates during the past 10 years were only 0% and 1% respectively. Considering that the nominal GDP for FY 2009 is estimated to decrease to JPY 473 trillion from JPY 515 trillion in FY 2007, these basic policies may be perceived to be very ambitious.

Hatoyama Administration concludes that the past growth strategies were bound by two success stories: 1) Economic growth underscored by public works, and 2) Growth strategy through the production enhancement by supply side under structural reform (excessive market fundamentalism) . The Administration also states that they will choose the third way (“creation of new demands” in the field of environment, health care and tourism) for the growth. To be more specific, they aim to create the new market with a size of JPY 100 trillion and 4.7 million job opportunities in these three fields by 2020.

In addition, they also picked up the following “6 targeted areas”;

- Growing areas where Japan has advantages:
 - (1) Environment, Energy
 - (2) Health care (medical care and nursing)
- Growing through developing new frontiers:
 - (3) Asia
 - (4) Tourism, Revitalization of rural areas
- Platform that supports growth:
 - (5) Science, Technology
 - (6) Employment, Human Resources

While ambitious numerical targets are set, nothing concrete has been presented for the reasoning, policies, or necessary financial resources to materialize these goals. The growth strategies will be finalized around June this year, and concrete road map to materialize them will be prepared.

They claim that the economy will be changed into a demand stimulating type by implementing the “third way” as stated above. If they try to stimulate the demand by emphasizing only the distribution of wealth, it could lead to severe fiscal deficit. Based upon the example in Europe regarding the “third way” -aiming to revitalize the economy by introducing market mechanisms partially while maintaining a welfare state-, we should not forget the viewpoint of how to increase productivity by strengthening the supply side, or “a source of growth”. We also need to aim for a domestic demand oriented economic growth driven by foreign demands in Asia as frontiers, and to

implement measures to enhance the vitality of corporations which underlies such growth. The service industries such as environmental, medical care, welfare, and education will have large potential for growth through deregulation if Japan can utilize its high technologies.

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